

### III. MANAGEMENT DISCUSSION AND ANALYSIS

#### (i) Industry Review

During the first half of 2005, as a result of an oversupply of CPTs, and the rapid growth of the sales volume of the flat panel display ("FPD") television sets, the market share of cathode ray tube ("CRT") television sets has been further eroded. In addition, faced with strong marketing campaigns for the FPD television sets, together with the surging prices of raw materials such as coal, steel and zircon sand, the CPT industry experienced the most critical challenge in recent years. Varying degrees of underperformance were seen in the production, sales and export aspects of the CPT industry in China, as well as in the downstream production and sales of CRT colour television sets. The sluggish demand in the CPT market and the decreasing CPT prices led to the increased inventories of CPTs.

In the first half of 2005, faced with a challenging market, the CPT manufacturers in China strengthened and implemented cost-control measures with flexible marketing strategies. In the global CPT market, the burden from surplus production capability was reduced, as certain CPT production lines were closed down or had their operations suspended.

Since July 2005, the domestic CPT market might be revitalised with the recent increasing orders for CPTs and the demand for certain types of CPTs outgrowing supply. As a result, the Directors believe that the CPT market in the PRC is likely to witness a resilient growth after the industrial stagnancy during the first half of 2005. The Directors further believe that the CPTs will retain a dominant position in the PRC and global television set markets for the short to medium term.

#### Statistics of the CPT Industry in the PRC for the First Half of 2005

	Six months ended 30 June		Change of percentage
	2005 ('000 units)	2004 ('000 units)	
Production volume	<b>27,760</b>	33,510	-17%
Sales volume	<b>25,550</b>	33,300	-23%
Including: export	<b>8,250</b>	8,530	-3%
Inventories	<b>4,810</b>	1,020	372%

Source: [www.chinaccm.com](http://www.chinaccm.com)

**(ii) Business Review****1. Operation Highlights**

The Group's operating results for the first half of 2005 decreased considerably as a result of difficulties in the operating environment of the CPT industry. For the first half of 2005, the Group's turnover amounted to RMB1,643,434,000, representing a decrease of 32%, as compared with the 2004 corresponding period, and the Group's loss for the period attributable to equity holders of the Company amounted to RMB30,840,000, representing a decrease of net profit by 117%, as compared with the 2004 corresponding period.

**2. CPTs Business**

During the first half of 2005, the Group sold 5,269,000 units of CPTs in total, representing approximately a decrease of 1,258,000 units, or 19%, as compared with the 2004 corresponding period. Sales revenue of CPTs was RMB1,414,475,000, representing a decrease of RMB788,022,000, or approximately 36%, as compared with the 2004 corresponding period.

The decline in sales volume of CPTs was mainly attributable to the substantial decline in the CPT industry in the PRC in the first half of 2005 resulting in a decrease of 23.3% in the total sales volume of domestic CPTs as compared with the 2004 corresponding period, including medium-size CPTs, with a decline of 27.4% in sales volume, which suffered the most. As the medium-size CPTs were the mainstream products of the Group, the Group has experienced a major impact. Despite initiatives and efforts to increase its market share in the domestic CPT industry to approximately 21.25% in order to maintain its leading role in the domestic CPT industry, the sales revenue of its CPTs decreased significantly, as compared with the 2004 corresponding period, due to the unsatisfactory sales of CPTs and continuously decreasing CPT prices.

During the first half of 2005, the Group has undertaken the following measures in response to the changing market:

1) Minimising cost by exploring potentials

Since the first quarter of 2005, with the CPT market shrinking and prices decreasing, cost competition became a key consideration in the CPT industry competition. As such, the Group explored and undertook various measures to minimise cost including encouraging the staff's technology renovation and management innovation. A total of 634 cost-saving and potential-exploring projects were confirmed for the year 2005 by the Group, including 74 "three-optimisation" projects in respect of design, production, equipment and raw materials, and 118 "two-new" projects in respect of new raw materials and new suppliers. As at the end of June 2005, a total of 314 cost-saving and potential-exploring projects were completed.

