BUSINESS REVIEW

Competition in the global consumer electronics market remained tough in the first half of 2005. Rapid technological developments shortened product life cycles, driving down selling prices at a speed faster than ever before. Manufacturers were challenged with their capabilities in product development, supply chain management, sales and marketing as well as inventory control. As a global leader in the TV industry, TCL has implemented a series of strategies in the first half of the year to counterbalance the negative factors and to enhance its competitiveness in its core markets.

The Group continued to consolidate its business through a series of restructuring and cost reduction programmes within TTE to capture benefits from procurement, R&D and manufacturing brought forth by economies of scale. Numerous cost reduction programmes known as "Best in Cost programmes" were implemented to improve overall production cost structure. Restructuring programmes to streamline organization were carried out not only in the profit centres of Europe and North America, but also in various functional divisions such as R&D centres and procurement centres. All of these programmes made good progress and the resulting benefits started to emerge. In addition to these ongoing restructuring efforts, in July this year, the Group reached a definitive agreement with Thomson, finalizing the transfer of sales and marketing activities from Thomson to TTE. Consequently, TTE gained direct control of its sales and marketing activities in Europe and North America. This move entails a better business model with closer ties between functions of sales and marketing, supply chain, production and after-sale services. These initiatives are expected to substantially enhance efficiency and reduce the overall operating costs of the Group.

TV Business

The TV business is the Group's major source of revenue. For the six months ended 30 June 2005, a total of 9.8 million sets of TVs were sold worldwide, representing a growth of 63.8% over the same period last year. Sales revenue increased by 119.8% to HK$13,444 million, accounting for 86% of the Group's total turnover.

In terms of geographical markets, the PRC market continued to be the major revenue stream for the TV business, accounting for 36.4% of the total TV sales, followed by Europe and North America which accounted for 26.6% and 23.6% of the TV sales respectively. Amongst the Group's five core profit centres, the PRC, Emerging Markets and the Strategic OEM business continued to record profit. The Emerging Markets and Strategic OEM business continued to expand with new markets and new customers, bringing greater opportunities to the Group. While better-than-expected performance was seen in the North American market as a result of the diversified product range and better channel strategy, operations of the European market were adversely affected by keen competition.

The Group reported an operating loss of HK$31 million for the six months ended 30 June 2005. While the second quarter was a low season in the PRC market, leading to a reduced contribution from the PRC, the Group benefited from the synergies generated from the European and North American operations, and thereby recorded a narrowed quarter-on-quarter loss in these markets.

	TV Unit Sales Unaudited results for the SIX months ended 30 June		
	2005	2004	Change
	('000 sets)	('000 sets)	
— PRC	**4,144**	3,747	+10.6%
— Europe	**1,302**	102	not comparable
— North America	**1,396**	not applicable	not comparable
— Emerging Markets	**1,494**	1,394	+7.2%
— Strategic OEM	**1,439**	723	+99.0%
Total TV Units	**9,775**	5,966	+63.8%

The PRC Market

The Group continued to outperform its peers and maintained its leading position in the market with a dominant share of 20% for the first six months of 2005, according to the MII report, as compared to 19% in the same period of last year.

Sales revenue from the PRC market amounted to HK$4,895 million. A total of 4.1 million sets of TVs were sold in the first half of 2005, of which TCL brand and Rowa brand TVs accounted for 3.5 million sets and 0.6 million sets respectively. Encouragingly, after two years' hard work for promoting Rowa brand TVs, the Group successfully established the position of Rowa brand TVs as competitively priced products for mass consumers. Unit sales of Rowa TVs posted an encouraging year-on-year growth of 113%.

During the first half of 2005, the overall market demand for CRT TVs was not strong as apparently the consumers' appetite was increasingly shifting towards flat TVs. Manufacturers from all over the world participated in the flat TV market, leading to decreases in selling price of flat TVs. The price war in flat TVs made consumer delay their consumption as they tended to wait for possible further reduction in price, dampening the overall demand for TVs in the second quarter, which was weaker than the same period last year. The Group also experienced a mild year-on-year decline in unit sales in the second quarter this year.

