
国美电器
GOME
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Management Discussion and Analysis

GROUP REVIEW

Year 2005 was a fruitful year for the Group as the Group aggressively adhered to its Growth Initiative for chain network expansion, rapidly developed its business and achieved remarkable results. In 2005, the Group recorded sales revenue of RMB17,959 million and net profit attributable to equity holders of RMB499 million. After completion of its business plans formulated at the beginning of the year, the Group continued to maintain its leading market position in household appliances industry in the PRC.

The Group strived to expand its chain store network in 2005. By the end of 2005, the Group added 143 traditional stores to the chain resulting in a network of 259 traditional stores. The Group operated 4 digital stores at the same time and a mega store of electrical appliances will be launched soon.

The management of the Group believes that competitive pressure in household appliances retail industry is very intense currently. In the future, the nature of competition among the industry is expected to be shifted from the addition of new stores in prime areas to service competition involving principally the enhancement of satisfactory level and loyalty in customers. Therefore, in 2005, the Group did not only put its efforts in enterprise image, store environment and customer service so that its customers could enjoy more quality and better service in GOME, but also continually launched membership program and installment purchase plan with a view to enhance the satisfactory level and loyalty in GOME's customers, thereby ensuring the Company has a more quality and more stable customer base.

Same as last year, the management of the Group put close attention to the construction of enterprise information technology. During the reporting period, the enhancement on and reconstruction of ERP system was completed. The Group has primarily built up a secured inventory management system and

membership service sub-system, with an aim to achieve high operating efficiency, to lower its cost and fund occupancy, and to satisfy an efficient running of the membership program.

To enhance operating coordination and financial reporting, the financial year end date of the Company has been adjusted from 31 March to 31 December since 2004. Accordingly, the 2004 audited results only covered a period of nine months from 1 April to 31 December 2004 ("Period A") and are not directly comparable with the full year 2005 results ("Period B"). Given that these two periods are not directly comparable and such a format provides limited information to our shareholders regarding the year to year change in the Group's financial performance, the management of the Company has decided to disclose comparable financial information for the full years of 2004 and 2005 in a separate section entitled "Supplementary Information to Shareholders" of this report. The annual financial information of 2004 had been reviewed by our auditor, Ernst & Young, in accordance with Statement of Auditing Standards 700 issued by the Hong Kong Institute of Certified Public Accountants.

BUSINESS REVIEW

Business Environment

With the persistent rapid pace of growth in the PRC economy in 2005, the aggregate amount of the nationwide retail sector of consumer goods was RMB6,720 billion, representing a rise of 12.9% as compared to that of last year (source: State Statistics Bureau). Driven by the income growth of residents, urbanization and residential property development, the consumption demand on household appliances continued to grow rapidly. According to statistics from the State Information Centre of the PRC, the CAGR of the market size of electrical appliances and consumer electronics retail industry in the PRC will reach 11.88% between 2006 and 2010 and is expected to grow further. In this regard, the Group is provided with a good market environment to maintain its fast and stable business development.

We believe the key drivers for economic growth in the PRC are well in place and will continue to fuel the growth of the electrical appliance and consumer electronics industry. In addition, the preference of consumers in urban markets to buy electrical appliances and consumer electronics has continued to shift to specialist retail chains, with an aim to have better price, shopping experience and after-sales service. As the largest retail chain operator of electrical appliances and consumer electronic products in the PRC, the management of the Group is confident to expand its market share and consolidate its leading position in the industry by leveraging on its own brand, scale of operation and service edge.

Retail Network Expansion

In 2005, the Group added 143 traditional stores resulting in a chain store network of 259 traditional stores. The Group operated 4 digital stores in the same period and a mega store will be launched soon. Geographically, the Group entered into 44 new cities in the PRC and has operations in 69 cities in the PRC by the end of 2005.