2) Strengthening sales and marketing

Facing the challenges arising from the declining market demand, the Group strengthened its information collection and analysis, as well as its market forecast ability. In addition, various sales and marketing tactics were flexibly utilised. Meanwhile, the sales and marketing teams were strengthened as a way for the Group to maintain its market share.

3) Enhancing the ability to address the changing market demand

To address the changing market demand, the Group reduced part of its capital expenditure. At the same time, as a result of technology renovation, now the 21" and 15" CPT production line (G line) is capable of producing 14" CPTs. The super large-size high definition CPT production line (K line) is under construction and is expected to commence trial production at the end of 2005 as scheduled.

### **3. CPT Components Business**

With enhanced internal supply capability of key CPT components during the first half of 2005, the Group encouraged its subsidiaries engaging in the production of CPT components to expand their external sales. By committing significant efforts to this area, the Group's turnover of CPT components amounted to RMB228,959,000, representing an increase of RMB12,701,000, or approximately 6%, as compared with the 2004 corresponding period.

## (iii) Future Prospects

The Directors believe that the CPT market in the PRC is witnessing a resilient growth after the industry downturn in the first half year of 2005. The Directors further believe that the CPTs will maintain a dominant position in the PRC and the global television sets market for the short to medium term. Therefore, the Company will continue to sharpen its CPTs and CPT components businesses based on the existing production capacity.

On the other hand, the global CPT market is shrinking slowly. As such, through cooperation with other companies as soon as possible, and based on effective risk controls in the next few years, the Group will actively enter into the FPD sector to establish new business opportunity and new profit growth base for the Company.

### 1. CPTs Business

Starting from July 2005, the Company has been experiencing a significant increase in clients' orders for CPTs. The sales volume of CPTs rose rapidly, with the production and sales levels reaching an equilibrium; the inventory level of CPTs basically returned to its normal level. However, whether the decreasing trend of CPT prices will slow down or see an upturn has yet to be observed. We will continue to strengthen our CPTs business through the following three aspects: (1) low cost; (2) new technologies; and (3) market expansion.

- 1) To further implement various "cost-saving" and "potential-exploring" activities.
- 2) To achieve better performance of pure flatness, slimness and high definition for CPTs, and compatibility, low cost and high quality for CPT components, in order to satisfy the market demand.
- 3) To increase sales and marketing efforts in order to expand our market share.

## 2. CPT Components Business

The Group's operations involve a wide range of CPT components ranging from chemicals, glass and metal parts processing. The CPT components business of the Group will embark on specialised production in order to achieve further business development. Based on enhanced internal supply capability, the Group will improve its CPT components business through the following steps:

- 1) The Group will continue to broaden its external sales of existing CPT components to take advantage of the enlarged market share.
- 2) Based on the existing product mix, the Group will develop new products other than CPT components to diversify its profit sources in the new markets.

## 3. FPD Devices

In view of the fast growth of the development of FPD devices, the Group will speed up its entry into this sector. With an overall consideration of the maturity of this technology, the required investment amount, the market capacity of FPD devices and the connection with our existing businesses, the Group will adopt suitable strategies. The current focus of the Group is the scale production of plasma display panels ("PDPs"). The Group will capitalise on the significant breakthrough in the scale production technologies of PDPs in the past two years, as well as effective risk controls for PDP industrialisation and production, and thereby gradually developing PDP business in an active manner and steadily expanding PDP business. Along with efforts in scale production of PDPs, the Company will keep a close eye on market opportunities raised from other new models of FPD devices.

