GROUP OVERVIEW

Introduction

The Group is the largest retailer of electrical appliances and consumer electronics in the PRC in terms of revenue in 2004. It has led the market in the past and is seeking to consolidate its leadership position further in the future. It offers a wide variety of products, ranging from traditional white goods such as audio-visual, refrigerators and washing machines, air conditioners to computers, telecommunications and digital products. The Group has operated in the PRC retail market of electrical appliances since its inception and will continue to focus its resources on this market in the future. The cornerstones of the Group's service commitment to its customers are: competitive prices, wide variety of products, convenient locations and the provision of professional customer services. It seeks to strengthen its commitments by building upon a proven foundation of credibility and integrity while continuing to build the reputation of and customer loyalty to the "GOME" brand.

As of June 30, 2005, the Group operated a chain of 188 retail stores across 42 cities in the PRC, of which 169 were traditional stores and 19 small digital stores. The size of traditional stores typically ranges from 3,000 – 6,000 square meters, averaging about 3,600 square meters. The size of digital stores is much smaller, averaging only 200 square meters. As of June 30, 2005, the total sales area was approximately 617,300 square meters and the weighted average sales area for the first six months of 2005 was approximately 536,300 square meters.

List of company stores network broken down by store format and by region

	30 June 2005	
Region	**Traditional**	**Digital**
Beijing	26	2
Tianjin	16	2
Chengdu	15	5
Chongqing	11	3
Xian	10	1
Shenyang	12	–
Qingdao	7	1
Jinan	8	–
Shenzhen	21	–
Guangzhou	19	3
Wuhan	8	1
Kunming	7	–
Fuzhou	9	1
Total	169	19

As of June 30, 2005, the Parent Group also operated an additional 119 stores across 38 cities, of which 112 were traditional stores and 7 small digital stores. These stores were operating in different locations and not in competition with the Group. Therefore, on a combined basis, the Group and the Parent Group operated a chain of 307 stores across 80 cities in the PRC as of June 30, 2005.

Management Discussion and Analysis

At the beginning of 2005, the Group announced an aggressive four-year expansion plan (the "Growth Initiative"). The main strategic thrust of the Growth Initiative is to increase the Group's revenue base, improve market share, and consolidate the Group's market leadership position. Together with the Parent Group, the Group aims to increase their combined market share from approximately 5% in 2004 to 10% – 15% by the end of 2008. Under the Growth Initiative, the Group plans to open a total of about 130 traditional stores in 2005. The management of the Group believes that the progress of store rollout in the first six months of 2005 is generally in line with its expectation and the Group will continue to work hard to achieve the full year target.

Rationale of the Growth Initiative

The Group adopted the Growth Initiative to proactively address and capitalize on the rapidly changing market dynamics. In formulating the plan, the management of the Group considered the following macro-economic and company specific factors:

- At the macro level, according to the National Bureau of Statistics of China the PRC economy grew by 9.5% in both 2004 and the first six months of 2005. Even though GDP growth may moderate in the next few years, the long term growth prospect remain robust.

- Retail sales in the PRC continue to grow. According to the National Bureau of Statistics of China, annual retail sales of consumer goods in the PRC increased from RMB1,626.5 billion in 1994 to RMB5,395 billion in 2004, representing an increase at a CAGR of 12.7%.

- The retail market of household appliances and consumer electronics continues to grow at an equally respectable pace. According to the State Information Centre of China, the size of the electrical appliance retail market increased from RMB 296.9 billion in 2000 to RMB491.0 billion in 2004, representing a CAGR of 13.4% and is expected to grow at a CAGR of 11.8% from 2005 to 2009.

- China is one of the largest manufacturing bases of household appliances in the world. Product availability in the market, while rich in the past, is becoming even more so with the further opening of import products beginning 2005.

- Demand in the market is driven by such favorable factors as rapid urbanization, income growth, residential property development, replacement and upgrading cycle, and rising demand for digital products.

- The retail market of household appliances and consumer electronics is still very fragmented. According to third party research, there are over 20,000 retail enterprises operating in the market and the top 16 players, including the Group, only account for approximately 22% of the market share.

- Under China's WTO commitments, the retail market has been thrown open to foreign competition starting 2005 with the approval of the Ministry of Commerce.

- At the micro level, the Group has operated in the China market for nearly 19 years, which represent one of the longest histories in the China market. The Group's experience and market knowledge is unrivalled.

- The Group's GOME brand name is widely recognized and is one of the Group's competitive advantages.

- The Group's financial strength and extensive network presence provides the Group with a strong growth platform.

The Group understands that the Growth Initiative is an ambitious project. However, the management of the Group believes it has the experience and track records and is confident that it will be able to capitalize on the positive seismic shift in the economy and in the industry, gain market share, and further consolidate its present leadership position in the future.

OVERVIEW OF FIRST HALF OF 2005

Year 2005 is the first year under the Growth Initiative and a pivotal year as the Group enters into a new stage of corporate growth and development. It is turning out to be as challenging as exciting. While its performance in the first six months of 2005 was generally in line with management expectation, the Group is confronted with a number of challenges as it embarks on the Growth Initiative:

- Most of the players in the market are trying to expand rapidly, which has created a very challenging environment
- Securing desirable store locations at reasonable costs is becoming increasingly competitive
- Sales growth at some of the newly opened stores in big cities has been slow due to denser store coverage and stronger competition for revenue and market share
- Sales at some of the newly opened stores in smaller and less affluent cities, compared to first tier cities, are not growing as quickly, primarily due to smaller market size and longer time to fully develop their market potential
- Cooler temperature and floods which affected much of Southern China in the first six months of 2005, have negatively affected sales of air conditioners
- Proportion of newly opened stores in the overall store portfolio is higher; new stores take time to grow and mature

During the first six months of 2005, significant resources were deployed to enhance network coverage and national footprint. Initiatives aimed at improving sales volume and store operating quality were also implemented. The Group believes that such investments were essential to effectively address competitive issues witnessed in the market place.

