

Management Discussion and Analysis

HDTV

is the ultimate home entertainment experience, brings sound and picture quality to a whole new level. There is never any chance of image distortion or disruption.



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BUSINESS PERFORMANCE REVIEW

IMPROVEMENT IN TURNOVER

The Group achieved another milestone of recording turnover of over HK\$10 billion. Turnover of the Group reached HK\$10,466 million in the year, compared to HK\$9,211 million of last year, representing an increase of 13.6%. The improvement in turnover was mainly attributable to:

- general economic improvement in the Mainland China pushing up the demand of high-end television ("TV") products;
- expanding coverage of digital broadcasting positively influencing consumers' behaviour in purchase of high definition digital TV products;
- intensive marketing campaign improving public awareness and recognition of Skyworth's brand and products; and
- successive launches of high-end TV products increasing revenue from the products.



OVERALL GROSS MARGIN

The overall gross margin of the Group for the year reduced by 1.1% point from that of last year to 15.2%. This reduction was mainly attributed to the increase in sales rebates payable to local distributors in the Mainland China by 120.9% this year. In general, sales rebates represented incentive payable to local distributors, under common practice in the Mainland China, for their efforts in promoting and selling Skyworth products.

Discounting the sales rebate impacts on both years, the adjusted gross margin of the Group for this year and last year were 20.2% and 18.8% respectively. This 1.4% point increase in gross margin is mainly due to changing in product sales mix tilted towards the high-end TV products which generated higher gross margins, together with the better costs control and the overall reduction in costs of raw materials.

NEW PRODUCTS AND NEW TECHNOLOGIES

Amid fierce competition in the electronic industry, the management still believes that the Group has its competitive edge to stand out from its competitors. This is due to, among others, that management emphasises on technology and always looks for breakthroughs.

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During the year, the Group has focused its research and development efforts in launching certain new products, including large-screen liquid crystal display ("LCD") TVs and slim cathode ray tubes ("CRT") TVs, and the application of the "V12 Digital Engine" technology in most of the TV products. Besides, more efforts have spent on the researches to include 3C applications, including USB, HDMI and set-top boxes, in the TV sets.

Following our "V12 Digital Engine" technology developed in last fiscal year, the Group has launched "Six Colour Digital" or "Magic Picture" TVs to the market in August 2004.

The "Magic Picture" technology is based on a processor that can handle six primary colours (red, indigo, green, yellow, blue and violet) instead of the traditional three primary colours (red, green and blue). The marvelous picture quality of "Magic Picture" TVs has created another revolution for the TV market.



Understanding the consumers' need is very important to our research team. The team has also developed "A12 Engine" to revolutionise the sound quality in the panel and CRT TVs. It is expected that with the "V12 Digital Engine" and "A12 Engine", the consumers will recognise Skyworth TV as one of the best TVs in the Mainland China.

INCREASE IN SELLING AND DISTRIBUTION EXPENSES

Compared to last year, the Group recorded an increase of HK\$280 million or 31.0% in selling and distribution expenses for the year. The ratios of selling and distribution expenses to turnover were 11.3% and 9.8% in the current year and last year, respectively. Less spending were made in last year due to the cut down of major promotion programs during that period when there was Severe Acute Respiratory Syndrome ("SARS") outbreak.

Other than long term brand building strategy, the Group has launched more promotional campaigns for some special events in 2004 and has launched new promotional campaigns during the year ended 31 March 2005, including:

Special events:

- UEFA (The Union des Associations Européennes de Football) Euro 2004; and
- 2004 Olympic Games.



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New promotional campaigns:

- set up flagship counters in major cities in the Mainland China;
- contracted 12 Girls Band as the spokespersons of "Skyworth" brand;
- implemented extensive promotional programs for launching of the new "V12 Digital Engine", "Magic Picture" and flat panel technology;
- granted attractive promotional gifts to customers for stimulating the sales of high-end TV products; and
- opened more sales counters in the large electronic chain stores and department stores in the Mainland China.



During the year, the number of contracted and temporary salesmen increased by 23.4% and 25.9%, respectively, in order to promote new products and expand the sales of the Group. Accordingly, there was a significant increase of HK\$65 million or 27.8% in compensation to salespersons as compared with that of last year. Other major factors causing the increase in selling and distribution expenses were (a) the increase in the number of large screen size TVs sold and (b) the continuous growth in sales volume of TVs in Eastern and Northern regions in the Mainland China, during the current year.

INVENTORY CONTROL

The net carrying value of the inventories of the Group was HK\$1,679 million as at 31 March 2005. There was an increase of HK\$343 million or 25.7% from the net carrying value of the inventories of the Group amounting to HK\$1,336 million as at 31 March 2004. This increase was mainly because the Group carried more high value items during the current year. In the year ended 31 March 2005, the turnover periods (based on average inventory balance net of provision) of raw materials and finished goods were 16 and 44 days, respectively.