**(iv) Financial Review**
**1. Business Results**

## 1) Unaudited profit and loss data (RMB'000)

	For the six months ended 30 June		Increase / (decrease)	Change of percentage
	2005	2004		
Turnover	<b>1,643,434</b>	2,418,755	(775,321)	-32%
– Sales of CPTs	<b>1,414,475</b>	2,202,497	(788,022)	-36%
– Sales of CPT components	<b>228,959</b>	216,258	12,701	6%
Cost of goods sales	<b>(1,472,891)</b>	(1,859,795)	386,904	-21%
Gross profit	<b>170,543</b>	558,960	(388,417)	-69%
Other revenues	<b>27,024</b>	22,712	4,312	19%
Operating expenses				
Administrative expenses	<b>(111,679)</b>	(108,919)	(2,760)	3%
– General administrative expenses	<b>(91,332)</b>	(89,392)	(1,940)	2%
– Research and development expenses	<b>(20,347)</b>	(19,527)	(820)	4%
Selling and marketing costs	<b>(52,972)</b>	(50,848)	(2,124)	4%
Other operating expenses	<b>(34,671)</b>	(40,800)	6,129	-15%
Operating profit	<b>3,188</b>	389,057	(385,869)	-99%
Finance costs	<b>(34,859)</b>	(28,481)	(6,378)	22%
(Loss)/profit for the period	<b>(40,950)</b>	262,511	(303,461)	-116%
Attributable to:				
Equity holders of the Company	<b>(30,840)</b>	183,681	(214,521)	-117%
Minority interests	<b>(10,110)</b>	78,830	(88,940)	-113%

2) Turnover

Turnover by product (RMB'000)

	For the six months ended 30 June		Increase / (decrease)	Change of percentage
	2005	2004		
CPTs	<b>1,414,475</b>	2,202,497	(788,022)	-36%
Including: Small-size CPTs	<b>373,725</b>	346,698	27,027	8%
Medium-size CPTs	<b>1,027,007</b>	1,832,677	(805,670)	-44%
Large-size CPTs	<b>13,743</b>	23,122	(9,379)	-41%
CPT components	<b>228,959</b>	216,258	12,701	6%
Total	<b>1,643,434</b>	<b>2,418,755</b>	(775,321)	-32%

Sales volume by product (Units)

	For the six months ended 30 June		Increase / (decrease)	Change of percentage
	2005	2004		
Small-size CPTs	<b>2,215,103</b>	1,984,240	230,863	12%
Medium-size CPTs	<b>3,034,615</b>	4,514,957	(1,480,342)	-33%
Large-size CPTs	<b>19,128</b>	25,374	(6,246)	-25%
Total	<b>5,268,846</b>	<b>6,524,571</b>	(1,255,725)	-19%

Average selling price by product (RMB / Unit)

	For the six months ended 30 June		Increase / (decrease)	Change of percentage
	2005	2004		
Small-size CPTs	<b>169</b>	175	(6)	-3%
Medium-size CPTs	<b>338</b>	406	(68)	-17%
Large-size CPTs	<b>718</b>	911	(193)	-21%

**2. Changes as Compared with the 2004 Corresponding Period and Analysis of Reasons**

## 1) Turnover and Gross Profit Margin

The Group's turnover for the first half of 2005 amounted to RMB1,643,434,000, representing a decrease of RMB775,321,000 or 32%, as compared with the 2004 corresponding period, including the turnover of CPTs of RMB1,414,475,000, a decrease of RMB788,022,000 or 36%, as compared with the 2004 corresponding period, and the turnover of CPT components of RMB228,959,000, an increase of RMB12,701,000 or 6%, as compared with the 2004 corresponding period.

The overall gross profit margin of the Group decreased from 23% of the first half of 2004 to 10% of the first half of 2005. This was mainly due to: 1) a significant decrease in the average selling prices of CPTs for the first half of 2005, as compared with the 2004 corresponding period, resulting from fierce competition in the PRC market of colour television sets; and 2) the surge in prices of certain raw materials.