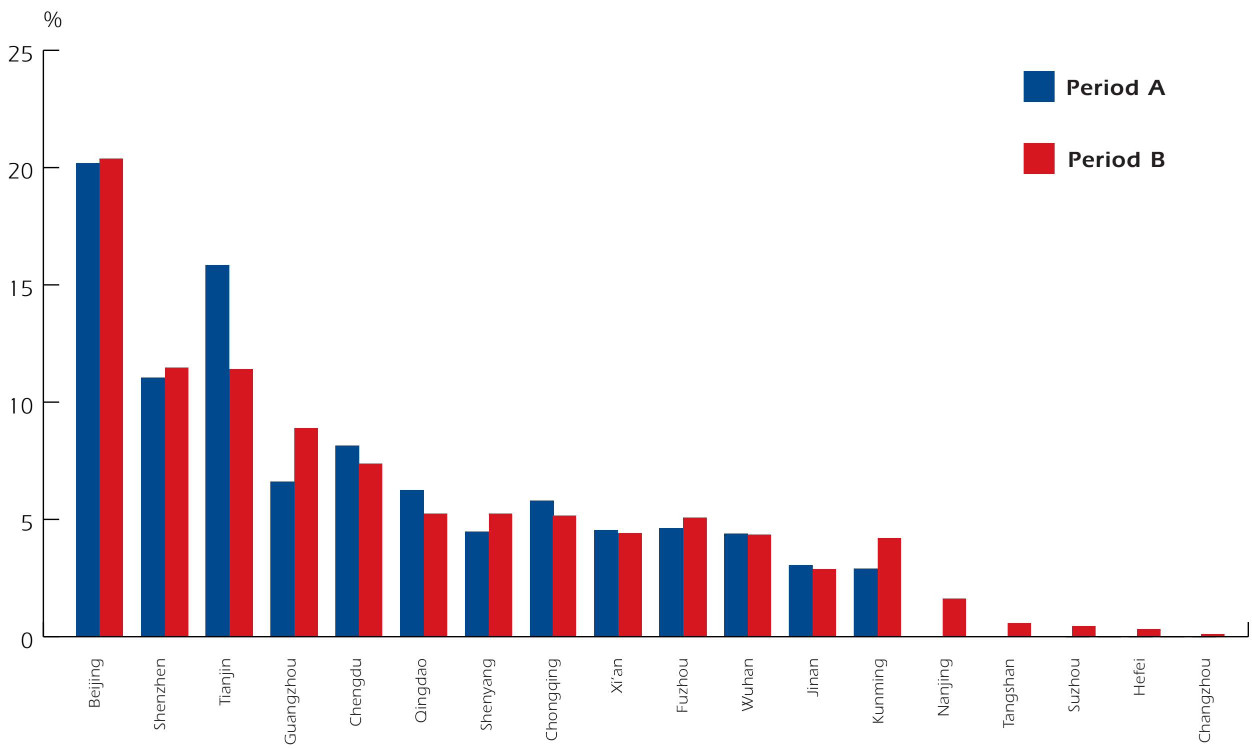
The size of traditional stores typically ranges from 3,000 – 6,000 square meters, averaging about 4,000 square meters.

By the end of 2005, the total sales area of the Group's stores was approximately 1,050,000 square meters, representing a growth of 158% as compared to that of 2004.

Adhering to its long-term strategies, the Group put much attention to the chain store network coverage in second tier cities. Among the 259 stores, 73 were operated in the second tier cities.

Turnover breakdown by region

In 2005, the network coverage of the Group included Beijing, Tianjin, Chongqing, Guangdong, Liaoning, Sichuan, Shandong, Shanxi, Fujian, Yunnan, Hubei, Jiangsu, Anhui and Hebei. Jiangsu, Anhui and Hebei were the Group's newly entered regions in the current year. The percentage of the Group's turnover attributable to each region is set out below:



Management Discussion and Analysis

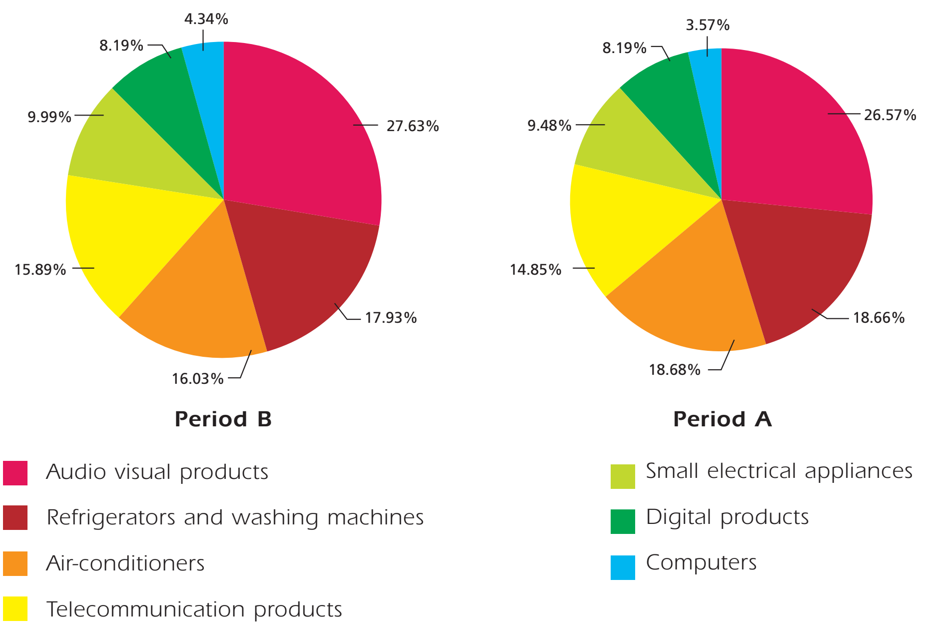
According to the turnover breakdown by region, the management of the Group is of the view that GOME's regional sales coverage is well-balanced, illustrating the chain model of GOME can be effectively reproduced to each area with a higher security and stability.