Store rollout

In the six month period ended June 30, 2005, the Group continued to expand its retail network. It opened 56 new and closed down 3 traditional stores. During the same period, the Group also closed down 9 digital stores. As of June 30, 2005, the Group had signed an additional 32 leases which typically would open in one to two months' time. In the corresponding period in 2004, the Group opened 18 traditional stores. The following table illustrates the Group's store network as of June 30, 2004 and 2005:

	As of June 30, 2005	As of June 30, 2004
Traditional stores	**169**	96
Digital stores	**19**	0
Sales area (square meters)	**617,300**	338,000
Weighted average sales area during the period (square meters)	**536,300**	314,600

Store leases

All of the Group's stores operating in the first six months of 2005 were under leases from independent third parties. Most of the leases range from five to fifteen years in tenor, averaging about 7.5 years. Rental expenses in about half of the leases are fixed for the entire duration of the leases and the other half are subject to intermittent upward adjustment mechanisms. They are not pegged to revenue and leases are typically subject to termination with a few months' prior notice.

Subsequent to June 30, 2005, the Group opened a store in Beijing in a location bought by the Group. This is a two-storey store with an area of approximately 9,700 square meters.

Going forward, the Group may consider acquiring additional select store locations which are considered strategic. As discussed, securing good store locations at reasonable costs is becoming increasingly competitive. Under the austerity measures being implemented by the government to rein in over-investments in the economy, some of the landlords may become less willing to lease than to sell their store properties. Therefore, the management of the Group believes that it must retain the flexibility and financial resources to make a purchase decision versus a lease decision if necessary. The Group is firmly focused on the retail business and does not intend to go into any unrelated businesses. It will undertake rigorous study and financial analysis to ascertain that, if it is presented with an acquisition opportunity, the decision to acquire makes strong financial and strategic sense.

Financial performance

Revenue

In the first six months of 2005, the Group generated most of its revenue from the retail sales of electrical appliances and consumer electronics in the PRC. With the disposal of its legacy securities and futures brokerage business in April 2005, the Group expects that retail sales will become its main revenue contributor in the future.

Revenue of the Group increased by 32.0% to HK$7,812.1 million in the first six months of 2005 from HK$5,917.3 million in the corresponding period in 2004. The increase was primarily attributable to the expansion of the Group's retail network with 56 new additional stores opened in the period. The Group had 75 comparable stores which were operating in the same locations throughout the first six months of both 2004 and 2005 and comparable-store sales increased by 4.6%. Sales at these 75 stores accounted for approximately 63% and 79% of total revenue in the first six months of 2005 and 2004 respectively. Increase in comparable-store sales was largely due to strong increases in comparable-store sales in cities such as Beijing, Tianjin, Wuhan, Shenzhen and Guangzhou, partially offset by decreases in comparable-store sales in cities such as Chongqing, Fuzhou and Jinan. The management of the Group is generally pleased with the comparable-store sales performance as it attested to the effectiveness of the Group's initiatives aimed at improving store quality and enhancing sales at existing stores. However, it realizes that it must seek to address the performance at Chongqing, Fuzhou and Jinan by actively improving store operating quality and implementing market savvy pricing and promotional policies in these regions.

Sales per square meter declined by 22.3% to RMB 30,900 (HK$29,100) in the first six months of 2005 from RMB39,800 (HK$37,600) in the same period in 2004 on an annualized basis. The decline was as expected and could be attributed to the following factors:

- Proportion of new stores in the overall store portfolio was significantly higher in the first six months of 2005 than the same period in 2004. New stores typically take two years to mature.

- The Group was expanding into smaller cities where, when compared to first tier cities, market size is typically smaller, population less affluent, purchasing power weaker, and market penetration taking longer to achieve.

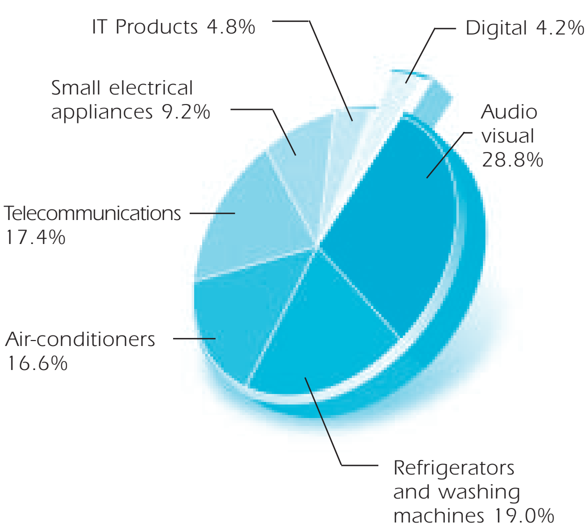
In light of the continued decline in sales per square meter, the Group will seek to mitigate this trend by implementing measures to enhance the competitiveness of its stores. Additionally, the management of the Group expects the trend to stabilize when competition starts to subside.