## 2) Administrative Expenses

The Group's administrative expenses for the first half of 2005 were RMB111,679,000, an increase of RMB2,760,000 or 3%, as compared with RMB108,919,000 of the 2004 corresponding period. This was primarily due to the recent establishment of Xianyang IRICO Electronics Shadow Mask Co., Ltd. and IRICO Display Technology Co., Ltd..

## 3) Finance Costs

The Group recorded RMB34,859,000 of finance costs for the first half of 2005, an increase of RMB6,378,000 or 22%, as compared with RMB28,481,000 of the 2004 corresponding period. This was mainly due to an increase in the bank loans and interest rates.



### 3. Current Assets and Financial Resources

As at 30 June 2005, the Group's cash and cash equivalents aggregated to RMB622,737,000, representing an increase of 73% from RMB360,338,000 as at 30 June 2004. The Group paid a total of RMB199,861,000 in capital expenditure during the half year ended 30 June 2005. Net cash used in operating activities and financing activities were RMB148,730,000 and RMB135,281,000 respectively, and net cash used in investing activities amounted to RMB189,768,000.

As at 30 June 2005, the Group's borrowings totalled RMB1,307,765,000 as compared with RMB1,420,000,000 as at 31 December 2004. The borrowings were all due within one year. As at 30 June 2005, short-term bank borrowings of approximately RMB300 million (31 December 2004: RMB300 million) were secured by certain property, plant and equipment of the Group with a net book value of approximately RMB303,323,000 (31 December 2004: RMB321,973,000). Short-term bank borrowings of approximately RMB235 million (31 December 2004: RMB200 million) were secured by trade bills receivable of the Group of approximately RMB57,946,000 (31 December 2004: bank deposits of RMB21,000,000 and trade bills receivable of RMB41,319,000).

As at 30 June 2005, short-term bank borrowings of approximately RMB220 million (31 December 2004: nil) were guaranteed by the ultimate holding company.

For the first half year ended 30 June 2005, turnover period for accounts receivable of the Group was 134 days, representing an increase of 38 days, as compared with 96 days of the 2004 corresponding period, which was mainly attributable to the keen CPTs market competitions in the first half of 2005 and the purchaser inability to repay amounts on time. For the half year ended 30 June 2005, inventory turnover period for the Group was 143 days, representing an increase of 68 days, as compared with 75 days of the 2004 corresponding period, which was mainly attributable to the increased inventories of finished products caused by the lower market demand in the first half of 2005.

#### 4. Capital Structure

As at 30 June 2005, the Group's borrowings were mainly denominated in Renminbi and US dollars, while its cash and cash equivalents were mainly denominated in Renminbi, Hong Kong dollars and US dollars.

The Group intends to maintain a suitable ratio of share capital to liabilities, so as to ensure an effective capital structure from time to time. As at 30 June 2005, its liabilities including bank loans aggregated to RMB1,307,765,000, with cash and cash equivalents totalling RMB622,737,000 and a gearing ratio (defined as: total liabilities/total assets) of 43%.

#### 5. Interim Dividend

The Company's dividend distribution policy remains unchanged. As the Company recorded losses in the first half of 2005, the Board does not recommend any distribution of interim dividend.

#### 6. Foreign Exchange Risk

The Group's income and most of its expenses are denominated in Renminbi and US dollars. For the six months ended 30 June 2005, there was no material impact on the Group's operations or working capital resulting from exchange rate fluctuations.

#### 7. Commitments

As at 30 June 2005, the commitments on capital expenditures for the Group amounted to RMB879,481,000 (31 December 2004: RMB679,916,000). The sources of funding for such commitments were mainly from the Group's working capital and bank loans.

#### 8. Contingent Liabilities

As at 30 June 2005, the Group had no material contingent liabilities.

#### 9. Charge on Assets

As at 30 June 2005, short-term bank borrowings of approximately RMB300 million were secured by certain property, plant and equipment of the Group with a net book value of approximately RMB303,323,000 and of approximately RMB235 million were secured by trade bills receivable of the Group of approximately RMB57,946,000.