In response to market demand, the Group invested further in the development of high end TVs and introduced a total of 61 new models including 12 models of LCD TVs, driving up the Group's market share in the LCD segment to 10%, according to the China Market Monitor report (previously known as China Economy Consultancy) of May 2005.

Europe

The market position of the Group's Thomson brand TVs saw improvements in Europe during the period under review. According to GFK April–May 2005 report, Thomson brand TV ranked the fifth in the European market with a 6% market share.

Sales revenue from the European market amounted to HK$3,572 million for the six months ended 30 June 2005. The European market sold a total of 1.3 million sets of TVs during the first half of the year, of which Thomson and Schneider brands each accounted for 1,229,000 sets and 73,000 sets respectively.

Against a highly competitive backdrop, operating environment in the European market remained tough. Sales of CRT TVs declined as market demand shifted towards flat LCD TVs. The Group seized market opportunities and recorded robust year-on-year growth of 132% in sales volume for its flat TVs. Despite this, fierce competition brought a drastic drop in the average selling price and further placed the profit margin of the European profit centre under pressure.

The Group offered a wide array of TVs through its multiple sales channels to reach out to all market segments. In keeping up with the latest market trends, the Group increased investment in high-end products. Six new models were launched in the first half of 2005, including a stylish and high-tech DLP model 50DSZ644 which received the prestigious EISA award for 2005–06 elected by a panel of European journalists. With a strong product portfolio, TTE successfully entered the private label market and attracted chained retailers to be its customers.

North America

The market share of RCA brand TVs in the North American market increased to 9% and was ranked among the top three brands in the market according to Synovate Jan–May 2005.

The Group's performance in the North American market was better than expected, with sales revenue amounting to HK$3,178 million and unit sales amounting to 1.4 million sets for the six months ended 30 June 2005.

By leveraging on its improved cost structure in manufacturing and capability in producing high end TVs, the Group secured several new regional mass merchant accounts, which will pave the way for further increasing the Group's turnover in the North American market in the future. At the same time, the Group supplied a range of high quality digital products (CRT-based RPTV models) at affordable prices to the mass market and boosted sales substantially. Gross and operating margins were widened as a result of higher market penetration, better raw materials costs and tighter operating cost controls.

Additionally, the Group refined its sales strategy to focus more effort on its largest customers. Overall speaking, the North American market showed significant improvements during the period under review.

Emerging Markets

The Emerging Markets continued to post strong volume growth. Sales revenue increased by 13.3% to HK$1,007 million and a total of 1.5 million sets of TVs were sold in the six months ended 30 June 2005, representing a year-on-year growth of 7.2%.

With an established international network, sales of TCL brand TVs generated by the Group's overseas branch offices surged substantially by 225% to 700,000 sets as compared with the same period last year. To capitalise on market opportunities, the Group opened new offices in the Middle East and Panama in the first half of 2005 and is planning to establish new branches in other markets such as Pakistan and Brazil in the second half of 2005.

Strategic OEM

In parallel to the development of Emerging Markets, Strategic OEM business also reported strong growth. Sales revenue increased by 88.7% to HK$792 million and unit sales amounted to 1.4 million sets in the six months ended 30 June 2005, representing a year-on-year growth of 99% by volume.

Appreciating the high quality standard of the Group's products and services, the existing customers continuously increased their order volume and the Group's products were sold in more countries.

On top of the existing customers, the Group also developed new accounts proactively and started to work with internationally renowned customers to produce theme decorated TVs to broaden its product variety. At the appropriate opportunity, the Group has also been promoting high end models in selected markets to improve the gross margin. Geographically, the Group is exploring OEM business opportunities in the ASEAN countries, Africa and Latin America.