Expecting further increase in future sales, the Group continues its tight controls on inventory and has been reinforcing the controls by, among others, improving the related operating procedures.



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TRADE RECEIVABLES; BILLS RECEIVABLE; AND PLEDGED DEPOSITS

As at 31 March 2005, trade receivables and bills receivable of the Group amounted to HK\$357 million and HK\$2,828 million, respectively, totalling HK\$3,185 million. As compared with 31 March 2004, the amount of trade receivables has increased by HK\$109 million or 44.0%, and the amount of bills receivable has increased by HK\$462 million or 19.5%. Also compared with 31 March 2004, the total amount of the trade receivables and bills receivable has increased by HK\$571 million or 21.8%.

The above significant increases can be explained by:

(i) Increase in turnover during the current year

The Group's turnover during the current year has increased by 13.6% compared with that of last year. Analysing from the sales mix in the current year, the increased sales of high-end TV products resulted in higher receivable balance.

(ii) Abolishment of consignment arrangements with department stores

Until March 2004, the Group used to place its products in local distributors in the Mainland China by consignment, and recognize sales only when the products were sold to consumers. However, this consignment arrangements were abolished since March 2004 and all the products delivered to the local distributors were recorded as sales.

Bills receivable of the Group as at 31 March 2005 increased by HK\$462 million or 19.5% as compared to HK\$2,366 million as at 31 March 2004. During the current year, the Group discounted its bills receivable to banks in return for cash, and at the same time the Group also issued bills to suppliers as settlement for raw materials supplies. As part of the arrangements with banks to issue bills to suppliers, the Group pledged an amount of cash (same as to amount of bills issued to suppliers) to banks as security. This explains the Group's position of inclusion of HK\$1,055 million pledged bank deposits as at 31 March 2005, shown as part of investing activities in the consolidated cash flow statements, and HK\$765 million associated financial liabilities as at 31 March 2005, shown as part of financing activities in the consolidated cash flow statements.

TRADE PAYABLES; AND BILLS PAYABLE

Total trade payables and bills payable of the Group as at 31 March 2005 amounted to HK\$2,774 million, representing an increase of HK\$1,250 million or 82.0% from 31 March 2004. As explained above, the Group arranged with banks in the current year to issue bills to settle purchases from suppliers. Since most of the suppliers granted longer credit terms to the Group when payments were made through bills payable, bills payable significantly increased by about 477.1%.



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PRODUCT SEGMENT AND GEOGRAPHICAL SEGMENT REVIEW

China market

Over 80% of the Group's sales were derived from the Mainland China market. For the year ended 31 March 2005, turnover from the Mainland China market amounted to HK\$8,952 million compared with HK\$7,734 million of last year, accounted for a 15.7% increase.

Overseas market

The Group's sales derived from overseas market accounted for 14.4% of the Group's total turnover in the current year. Overall increase in sales to overseas market in this year as compared to last year was 1.1%, which can be analysed by a 5.2% increase in sales of TV products and a 32.6% decrease in sales of audio-visual ("AV") products.

TV products

The Group's overseas sales of TV products (82.4% of total overseas sales in the current year) were mainly to overseas OEM customers. The economy of many countries had recovered from the outbreak of Iraq war and SARS, to a significant extent in the year ended 31 March 2005, and thus the demand for consumer electronics products has been increasing. Management believes that sales of TV products to overseas market can still maintain a steady growth by the Group's strong effort in exploring new markets in other countries, and the reputation of Skyworth high quality products.

AV products

Sales of AV products represented 11.7% of the total overseas sales in the current year as compared to 17.5% of the same in last year. As the sale of AV products is not the core business of the Group, the production volume of, and resources devoted to it are not significant, making the Group less competitive against other AV suppliers.

Digital set-top boxes

The Group offers digital set-top boxes to the overseas markets which attributed to over 6% of the total overseas sales in the current year.



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Geographical distribution

The percentage of geographical distribution of sales to overseas market is analysed below:

	For the year ended 31 March 2005 (%)	For the year ended 31 March 2004 (%)
Asia (including Japan, Korea, Vietnam, etc.)	59	58
America	17	13
Europe/Middle East	20	26
Australia and New Zealand	3	2
Africa	1	1
	100	100

The biggest overseas market for the Group is Asia. The sales to Asia represented over 50% of the total overseas sales for both of the years.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 March 2005, the Group had bank balances and cash of HK\$1,940 million, which includes HK\$1,055 million pledged deposits maintained in banks to secure the issuance of bills payable to suppliers. Bank balances and cash of the Group as at 31 March 2004 was HK\$445 million only. This indicated that the Group achieved a 336% increase in bank balances and cash over the year ended 31 March 2005. Excluding the associated financial liabilities arising from discounting bills receivables with recourse, bank borrowings of the Group represented mortgage loans amounting to HK\$4 million in respect of the land and building located in Hong Kong. As at 31 March 2005, the book value of the mortgaged land and buildings was HK\$19 million. Gearing ratio of the Group was 0.1% as at 31 March 2005. This ratio is calculated with reference to the mortgage loans of HK\$4 million and shareholders' fund of HK\$2,939 million.