The Group sells the following product categories:

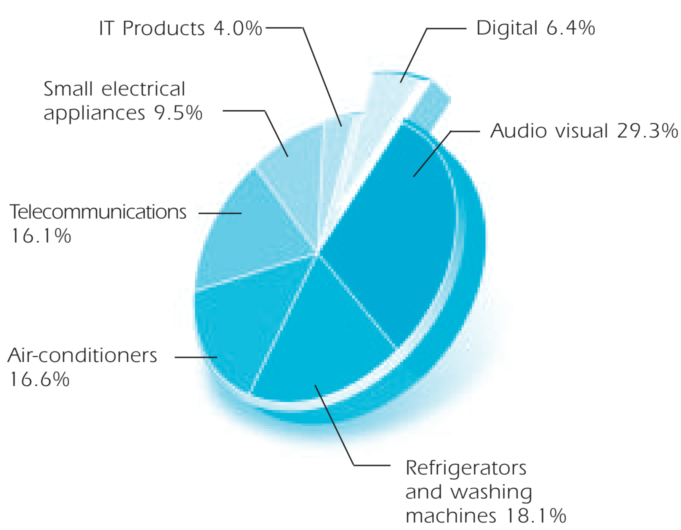
Product category	Main products
Audio visual	Televisions, DVD players, CD players, VCD players, video tape recorders, amplifiers and speakers
Refrigerators and washing machines	Refrigerators, washing machines and clothes dryers
Air-conditioners	Air-conditioners
Telecommunications	Mobile telephones and accessories
Small electrical appliances	Rice cookers, vacuum cleaners, irons, water heaters, microwave ovens, mixers, dish-washers and similar products
Digital	Digital video recorders, digital cameras, MP3 players, portable DVD and CD players and similar products
IT Products	Personal computers, notebook computers, monitors, printers, scanners, facsimile machines and accessories

The following graph illustrates the revenue breakdown in the first six months of 2005 and 2004 respectively:

Revenue break by product category - 1H2004



Revenue breakdown by product category - 1H2005



Audio visual products continued to make up the largest revenue component in the Group's product portfolio in the first six months of 2005, accounting for approximately 29.3% of the revenue, compared to 28.8% in the same period in 2004. As a percentage of revenue, digital products, air-conditioners, and small electrical appliances rose while refrigerators and washing machines, telecommunications products, and IT products declined in the same period in 2005 from 2004.

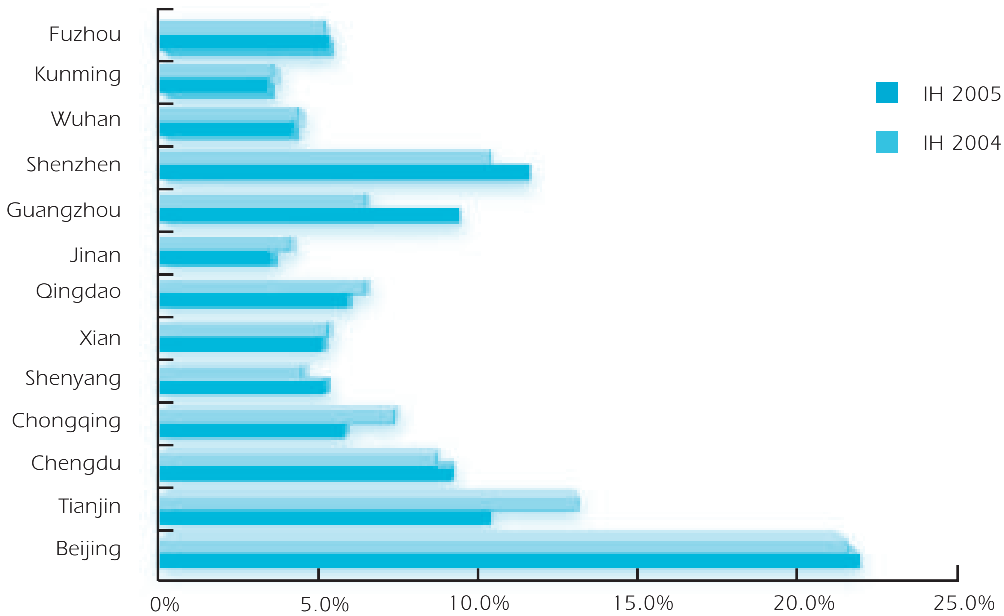
In terms of revenue, audio visual products, small electrical appliances, and digital products increased by 34.3%, 35.6%, and 100.8% respectively in the first six months in 2005 from the same period in 2004. The rapid rise in revenue from audio visual products was attributed to more stores opened and significant price promotions undertaken on these products during the period. The improvement in the sales of digital products was due to the introduction of more brands and product lines in digital cameras, digital camcorders, MP3 and other digital accessories, primarily as a result of the lifting at the beginning of 2005 of import duties levied on these products. The increasing popularity and affordability of these digital products also helped create enhanced demand. In the small electrical appliances category, the Group was able to increase the number of brand names in its network. Additionally, the Group has strengthened relationships with a number of core brands and increased sales and marketing. The combined impact of these initiatives had led to robust growth in this category.

On the other hand, revenue of IT and telecommunications products grew by only 8.7% and 22.8% respectively in the first six months of 2005 from the same period in 2004. Slow growth in IT products in the period was primarily due to a number of structural issues such as the fragmented nature of the market, the presence of alternative sales channels, and lower profit margins and higher price volatility of these products. These factors have led to less commitment to IT products by suppliers and retailers. Sales in telecommunications products, mainly mobile phones, were negatively affected by the performance of Chinese branded mobile phones in the market and the Group's increased emphasis on profitability contribution from the better selling telecommunications products.