Turnover breakdown by products

In 2005, the product categories operated by the Group are set out as follows:

Product category	**Major products**
Audio visual products	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
Small electrical appliances	Rice cookers, vacuum cleaners, irons, water heaters, microwave ovens, mixers, dish-washers and similar products
Telecommunication products	Mobile phones and accessories
Digital products	Digital video recorders, digital cameras, MP3 players, portable DVD/CD players and similar products
Computers	Personal computers, notebook computers, monitors, printers, scanners and accessories

The following chart illustrates the sales percentage attributable to each type of product:



As a kind of traditional product with competitive advantage, audio visual products accounted for 27% and 28% of sales in Period A and Period B respectively, continued to make up the largest revenue component of the Group's product portfolio. Air-conditioners accounted for 19% of sales in Period A while accounted for 16% in Period B, the decrease was primarily due to the different seasons covered by Period A and Period B.

When compared to Period A, the sales structure of seven main products has fundamentally remained stable in Period B. Of the four traditional household appliances including audio visual products, refrigerators and washing machines, air-conditioners and small electrical appliances accounted for 72% of sales revenue in Period B while three kinds of consumer electronic products including telecommunication products, digital products and computers accounted for 28% of sales revenue, generally remained stable as compared to Period A. (In Period A, four traditional household appliances including audio visual products, refrigerators and washing machines, air-conditioners and small electrical appliances and three consumer electronic products including telecommunication products, digital products and computers accounted for 73% and 27% of sales revenue respectively).

Management Discussion and Analysis

Sales proportion of local and international brands

The Group estimates, in terms of sales revenue contribution, local Chinese brands contributed approximately 60% while foreign brands accounted for the rest in 2005. The management of the Group believes 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.

Procurement and relationship with suppliers

Capitalizing on its cooperation with suppliers in different aspects and under different arrangements, the Group is more experienced to cope with its relationship with suppliers. The management of the Group considers the Group can be well-positioned to overcome future competition as long as the Group fosters a long-term relationship with those major suppliers for strategic cooperation.

The purchases attributable to the Group's top five largest suppliers (in terms of brands) accounted for 30% of total purchases in 2005 and the purchases attributable to the Group's top five largest suppliers (in terms of brands) accounted for 28% for total purchases in 2004.

Store Leases

By the end of 2005, the Group operated 259 traditional stores, as to 5 stores were self-occupied properties and the remaining 254 stores were operated under leases. The average remaining duration of the leases of these 254 stores was about 7.35 years. Of the above store leases, the number of leases to be expired in 2006, 2007 and 2008 are 2, 10 and 36 respectively, representing 0.8%, 3.9% and 14.2% of the total number of leased stores respectively. Rental expenses in 108 stores are fixed for the entire duration of the leases, representing 42.5% of the total number of leased stores. There are 146 stores subject to variable rental, representing 57.5% of the total number of leased stores.

All in all, though the rental of the Group's stores rose rapidly in recent years, the variable range of rental and the lease term are well-controlled under leases.

Second tier markets

The management of the Group believes second tier markets with lower popularity of electrical appliances and consumer electronic products and with enormous room for growth are the strategic opportunities of the Group for long-term development in future. The huge numbers and fragmented regions of second tier markets has exerted many difficulties on business operation and management, for example, it may be more difficult to recruit qualified staff, the procurement costs and complexity is high and the business cooperation with suppliers may not be as smooth as in first tier markets. In general, the income level, expenditure structure and spending habits in second tier markets differ from first tier markets, thus the sales and marketing strategies of the Group have to be featured with diversity and adaptability.

The Group started entering the second tier cities on a big scale in 2005, thereby continued to explore any policies and methods to effectively operate the second tier markets.

Development of key events

Membership program

In 2005, the Group launched a membership program in priority by introducing a tiered, point membership program nationally. Under the program, members can redeem points for a number of privileges, including priority access to promotional or discounted products, free exchange of paid services, participation in lucky draws, and etc. In addition, the Group has also formed alliance with more than 400 retail establishments under which members can enjoy discounts and other privileges. The Group's management views the membership program as a market-first initiative and a key component of its overall effort to enhance loyalty in its customers. In this regard, the Group may attract more valuable customers to perform long-term consumption.