TREASURY POLICY AND CASH FLOW MANAGEMENT

The Group's investments are mostly in the Mainland China and its main revenue stream is in Renminbi. Other than Renminbi, most of the Group's remaining assets and liabilities are denominated in either Hong Kong dollars or US dollars. Management believes that the operations of the Group are not subject to significant foreign exchange risks and accordingly, the Group does not engage in any hedging activities at present. Similarly, the Group does not engage in any instrument to hedge against any risk relating to the uncertainty of interest rate development. However, management will monitor the foreign currency movement and interest rate movement to evaluate the need of any hedging policy in the future.

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In this fiscal year, the Group has changed its policy for the utilisation of bills received from customers, which are guaranteed by local banks. The Group has initiated the discounting of such bills and either utilising the cash from discounting as pledged deposits to banks for security for issuance of bills payable to suppliers, or for settlement of accounts payable.

SIGNIFICANT INVESTMENTS AND ACQUISITION

During the year ended 31 March 2005, the Group's addition to construction-in-progress was HK\$37 million mainly for the development of a production plant in Shiyan of Shenzhen, the PRC. Construction of the Shiyan production plant is expected to be completed by the end of December 2005. The Group will use this production plant as its new base for manufacturing panel TVs and mobile phones as well as related products such as liquid crystal displays and precision moulds. During the same year, the Group also spent about HK\$48 million mainly in the replacement of old production facilities.

HUMAN RESOURCE

As at 31 March 2005, the Group had approximately 12,800 employees in Hong Kong and Mainland China. This includes sales persons located in the sales offices covering over 160 sales points in the Mainland China. Employees' remuneration packages are determined with reference to the qualifications and experiences of individuals and are reviewed annually and as required from time to time. The Group also offers incentives to employees, such as discretionary bonus and share options. In the year ended 31 March 2005, the Group has spent more resources in training, retention and recruitment programs. In the same year, the Group commenced to set the "key performance indicators" for managerial staff using a methodical system to monitor and evaluate the performance of such staff. The Group acknowledges that its future success depends on its ability to build up a team of high quality professional managers as its human resource capital. It is fully committed to build up such human resource capital to enhance its assets for ensuring future growth.

Currently, the emoluments payable to directors are determined with reference to the qualifications and experiences of the directors. With the set up of a remuneration committee on 19 August 2005, the remuneration packages of directors and senior management of the Group will be reviewed by the remuneration committee from time to time. The Company has set up a nomination committee, also on 19 August 2005, to deal with nomination of directors and senior management.



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FUTURE PROSPECTS

Judging from the sales of the Group to the current date, management is confident that the Group will have a successful fiscal year 2005/06.

Following the development of "V12 Digital Engine" and "Six Colour Digital" technologies, the Group added "A12" technology to certain of its TV products in April 2005. The "A12" technology improves the sound system of the TV products.

The Group aims at focusing on its core business to produce high technology TV products whilst increasing its margin and broadening its revenue base by vertical integration. It is looking for good investments opportunity in areas complimentary to its core business.



The Group expects that the construction of the new production plant in Shiyan of Shenzhen will be completed by the end of December 2005. It has also commenced the setting up of another new production plant for manufacturing of TV products in Huhot, Inner Mongolia, the PRC. The construction of Huhot production plant is expected to be completed by the end of December 2005 as well. The new Shiyan production plant will provide the Group with additional production facilities for TV and other products. The setting up of the Huhot production plant would enhance the Group's competitiveness in its sale of TV products in the Northern region by improving working capital control and saving increasing transportation costs.

Recognising the growth potential for semi-conductors, the Group proposes to build a factory sized to produce semi-conductor chips. This proposed project has obtained the in-principle approval and support from the Shenzhen government. The Group has also started its manufacturing of liquid crystal display module in June 2005 and obtained a licence to manufacture mobile phones in May 2005. It is expected that the Group will have a better growth in this fiscal year due to the growth of other business units.



The Group also recognises that the price fluctuation in panels and CRTs are significant and has implemented a series of inventory control program to reduce the inventory level. With the Shiyan and Huhot production bases, it is anticipated that subcontracting and logistics costs would be reduced.

The management believes that with the tax inspections and restructuring of the management team having been finalised, the Group will now be able to fully focus on the core business activities.

Although the electronic industry is facing challenges, Skyworth team, with strong research, sales and management team support, is ready to approaching another climax.