The Group employs exclusive arrangements with its suppliers, whereby a wide range of models are offered exclusively to it in cities where it has operations. These exclusive models typically command a higher gross margin than non-exclusive products. The exclusive arrangements with its suppliers include: (i) new models being made available to the Group before they are made available to other retailers in the same cities or regions, for a period of typically around one month, (ii) the Group being the sole retailer of selected models in cities where it has operations, and (iii) certain exclusive models being produced according to specifications requested by the Group.

In addition to a diversified product portfolio, the Group is also balanced in terms of geographical revenue contribution. Beijing continued to be the largest revenue contributor, accounting for approximately 21.8% of the Group's revenue in the first six months of 2005, compared to approximately 21.4% in the same period in 2004. The revenue breakdown by region in the first six months in both 2004 and 2005 is illustrated as follows:

REVENUE BREAKDOWN BY REGION



The management of the Group estimates that in terms of revenue contribution, Chinese brands contributed approximately 60% while foreign brands accounted for the rest in the first six months of 2005. The Group has not seen any discernable change in the mix from the same period in 2004. The management of the Group believes that such a balance reflects a healthy mix of products and brands and preference by consumers. It is also testament to the ability of the Group to work effectively with both foreign and domestic brands and distribute their products through its retail channels.

The Group deals with approximately 400 major suppliers. The top 5 and 10 suppliers accounted for approximately 25.8% and 37.6% of the Group's total purchase respectively in the first six months of 2005, compared to 26.3% and 38.6% respectively in the same period in 2004.

Cost of sales

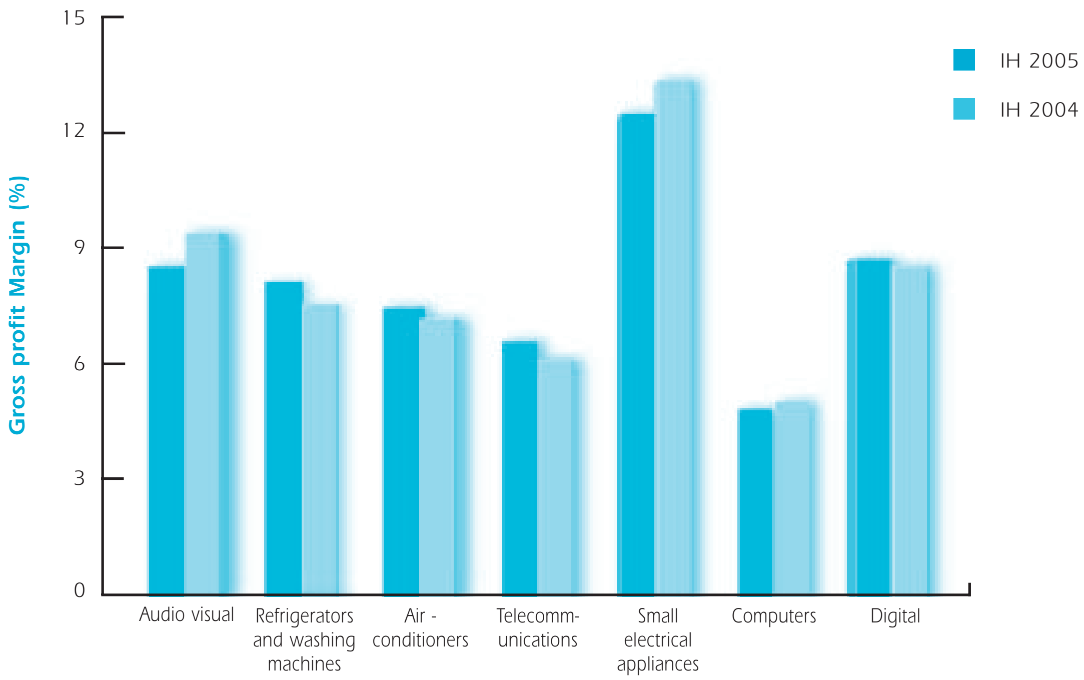
Cost of sales of the Group increased by 32.1% to HK$7,137.6 million in the first six months of 2005 from HK$5,403.2 million in the corresponding period in 2004 principally as a result of increased sales volume in this period in 2005 compared to the same period in 2004.

Gross profit

Gross profit of the Group increased by 31.2% to HK$674.5 million in the first six months of 2005 from HK$514.1 million in the same period in 2004. Gross profit margin declined slightly to approximately 8.63% from approximately 8.69%. The slight decline in gross profit margin reflected the keen competition between suppliers in promoting their respective product offerings and management's initiative to adopt more flexible pricing policies, especially at newly opened stores in order to enhance sales and counter competition.