Looking forward, the Group will apply the membership program as its platform and will consolidate its internal resources so as to provide a wide diversity of enhanced value-added service to customers. By the end of 2005, membership reached more than 1.2 million at the Group. Together with members at the Parent Group, total membership reached more than 2 million.

Installment purchase plan

In the PRC, personal credit spending mainly focus on housing commodity and motor vehicles, the proportion of household appliances credit spending is so small, which greatly differs from rich countries.

Management Discussion and Analysis

With a view to stimulate its sales growth, the Group introduced a new spending model to take up the household appliances credit spending market. In alliance with China Merchants Bank and CITIC Bank, the Group launched the first ever installment purchase scheme in electrical appliances and consumer electronics retail industry on 5 May 2005 which was highly welcomed by and gained active participation from consumers especially the white collar ones.

The Group is of the view that installment purchase business is a new business model for boosting consumption and has enormous potential and huge room for growth in future.

Quality store property purchases

In 2005, the Group purchased part of quality store properties. The gross areas of store properties purchased over Beijing, Tianjin, Shenyang and Changzhou in the full year was approximately 82,000 square meters and cost totalled RMB700 million.

The properties purchased by the Group are situated in prime commercial sites suitable for household appliances mega stores. By purchasing these quality store properties, the operating rental expenses in stores went down, thereby facilitating the market competition of the locations where the Group operates.

Although store property purchase has the above merits, the Group adheres to its policy of maintaining low assets operation.

Information technology

Information technology has been the vital assurance to the rapid development of chain retain enterprises, thus the Group puts a great emphasis on it.

In 2005, in addition to expanding its national network completed in 2003, the Group further enhanced its existing ERP system, set up the information exchange mechanism between the Group and partial suppliers, and improved the database of sales information through introduction of membership program. The above works will safeguard the Group's information resources for its next development.

FINANCIAL REVIEW

Revenue

In Period B, the Group's revenue reached RMB17,959 million, as compared to RMB9,716 million in Period A. As a result of rapid network expansion, the Group's weighted average sales area was approximately 692,000 square meters in Period B, compared to 366,700 square meters in Period A. Comparable store sales increased by approximately 1.6% and 2.2% in Period B, and full year 2004 respectively. Sales at the 74 stores, which qualified for the comparable store sales calculation in Period B, accounted for approximately 53% and 74% of total revenue in Period B and the full year of 2004 respectively. The Group is generally pleased with the comparable-store sales increase in

Period B, in light of rapid addition of sales area in the industry in Period B, which far exceeded the growth of the industry itself. Increase in comparable store sales was largely due to strong performance in cities such as Beijing, Tianjin and Wuhan, partially offset by cities such as Chongqing and Fuzhou.

Sales per square meter were RMB25,900, RMB35,300 and RMB37,570 respectively in Period B, Period A and the full year 2004. Therefore, on a year to year basis, sales per square meter declined by 31% in Period B from the full year 2004. The decline was attributed to the proportion of new stores in the overall store portfolio was significantly higher in Period B than the full year 2004. The number of new traditional stores opened in Period B, and the full year of 2004 were 143 and 37 respectively.

Besides, the Group started to enter into second tier cities on a big scale in 2005. The Group's management strongly believes that expansion into second tier cities represent the next phase of growth. However, market size in these cities is typically smaller, population less affluent, purchasing power weaker, and market penetration taking longer to achieve. This, coupled with the Group's observation that a newly opened store typically takes two years to mature, had meant that revenue increase at these newly opened stores was generally slow.