PC Business

The Group maintained its position as one of the top 5 players in the PRC desktop PC segment, with a 4% market share, according to the CCID report for the first quarter of 2005.

Sales revenue from the PC business amounted to HK$971 million, representing a year-on-year growth of 0.5% and accounting for 6.2% of the Group's total turnover. Sales volume of PCs rose by 7.1% year-on-year to a total of 331,000 units. The growth was mainly due to the increase of sales of consumer PCs.

The Group deployed additional resources to uplift the image of TCL products. More high-end products such as PCs with LCD monitors were sold, enhancing the product mix and driving up the gross margin during the period under review. The Group reduced the layers in distribution channels, leading to a simpler and slimmer structure. As a result, the sales head count was reduced and the operational efficiency was greatly enhanced. Meanwhile the Group placed greater efforts in R&D with an aim to enrich its notebooks and desktop PC product offering.

FUTURE PLANS

Looking ahead into the second half of 2005, the Group expects challenges and difficulties to remain as keen as in the first half of the year. The Group will continue to solidify its domestic leadership, improve performances in the North American and European markets, and eventually achieve a turnaround.

Having completed the majority of the contemplated restructuring following the formation of TTE, we are pleased to see that Thomson has exercised its exchange options and is now the second single largest shareholder of the Group after TCL Corporation. We believe such international shareholding structure will help the Group to restore its profitability as scheduled.

On the product front, flat TVs are taking the lead in the mainstream product market across different regions. To sharpen its competitive edge, the Group will reorganize its global strategy for the production and sales of flat screen TVs. The Group has already laid a solid foundation and has established an edge in terms of R&D, production know-how, cost control and pricing. The ultimate goal is to shift the product portfolio towards the higher-end models with wider offering. The Group is well positioned to capture market growth.

The Group continued to implement strategies to realize synergies and to reduce costs. Restructuring and cost saving plans continued to be executed and have led to certain synergies in procurement, R&D and manufacturing. The finalization of the transfer of sales and marketing functions from Thomson to TTE has enabled TTE to gain direct control over its sales force in Europe and North America, creating stronger internal links between sales and marketing and other functions. Operating cost is expected to further go down. The Group expects the effects of stringent cost controls and reorganized business strategies will become more apparent in the second half of 2005.

The Board of Directors is confident that the Group will turn around its business and create remarkable value for shareholders in the long run.

FINANCIAL REVIEW

The commencement of TTE's operations brought about changes to the Group's operations as well as to its financial performance. While the Group evolved from primarily a PRC-focused TV player into a global TV manufacturer on an international platform, our financial performance also reflected this change.

For the six months ended 30 June 2005, the Group's consolidated turnover amounted to HK$15,615 million, representing a year-on-year growth of 99.1% and the gross profit also increased by 83.6% to HK$2,589 million. The strong growth in revenue and gross profit is mainly due to the inclusion of European and North American businesses which were formerly Thomson TV business.

However, as the gross profit margin of the overseas business is for the time being still lower than that of the PRC, the Group's overall gross profit margin was lowered to 16.6% (2004: 18.0%).

An operating loss of HK$36 million was recorded during the period under review, as the loss of the North American and European businesses acquired from Thomson was higher than the sum of the profits from other profit centres, despite the improved performance of these two profit centres as compared with the same period last year when they were operated by Thomson.

The PRC market showed stable performance in the first half of 2005 and continued to be the Group's major revenue stream. The North American market outperformed our expectations as a result of the implementation of effective cost control initiatives and restructuring measures. Nevertheless, with the drastic decline in flat panel TV prices driven by keen competition, the performance of the European market was unsatisfactory with a loss against the Group's expectation.

Moving ahead, the Group anticipates that synergies will be more apparent starting from the second half of the year following the completion of business restructuring of TTE. Efficiencies will be further enhanced as business integration continues to take place. The Group expects that profitability will be achieved for the full year of 2005 and in the years ahead.