Specifically, gross profit margin of audio visual products declined to 8.94% in the first six months of 2005 from 9.82% in the same period in 2004. The drop in gross profit margin of this product category could be attributed to significant price promotions on flat panel TVs during the May 1 Golden Week in 2005. On the other hand, refrigerators and washing machines, and telecommunications products improved their gross profit margin to 8.49% and 6.92% in the first six months of 2005 from 7.92% and 6.45% respectively in the same period in 2004 as the Group focused more on profitability in these two product categories. Other product categories which experienced decline in gross profit margin were small electrical appliances and IT products while air conditioners and digital products gained in gross profit margin. The following illustrates gross profit margin by product category in the first six months of both 2004 and 2005:

PRODUCT GROSS PROFIT MARGIN FOR BOTH 1H2005 AND 1H2004



Other operating income

The Group has been able to secure other operating income, mainly from suppliers pursuant to the Group's standardized supply contracts, including:

- Promotional fees paid by suppliers for their participation in promotional activities organized by the Group
- Management fees paid by suppliers for management services provided by the Group for the promotion of their products, including managing and training of the suppliers' sales representatives

- Display space leasing fees paid by suppliers for display of their products in the stores of the Group
- Product listing fees paid by suppliers for placing and displaying of their products on the shelves of the stores of the Group

In addition, other operating income also includes:

- Fees paid by air-conditioner installation contractors in connection with their installation services for customers referred by the Group
- Management and purchasing service fees paid by the Parent Group for the provision of management and purchasing services by the Group in respect of the Parent Group's electrical appliance and consumer electronics retail operations in designated cities in the PRC

The following table illustrates a summary of other operating income:

	Six months ended 30 June			
	2005		2004	
	HK$m	**% to revenue**	HK$m	% to revenue
From suppliers				
Promotion income	**120.6**	**1.54%**	95.0	1.61%
Management fee income	**34.2**	**0.44%**	24.8	0.42%
Display space leasing fees	**29.2**	**0.37%**	14.6	0.25%
Product listing fees	**17.8**	**0.23%**	14.6	0.25%
Subtotal	**201.8**	**2.58%**	149.0	2.53%
Management fee for air-conditioner installation	**19.6**	**0.25%**	17.1	0.29%
Management fee from the Parent Group	**62.0**	**0.79%**	33.2	0.56%
Others	**31.2**	**0.41%**	48.3	0.81%
Total other operating income	**314.6**	**4.03%**	247.6	4.19%

Other operating income of the Group increased by 27.0% to HK$314.6 million in the first six months of 2005 from HK$247.6 million in the same period in 2004. The rise was primarily due to higher income from suppliers, which grew by 35.4% to HK$201.8 million, or 2.58% of revenue in the first six months of 2005 from HK$149.0 million, or 2.53% in the same period in 2004. Higher management fee from the Parent Group also contributed to the rise in other operating income. Other operating income as a percentage of revenue declined slightly by 0.16% to 4.03% in the first six months in 2005 from 4.19% in the same period in 2004.

However, the management of the Group would like to draw the reader's attention to the fact that the decline of other operating income as a percentage of revenue from the first six month of 2004 to the same period in 2005 was somewhat distorted by a gain of approximately HK$20 million recognized by the Group's non-core businesses resulting from a wavier of debt in the first six months of 2004 (the "Distorting Factor"). By looking at GOME Appliance Co., Ltd. ("GOME Appliance"), which is a major subsidiary of the Group alone, other operating income as a percentage of revenue at GOME Appliance actually increased by 0.19% to 4.03% in the first six months of 2005 from 3.84% in the same period in 2004.

Operating expenses

The Group's operating expenses include:

- Selling and distribution expenses primarily consist of transportation expenses, store leasing expenses, marketing and promotional expenses, salaries and benefits for staff, and depreciation of fixed assets at the retail store level and utilities and advertising expenses;

- Administrative expenses primarily consist of office rental, salaries and benefits for administrative personnel, daily operating costs and depreciation of office equipment and fixtures for the headquarters and regional offices; and

- Other operating expenses consist primarily of business taxes, bank processing fees, and miscellaneous expenses

The following table sets out the breakdown of operating expenses for the first six months of 2005 and 2004 respectively:

	Six months ended 30 June			
	2005		2004	
	HK$m	**% to revenue**	HK$m	% to revenue
Selling and distribution expenses	**474.1**	**6.07%**	291.7	4.93%
Administrative expenses	**104.9**	**1.34%**	76.6	1.29%
Other operating expenses	**38.5**	**0.49%**	26.7	0.45%
Total operating expenses	**617.5**	**7.90%**	395.0	6.67%

- Selling and distribution expenses

  Selling and distribution expenses of the Group increased by 62.6% to HK$474.1 million in the first six months of 2005 from HK$291.7 million in the same period in 2004. The increase was primarily due to increases in rental expenses, salaries, advertising, promotion, and other store-related expenses and depreciation of fixed assets.

  As a percentage of revenue, selling and distribution expenses rose to 6.07% from 4.93%. The rise in selling and distribution expenses could be attributed to a marked increase in rental expenses, as the Group expanded its network, which accounted for approximately 2.04% of revenue in the first six months of 2005, compared to approximately 1.59% in the same period in 2004. Additionally, salaries, advertising, and marketing and promotional expenses rose to 1.12%, 0.77%, and 0.40% from 0.92%, 0.70%, and 0.37% as a percentage of revenue respectively.

- Administrative expenses

  Administrative expenses of the Group increased by 37.0% to HK$104.9 million in the first six months of 2005 from HK$76.6 million in the same period in 2004. The increase was primarily due to higher salaries expenses incurred by the hiring of additional personnel and increases in salary and staff welfare for management personnel. However, administrative expenses as a percentage of revenue increased only slightly to 1.34% in the first six months of 2005 from 1.29% in the same period in 2004.