Cost of sales

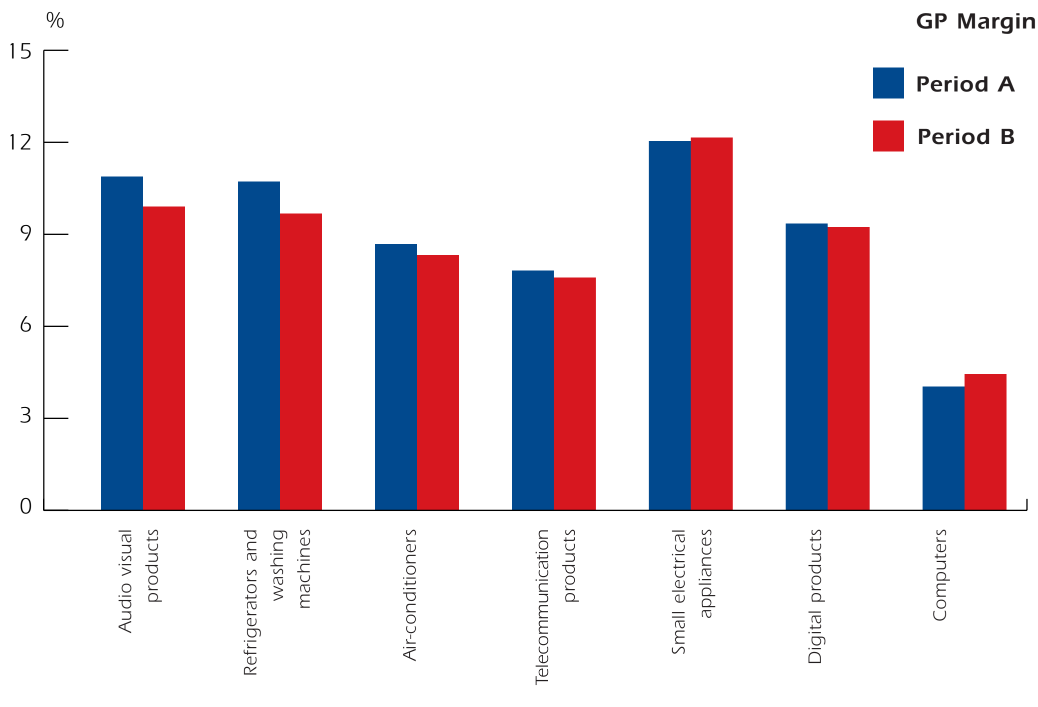
Cost of sales at the Group increased to approximately RMB16,307 million in Period B, compared to approximately RMB8,763 million in Period A, was driven by higher revenue recorded in Period B.

Gross profit

Gross profit of the Group was approximately RMB1,652 million in Period B, compared to approximately RMB953 million in Period A. Gross profit margin declined slightly to approximately 9.2% in Period B from approximately 9.81% in Period A. The lower gross profit margin in Period B reflected 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.

The gross profit margin of audio visual products was approximately 9.89% in Period B, compared to 10.95% in Period A. The product categories with a drop in gross profit margin included refrigerators and washing machines, air-conditioners, telecommunications and digital products.

On the other hand, small electrical appliances and computers recorded higher gross profit margin at 12.70% and 4.95% in Period B, compared to 12.10% and 4.11% respectively in Period A. The following illustrates gross profit margin by product category in Period B and Period A:



A drop in gross profit margin of audio visual products was attributed to significant price promotions on flat panel TVs as suppliers were eager to lower pricing points on these products and encourage consumers to upgrade. The product category of air-conditioners recorded lower gross profit margin because the manufacturers raised the prices of products supplied as a result of the rise in prices of raw materials but the retail prices could not go up at the same time under fierce competition.

Other income

The Group derives two main income streams from suppliers, of which one is reflected in gross profit and the other included in other income. Other income secured from suppliers pursuant to the Group's standardized supply contracts includes:

- Promotion income 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 income also includes mainly 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 operation in designated cities in the PRC.

The following table illustrates a breakdown of other income:

	Period B		**Period A**	
	RMB million	*% to sales*	*RMB million*	*% to sales*
From suppliers:				
Promotion income	317	1.76%	145	1.50%
Management fee income	66	0.37%	40	0.41%
Display space leasing fees	64	0.36%	41	0.42%
Product listing fees	46	0.26%	22	0.22%
	493	2.74%	248	2.55%
Management fee from the Parent Group	144	0.80%	60	0.62%
Management fees for air-conditioner installations	48	0.27%	30	0.31%
Government grants	16	0.09%	9	0.09%
Excess over the cost of a business combination	6	0.04%	–	0.00%
Other income	33	0.18%	39	0.39%
	740	4.12%	386	3.97%

Operating expenses

The Group's operating expenses principally include selling and distribution costs, administrative expenses and other expenses. The breakdown are set out as follows:

	% to sales	
Item	**Period B**	**Period A**
Operating expenses:		
Selling and distribution costs	6.84%	5.60%
Administrative expenses	1.50%	1.34%
Other expenses	0.54%	0.63%
Total	**8.88%**	**7.57%**

Selling and distribution costs

Selling and distribution costs of the Group primarily represent shops rental expenses, staff cost of sales-related staff, advertising, delivery and promotional expenses and utility charges. The following table illustrates the main selling and distribution costs items as a percentage to sales revenue:

	% to sales	
Item	**Period B**	**Period A**
Rental	2.43%	1.68%
Salaries	1.26%	1.02%
Advertising expenses	0.77%	0.85%
Delivery expenses	0.40%	0.42%
Promotional expenses	0.41%	0.33%
Utility charges	0.67%	0.51%
Others	0.90%	0.79%
Total	**6.84%**	**5.60%**

Rental expenses and utility charges rose significantly as a result of the expansion of sales areas of substantial newly opened stores. Another factor resulted to a high rental expenses is a rise in rental of commercial properties. Salary expenses also increased remarkably because substantial newly opened stores needed to recruit staff beforehand. The rise in promotional expenses was attributed to the more frequent promotional activities underwent by substantial newly opened stores. The management of the Group considers during the rapid development period of the Company, investments for reserve are inevitable to the substantial newly opened stores. Since the increase in expenses incurred from such investments is normal and positive, it is believed such condition will be improved with the newly opened stores becoming more mature.

Administrative expenses

The expansion of the Group's scale of operation and the need for reinforcement of sophisticated management resulted in a rise in administrative expenses, but the Group has intensified its control over administrative expenses so that the administrative expenses accounted for approximately 1.34% of sales revenue in Period A rose to 1.50% in Period B.

Other expenses

Other expenses of the Group mainly represent business tax, bank processing fees and miscellaneous expenses were approximately RMB96.6 million in Period B, as compared to RMB61.1 million in Period A. As a percentage of revenue, they accounted for only approximately 0.54% and 0.63% in Period B and Period A respectively.

Finance income, net

The net finance income of the Group was approximately RMB70.3 million and RMB22.2 million in Period B and Period A respectively. The significantly higher finance income as recorded in Period B was primarily due to higher interest income as a result of an increase in average cash balance, including more pledged deposits, at the Group during Period B.

Profit before tax

As a result of the foregoing, profit before tax of the Group was approximately RMB869 million in Period B, as compared to RMB625 million in Period A. Operating profit margin was approximately 4.84% and 6.43% in Period B and Period A respectively.

The higher operating expenses and thus the lower profit before tax as a percentage of revenue in Period B as noted above was in line with the management's expectation under the Growth Initiative. Rapid network expansion in Period B as mandated under the Growth Initiative called for significant start-up investment in ensuring the establishment of a robust national footprint and accompanying corporate infrastructure and systems. The Group considers the initial investments critically necessary in achieving the Growth Initiative and to be in the long term interest of the business.

Income tax

Income tax paid by the Group was approximately RMB91.9 million and RMB44.6 million, representing effective tax rates of 10.58% and 7.13% in Period B and Period A respectively. The Group considers the higher effective tax rate in Period B to be within a normal band.

Profit for the year and EPS

As a result of the foregoing, the net profit for the year/period was RMB777 million and RMB581 million in Period B and Period A respectively. Profit margin were accordingly 4.33% in Period B and 5.98% in Period A. After deducting 35% minority interest in GOME Appliance, profit for the year/period attributable to equity holders was RMB499 million and RMB374 million, representing a profit margin of 2.78% and 3.85% in Period B and Period A respectively. Basic EPS of the Group was approximately RMB30 fen in Period B, as compared to RMB23 fen in Period A.

Cash and cash equivalents

The Group's cash and cash equivalents on hand decreased which is principally due to the substantial rise in pledged deposits as a result of business acquisitions, store property purchases and offer of bank acceptance drafts.

Inventory

By the end of 2005, the Group's inventory amounted to RMB2,725 million, representing an increase of 145.73% as compared to that of 2004. The increase in inventory was mainly due to the fact that the Group had to store up adequate inventory before important festivals such as New Year and Lunar New Year. In addition, the Group commenced to enter into second or third tier markets in large scale, thereby its inventory became more fragmented leading to a slower turnover cycle.

Management Discussion and Analysis

Prepayments and other receivables

By the end of 2005, prepayment and other receivables of the Group amounted to RMB467 million, representing an increase of 148.80% as compared to that of 2004. The increase was attributed to the adoption of prepaid purchase strategy for acquiring adequate supply of best selling products in market as a result of keen market competition. Substantial newly opened stores led to rapid increase in housing deposits and rise in pre-paid normal rental.

Trade payables and bills payable

By the end of 2005, trade payables and bills payable of the Group amounted to RMB6,805 million, representing an increase of 113.12% as compared to that of 2004. The turnover days of trade payables and bills payable days were 112 for Period B, slightly longer than that for Period A.

Capital expenditure

Capital expenditure incurred by the Group amounted to approximately RMB958 million and RMB54 million in Period B and Period A respectively. Capital expenditure incurred in Period B, were mainly used in business acquisitions and purchase of selected retail stores in prime locations, leasehold improvements and office equipment in connection with the expansion of its retail store network.