Significant Investments and Acquisitions

There was no significant investment or acquisition during the period.

Subsequent to the balance sheet date, the following investments and movements were recorded:

(1) On 4 July 2005, the Group entered into an acquisition agreement with TCL Corporation, the ultimate controlling shareholder of the Company, for the acquisition of 49% equity interest in TCL Electrical Appliance Sales Co, Ltd. ("Sales Company") which controls and operates a distribution and after-sales services network in the PRC. Upon completion of the acquisition, the Group will own the entire equity interest of the Sales Company. Further details of the acquisition are set out in the Company's announcement dated 5 July 2005.

(2) On 12 July 2005, the Group and Thomson Group entered into definitive agreements for the transfer of the sales and marketing activities in Europe and North America from Thomson to TTE. TTE and Thomson also agreed on the terms of a number of related agreements to modify the existing operational arrangement of the Angers factory in France, and to revise certain sales and marketing and service arrangements between the two groups. These agreements will enable TTE to directly manage its sales and marketing activities, and provide the basis for improving the Company's ability to serve customers and coordinate product planning, pricing marketing and business strategy. For further details, please refer to the Company's announcement dated 12 July 2005 and the Company's circular dated 2 August 2005.

(3) On 26 July 2005, the Company entered into a sale and purchase agreement with Opta Systems, LLC ("Opta"), a company controlled by TCL Corporation, to purchase certain intellectual property rights including trademarks, service marks, patents applications and copyrights at an initial consideration of US$10 million, subject to adjustments by reference to a valuation to be determined by an independent valuer to be appointed by the Company and Opta. Further details of the transaction are set out in the Company's announcement dated 29 July 2005.

(4) On 10 August 2005, pursuant to the Exchange Option Agreement dated 30 July 2004, Thomson exercised an exchange option to exchange its 33% interest in TTE for an interest in the Company. A total of 1,144,182,095 shares representing 29.32% of the enlarged issued share capital of the Company were issued to Thomson. For further details, please refer to the Company's announcement dated 10 August 2005.

Liquidity and Financial Resources

The Group's principal financial instruments comprise bank loans, factorings, convertible notes, cash and short-term deposits. The main objective for the use of these financial instruments is to maintain a continuity of funding and flexibility at the Group's lowest cost.

The cash and bank balance as at the period end amounted to HK$1,654 million, of which 12% was maintained in Hong Kong dollars, 25% in US Dollars, 47% in Renminbi, 6% in Euro and 10% held in other currencies for the overseas operations.

There was no material change in available credit facilities when compared with the year ended 31 December 2004 and there was no asset held under finance lease at the period end. A convertible note which was due for redemption on 8 November 2005, was subject to fixed interest rate at 3% per annum.

At the period end, the Group's gearing ratio was 0.59 which is calculated based on the Group's net borrowing of approximately HK$1,972 million (calculated as total interest-bearing borrowings less cash and bank balances) and the equity attributable to equity holders of the Company of approximately HK$3,368 million.

Capital Commitments and Contingent Liabilities

There was no significant change in capital commitments and contingent liabilities of the Group compared to the position outlined in the annual report for 2004.

Foreign Exchange Exposure

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

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

EMPLOYEE AND REMUNERATION POLICY

The Group had a total of 33,000 dynamic and talented employees. They were all dedicated to advancing the quality and reliability of our operations. Total staff costs for the period were approximately HK$941 million. Remuneration policy was reviewed regularly, making reference to current legislation, market condition and both the individual and company performance. In order to align the interests of staff with those of shareholders, share options were granted to employees under the Company's share option schemes. During the period options for subscribing a total of 152,920,000 shares were granted to directors and employees at an exercise price of HK$1.40. Options for subscribing a total of 183,342,861 shares remained outstanding at the period end. Employee share option expenses of HK$5,662,000 was charged to the income statement for the period under review.