- Other operating expenses

  Other operating expenses of the Group increased by 44.0% to HK$38.5 million in the first six months in 2005 from HK$26.7 million in the same period in 2004. The increase was primarily due to the expansion of the retail network of the Group, the increase in revenue, and the accompanying increase in business taxes, bank processing fees, and miscellaneous expenses. Other operating expenses as a percentage of revenue increased to 0.49% in the first six months of 2005 from 0.45% in the same period in 2004.

Profit from operating activities

As a result of the foregoing, profit from operating activities of the Group increased only by 1.32% to HK$371.7 million in the first six months of 2005 from HK$366.8 million in the same period in 2004. However, the operating profit margin of the Group declined to 4.76% in the first six months in 2005 from 6.20% in the same period in 2004.

The increase in operating expenses as noted above was expected and management at the Group believed that start-up costs would have to be invested first during the growth phase at the Group. Initial investments were necessary to build up a solid corporate infrastructure and platform on which the Group could continue to grow and consolidate its market leadership position, with return and benefits of such investments to be derived in the longer term. The Group is mindful of the impact such increases in operating expenses would have on the Group's profitability and therefore is implementing better cost control to address such trends.

Finance income, net

The net finance income of the Group increased by 117% to HK$19.8 million in the first six months of 2005 from HK$9.1 million in the same period in 2004 primarily due to an increase in interest income as a result of higher cash balance, including more pledged deposits.

Income tax

Income tax paid by the Group decreased by 16.2% to HK$41.6 million in the first six months of 2005 from HK$49.7 million in the same period in 2004. The effective tax rates in the first six months of 2005 and 2004 were 10.6% and 13.2% respectively. The decrease in effective tax rates was primarily due to the additional tax benefits enjoyed by the Group's subsidiaries and stores it opened in the first six months of 2005.

Net profit and EPS

As a result of the foregoing, the net profit of the Group after minority interest increased only slightly by 4.5% to HK$224.2 million in the first six month period of 2005 from HK$214.6 million in the same period in 2004. Net profit margin after minority interest accordingly declined to 2.87% from 3.63%. Basic EPS of the Group increased by approximately 2.2% to 13.7 cents in the first six months in 2005 from 13.4 cents in the same period in 2004.

By ignoring the Distorting Factor discussed previously in the section under other operating income and looking at GOME Appliance alone, the management of the Group estimates that net profit at GOME Appliance would have increased by approximately 12.7% in the first six months of 2005 from the same period in 2004.

DECLARATION OF DIVIDEND AND DIVIDEND POLICY

The Board of Directors of the Company has decided to declare an interim dividend of 4.2 HK cents per share, representing approximately 30% of the net profit of the Group during this period.

Currently, the Directors anticipate that the dividend payout ratio will be maintained approximately 30% of the Group's distributable profit of the relevant financial year. However, the actual payout ratio in a financial year will be determined at the Directors' full discretion, after taking into account, among other considerations, availability of investment and acquisition opportunities.

OTHER BUSINESSES AND ASSETS

The securities and futures brokerage operation of the Group was immaterial in terms of both revenue and net profit in the first six months of both 2005 and 2004. In order to focus the Group's resources on the retail business, the Group announced on 14 April 2005 that it would dispose of all of its interest in such business for a total consideration of approximately HK$51 million, and of an existing shareholder's loan in the amount of HK$25 million, to an unrelated third party. The disposal was subsequently completed on 19 July 2005. In the opinion of the management of the Group, the relevant entities were effectively disposed of on 30 April 2005.

Additionally, the Group also holds a piece of land in Beijing. This piece of asset is considered non-core and the Group will not commit any further capital to it. The management of the Group is actively looking for suitable opportunities to dispose of this asset.

COMPETITION AND OUTLOOK

While the Group's financial performance was affected to a certain extent by sales performance at some of the newly opened stores and the rise in operating expenses as it moved swiftly to execute the Growth Initiative, it envisages the following positive trends as it steps into the second half of 2005:

- Continued improvement in performance at the newly opened stores
- Potential upside in suppliers' terms as a result of increasing corporate scale
- Potential easing of competition as a result of market consolidation
- Continued shift in demand from traditional outlets to specialty chains

The Group is confident that it will be able to capitalize on these positive trends and continue to tackle challenges in the future. As discussed previously, the retail market of household appliances and consumer electronics in the PRC is highly fragmented and competitive. While the Group is the largest player in terms of revenue in 2004, with market shares generally ranging from 25% to 55% in cities where it has stores, its overall national market share is still relatively low. The Group faces challenges from local and regional competitors in a number of cities and regions.

At this stage, competition is mostly between domestic players and foreign competition is still very limited. However, now that the market has been opened to foreign entrants under China's WTO commitments, a number of foreign players are actively studying market opportunities in the PRC and exploring means of entry into this market.

The Group recognizes that the market dynamics are rapidly evolving. In order to meet these challenges, the Group understands that it must continue to strengthen its core competencies and address areas of deficiency. Under the Growth Initiative, the Group plans to open a total of about 130 traditional stores by the end of 2005. While the store rollout progress achieved in the first six months of 2005 was generally in line with management expectation, the Group realizes that it has a bigger task on its hands in the second half of 2005 in order to achieve the full year target. At the same time as new stores are being rolled out, the Group is working diligently to enhance its operating quality.

In summary, the Group is undertaking the following initiatives and strategies:

Pushing ahead with the Growth Initiative – to progress under its expansion plan, the Group will continue to open new stores in the second half of 2005 in existing cities and new cities that have exhibited favorable market growth potential.