The Group intends to selectively purchase additional store sites and premises in 2006. The Group believes that ownership of select store sites and premises will allow the Group to secure strategic locations while reducing the effects of rental fluctuations on its operating results.

Acquisition during the year

During the year, the Group acquired 100% equity interest in Tianjin Pengze Investment Co., Ltd. and Changzhou Jintaiyang Zhizun Home Appliance Co., Ltd. and the business and inventories of certain electrical appliances retail outlets of Wuhan Zhong Shang Group Co., Ltd. with a total consideration of RMB343.30 million. In addition, the Group entered sales and purchase agreement to acquire the entire equity interest in Shenzhen eHome Commercial Chain Co., Ltd. and Nanjing Pengze Home Appliance Company Limited and RMB35.00 million and RMB126.00 million were paid respectively for these two acquisitions.

Cash flow

Cash inflow from operating activities amounted to RMB591.46 million and RMB522.79 million in Period A and Period B respectively.

Cash outflow from investing activities amounted to RMB54.23 million and RMB1,092.39 million in Period A and Period B respectively.

There was no cash flow from financing activities in Period B, compared to cash inflow of RMB764.34 million in Period A.

OUTLOOK AND PROSPECT

2006 Expansion Plan

In 2006, the Group will continue its expansion in first tier cities and further expand its development on second or third tier cities. The Group is planning to open 120 – 150 traditional stores and three mega stores throughout the year 2006.

To capture the strategic competitive advantages in future, the Group has established a management centre for second tier markets, dedicating to seize the strategic opportunities in second or third tier cities and actively undergo network expansion. At the same time, the management of the Group is committed to improve its quality of operation in second or third tier cities, bringing a new source of profitability to the Group.

In pursuit of advantageous position in different geographical regions and product range

Among the household appliances retail markets in the PRC in 2005, retail markets under the categories of televisions, washing machines and digital cameras appeared to have a more rapid growth. To cope with differentiated consumption demand, the Group will adopt different strategies in first tier and second or third tier markets by strengthening its management on different product categories, and extensively establish its advantageous position in different geographical regions and product range.

Enhancement of customer service and quality in store operation

In 2005, by focusing on chain network coverage, the Group completed its network coverage in first tier cities rapidly through fast retail network expansion, and then started to penetrate into second tier cities.

Management Discussion and Analysis

In 2006, The Group will put much more emphasis on the enhancement of quality in store operation. In this regard, the Group will actively launch new categories, new products in order to widen the product range and utilization of space and resources in its stores, and to enhance the ability of store operation and trading volume of customer purchases. The Group will also strengthen its sales, system and marketing activities by building up a good relationship with suppliers so as to increase it profitability. Leveraging on its customer-oriented strategy, the Group is committed to further improve the pre-sales, sales and after-sales service and build up a healthy service quality control system for second tier cities, so that a standard system for chain household appliances maintenance service is formed and serves to enhance customer loyalty to the GOME brand name and thereby edge of scale will further be transformed to edge of profitability.

"Household Appliances Hospital" – Establishment of maintenance system for household appliances

The management of the Group views "service concretization" to be the newly key competition in household appliances service. Adhering to its customer-oriented strategy, the Group will steadfastly dedicate itself to expand its system of household appliances maintenance service in order to maintain its leading position in the industry in terms of service. Through the commencement of such service, the benefits of the Group's customers will surely be safeguarded and those customers will be served under a standard and unified service model. By "service concretization", the customers may experience and perceive GOME's quality household appliances maintenance service.

The management believes the set up of "Household Appliances Hospital" system will procure the enhancement of GOME's service image so that the Group may gain much recognition from markets. This will also change the past image of GOME as sole electrical appliances stores in the customers' view.

Development of group purchase customers

As the most leading enterprise in household appliances retail industry in the PRC, the Group puts much effort on expanding household appliances business and at the same time concerns the development dynamics of group purchases. Besides, the percentage of the Group's group purchase sales as to the gross sales has been growing persistently. The management of the Group considers it as a new channel for profit growth.

To further reinforce the competency of the Group's service to major customers and capture their resources, the Group will form a sector for major customers and develop group purchase business with great exertion in 2006.

Enhancement of information technology

The Group will further intensify its effort on information centre to well facilitate more complicated business requirements. In 2006, the Group will further develop on the application of e-commerce, actively undergo e-data exchange with key suppliers, and reinforce its strategic cooperation relationship with key suppliers. Leading edge of its established brand, purchasing power and logistics and procurement system, the Group will fully exploit the tremendous potential of internet sales business and maximize its coverage on "online shopping mall".