Enhancing service quality and brand loyalty – to differentiate itself from the competition, the Group will seek to enhance its service quality and customer loyalty to the GOME brand.

Increasing core competencies – to solidify its competitive advantages, the Group will continue to improve management at the store level, increase intensity in customer service training, scrutinize over details about store layout and product variety, and establish market-savvy pricing policies.

Strengthening human resources – to better execute the Growth Initiative, the Group will continue to recruit the best qualified people and provide training and skill upgrades. The Group is also putting in place effective incentive scheme.

Capitalizing on high growth trends – to focus on strong growth products, the Group will continue to emphasize audio visual products, small electrical appliances, and digital products in its product offerings. These categories have the highest gross profit margins in the Group's product portfolio in the first half of 2005.

Leveraging on core brands and key suppliers – to broaden its product variety, enhance standards of after-sales services, simplify procurement procedures, and achieve better logistics efficiency, the Group will continue to establish new and strengthen existing strategic alliances with key suppliers.

Exploring alternative sales channels – to increase sales and enhance coverage, the Group will explore alternative sales channels and different store formats on a prudent basis

Implementing more effective cost control – to mitigate competitive pressure on margins, the Group will continue to exercise strict cost controls at its stores by streamlining procurement procedures and improve office automation.

Upgrading ERP functionalities – to achieve better information flow and data analyses, the Group will further upgrade its ERP system.

The management of the Group strongly believes that only by confronting challenges and succeeding in a highly fragmented and competitive environment can the Group prosper in the long term. The Group is highly confident that it will continue to enhance its competitiveness, widen the gap between itself and the competition, and consolidate its market leadership position.

ACQUISITION OF EHOME

The management of the Group believes that network presence and economies of scale are integral to the success in this business. This assessment, coupled with the fragmented nature of the market itself, points to a direction of industry consolidation. Many of the Group's peers share its notion and the resulting race to build new stores has therefore created a very challenging environment for all. However, the management of the Group believes that the current industry landscape is not sustainable. Market consolidation will inevitably set in with some of the existing players either leaving the market or merging with each other. The management of the Group believes that the sooner the consolidation phase plays out and the market settles down, the better. Indeed, consolidation has already begun and the management of the Group believes the trend will accelerate in the near future.

In July 2005, the Group entered into an agreement pursuant to which the Group aggress to acquire the entire equity interest in Shenzhen eHome Commercial Chain Co., Ltd. ("eHome"), a company incorporated in the PRC carrying on the electrical appliance retailing business under the trade name of "e-Home", and the relevant interest in a shareholder's loan, with the acquisition price to be paid by four instalments including a final payment by 30 August, 2007. The management of the Group views the acquisition as strategically beneficial and the acquisition price and payment terms favorable.

eHome was founded in July 2004 in Shenzhen and currently operates a network of 10 stores, mostly in Shenzhen and Guangzhou, and with little overlap with the Group's network. eHome has also planned a number of new store openings, which will now be synthesized with the Group's existing network expansion plan. The Group may continue to use the eHome brand at select locations.

The Group is confident about turning around the currently loss-making eHome in three to six months after the acquisition by merging eHome into its own network, improving its operating quality, and leveraging the Group's industry leadership position, widely recognized brand name, and strong bargaining power in the market.

The management of the Group believes that the acquisition provides a number of key benefits:

- Enhance the Group's leadership position further in the Guangdong province
- Improve the Group's competitiveness in the marketplace
- Facilitate and expedite the consolidation process in the market
- Bring synergetic benefits to its business model.

In the future, the Group will continue to execute the Growth Initiative. At the same time, it will continue to explore suitable acquisition opportunities which may create financial and strategy synergies to the Group.

LIQUIDITY AND FINANCIAL RESOURCES

Cash and cash equivalents

The Group continues to follow a prudent policy in managing its cash balance and maintaining a high level of liquidity to ensure that the Group is well-equipped to take advantage of growth opportunities. As at 30 June 2005, the Group had HK$3,933 million in cash and cash equivalents, which primarily consist of cash on hand, time deposits including deposits pledged as a security for bank acceptance drafts. Pledged deposits increased by HK$919.7 million to HK$1,770 million as of June 30, 2005 from HK$850.3 million at the end of 2004.

The working capital of the Group, which represent current assets (excluding cash and cash equivalent) less current liabilities, decreased by HK$1,476 million to -HK$2,733.2 million as of June 30, 2005 from -HK$1,257.2 million at the end of 2004.

Trade payables and bills payable

Trade payables and bills payable amounted to HK$4,861.3 million as of 30 June 2005, representing a 61% increase from HK$3,012.5 million at the end of 2004. Trade payables and bills payable days decreased slightly from 106 in 2004 to 99 in the first six months of 2005. The decrease was consistent with the Group's initiative to either strengthen its relationship with key suppliers or obtain better procurement terms.

Inventory

Inventories increased from HK$1,046.3 million as of 31 December 2004 to HK$1,378.4 as of 30 June, 2005. Inventory turnover days decreased from 33 in 2004 to 31 in the first six months of 2005. The management of the Group considers the movement stable and within a normal band.

Prepayments and other receivables

Prepayment and other receivables increased from approximately HK$177.1 million as of December 31, 2004 to approximately HK$445 million as of June 30, 2005, primarily as a result of increase in advances to suppliers, and deposits and other receivables.

Indebtedness and leverage

As of June 30, 2005, the Group had no long-term or short-term indebtedness. The management of the Group believes that the Group's financial profile is very strong, considering the cash generative nature of the business, its strong cash position, and favourable working capital model. However, it is a long term intention of the Group to implement an appropriate mix of equity and debt to ensure an efficient capital structure over time. Therefore the Group will consider incorporating debt into its balance sheet at an appropriate time in the future.

Capital expenditures

Capital expenditures incurred by the Group during the first six months of 2005 amounted to approximately HK$209.7 million, of which approximately HK$176.8 million reflected the purchase of one store location in Beijing and down payment of another location the Group planned to negotiate to purchase in the near future. The balance was primarily used for leasehold improvements and purchase of motor vehicles and office equipment in connection with the expansion of its retail store network.

As discussed, the Group intends to selectively purchase store sites and premises in key strategic locations. The Group believes that ownership of selected store sites and premises will allow the Group to secure attractive store sites while reducing the effects of rental fluctuations on its operating results. Pursuant to this plan, HK$124.5 million (RMB132 million) was used to purchase a store location in Beijing in March 2005, of which HK$98 million (RMB 104.2 million) was paid. The Group is currently exploring a few other opportunities. The prices of additional store location purchases will be incremental to the capital expenditures of approximately RMB100 million planned for store openings in the second half of 2005.

Cash flow

Cash inflow from operating activities amounted to HK$1,650.8 million in the first six months of 2005, compared to HK$411.5 million in the same period of 2004, primarily as a result of the change in working capital.

Cash outflow from investing activities amounted to HK$1,052.7 million in the first six months of 2005, compared to HK$117.6 million in the same period of 2004, primarily as a result of a more significant increase in pledged deposits and in capital expenditures during the first six months of 2005.

There was no cash flow from financing activities in the first six months of 2005, compared to a cash outflow of HK$43.7 million in the same period of 2004. The outflow in the first six months of 2004 pertained to the net impact of distribution to the owner and new shares issued pursuant to a restructuring in conjunction with the injection of GOME Appliance into the Group.

CONTINUING CONNECTED TRANSACTIONS

On 17 March 2005, GOME Appliance and Beijing GOME Electrical Appliances Co., Ltd. ("Beijing GOME") entered into (i) the Master Purchase Agreement dated 29 July 2004 pursuant to which GOME Appliance agreed to purchase electrical appliances and consumer electronics products (the "Products") from Beijing GOME from time to time; and (ii) the Master Supply Agreement dated 29 July 2004 pursuant to which GOME Appliance agreed to sell the Products to Beijing GOME from time to time, for the three financial years ending 31 December 2007.

GOME Appliance is a subsidiary of the Group. Beijing GOME is a member of the Parent Group. The Parent Group is wholly-owned by Mr. Wong who is a Director and a substantial shareholder of the Company holding, together with his associates, an approximately 65.55% interest in the Company. Accordingly, transactions contemplated under the Master Purchase Agreement and the Master Supply Agreement will constitute continuing connected transactions for the Company under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules").

CHARGES ON CAPITAL ASSETS

As of June 30, 2005, the Group had pledged deposits amounting to HK$1,769.9 million, which were used to secure the bank acceptance draft facilities granted to the Group.

CONTINGENT LIABILITIES AND CAPITAL COMMITMENT

There were no material contingent liabilities as of 30 June 2005 and 31 December 2004. However, the Group had capital commitment of approximately HK$68 million as of 30 June 2005.

FOREIGN CURRENCIES AND TREASURY POLICY

All of the Group's revenues and most of its expenses are denominated in RMB. The Group does not believe that it currently has any significant direct foreign exchange risk and has not hedged exposures denominated in foreign currencies or any other derivative financial instruments. It is the Group's treasury policy to manage its foreign currency exposure, if any, only when its potential financial impact is material to the Group.

The management of the Group estimates that less than 10% of the Group's current purchase is imported products, which are sourced indirectly from distributors in the PRC and the transactions are denominated in the RMB. Given the recent appreciation of the RMB against the USD, the impact of such an appreciation on the Group is likely to be neutral to slightly positive. Additionally, the functional currency of the Group is the RMB but its reporting currency is the HKD, which is pegged to the USD. Therefore, the impact of the RMB appreciation will manifest itself in the Group's financial reports in the second half of 2005 and beyond.

HUMAN RESOURCES

As at 30 June 2005, the total numbers of employees of the Group were 13,489, including 13,469 in the PRC and 20 in Hong Kong. The Group values its human resources and recognizes the importance of attracting and retaining qualified staff for its continuing success. The Group also places emphasis on building a robust and team-oriented corporate culture while at the same time seeks to respect individuality.

OTHER UPDATES

As reported in the Clarification Announcement dated 18 January 2005, Mr. Wong Kwong Yu, Chairman and controlling shareholder of the Group and the ultimate beneficiary owner of the 35% interest in GOME Appliance Co., Ltd. that the Company does not already own, has informed the Company that he is in the process of applying to the relevant Chinese government authority for the disposal of such 35% interest. However, as informed by Mr. Wong Kwong Yu, there has been no major development on the approval status as at the date hereof and the Group has not engaged in any negotiation, entered into any agreement, or reviewed any financing means, which is discloseable under rule 13.23 of the Listing Rules.

APPRECIATION

On behalf of the Board of Directors, I wish to thank our shareholders, customers, suppliers, bankers and professionals for their support to the Company and to extend my appreciation to all staff members for their dedication and contribution throughout the period.