Others

In 2006, the Group will also start to proceed consumers' study, category and model management, and platform upgrade with a view to enhancing quality and efficiency of operation. At the same time, the Group will, to a certain extent, undergo certain adjustments to its original sales-oriented business strategies and swift to devoting on business profitability.

OTHER BUSINESSES AND ASSETS

The securities and futures brokerage operation of the Group was immaterial in terms of both revenue and net profit in both Period B and Period A. In order to focus the Group's resources on the retail business, the Group announced on 14 April 2005 and completed on 19 July 2005 the disposal of all of its interest in the business for a total consideration of approximately RMB54 million to an independent third party. In the opinion of the management of the Group, the relevant entities were effectively disposed of on 30 April 2005.

In November 2005, the Group also disposed of its interest in a piece of undeveloped land in Beijing, which the Group considered non-core, to a company beneficially held by Mr. Wong Kwong Yu, the substantial shareholder of the Group. The total consideration was RMB791.9 million. The disposal was completed with the approval of independent shareholders in the special general meeting of the Company held on 15 December 2005.

After the disposal of the brokerage business and its interest in the land in Beijing, the Group has become a pure retail business without the burden or extraction of any non-core legacy business.

Management Discussion and Analysis

DECLARATION OF DIVIDEND AND DIVIDEND POLICY

The Board of Directors of the Company has decided to declare a final dividend of HK4.3 cents (equivalent to RMB4.5 fen) per share. Together with the interim dividend of HK4.2 cents (equivalent to RMB4.4 fen) per share paid during the year, the total dividend for the year would amount to HK8.5 cents (equivalent to RMB8.9 fen) per share. 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.

CONTINGENT LIABILITIES AND CAPITAL COMMITMENT

There were no material contingent liabilities at the end of Period A and Period B. However, the Group had capital commitment of approximately RMB67 million at the end of Period B.

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 at its retail business. However, as a result of the issuance of convertible bonds, which are denominated in USD, to Warburg Pincus, the Group does have exposure to foreign exchange risk on its financial liabilities. Should USD strengthens relative to HKD or RMB, the Group's financial liability associated with the convertible bonds, if left unconverted into the Company's common shares, will increase. The Group has not hedged such exposure but may consider doing so in the future. 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.

HUMAN RESOURCES

By the end of 2005, the total number of employees of the Group were 22,171, including 22,151 in the PRC and 20 in Hong Kong. The Group values its human resources management and development. Through implementation of a series of measures such as "Reservoir Project", "Top 100 Leading Store Managers Program" and the establishment of GOME Management College, the Group has further strengthened the scale of its professional teams, thereby assuring the Group has an expertise foundation necessary for its business expansion.

SUBSEQUENT EVENTS

Strategic alliance with Warburg Pincus

On January 28, 2006, the Group announced a strategic alliance with Warburg Pincu LLC ("Warburg Pincus"), under which Warburg Pincus agreed to make a strategic investment in the Company through the subscription of US$125 million convertible bonds and US$25 million warrants of the Company.

Warburg Pincus is a leading global private equity investment fund with more than US$12 billion under its management with another US$7 billion available to invest. This significant strategic investment in the Company is the largest that Warburg Pincus has made to date in China. Under the subscription agreement, Warburg Pincus has agreed to subscribe for five-year convertible bonds due 2011 in the aggregate principal amount of US$125 million. The bonds carry an annual coupon of 1.5% payable semi-annually and a yield to maturity of 3.26%, and will be convertible, subject to certain conditions, into the Company's new ordinary shares at an initial conversion price of HK$6.40 per ordinary shares.

In addition, Warburg Pincus has also subscribed US$25 million five-year warrants for new ordinary shares of the Company at a subscription price of US$3 million. Warburg Pincus has the right to exercise the warrants at an initial exercise price of HK$7.70 per ordinary share.

Upon the full conversion of the convertible bonds and exercise of the warrants, Warburg Pincus will hold 176,680,630 ordinary shares, which is equivalent to approximately 9.71% of the existing issued capital of the Company.

To further demonstrate his support and commitment, Mr. Wong Kwong Yu, a director and the substantial shareholder of the Company, has taken additional undertakings to the Company with respect to the Parent Group's business and assets, including audit and eventual injection of the Parent Group's retail business into the Group.

Other updates

Since the Clarification Announcement dated 18 January 2006 which referred to a possible disposal by Mr. Wong Kwong Yu, a director and the substantial shareholder of the Company of his 35% interest in GOME Appliance Co., Ltd., our 65% subsidiary, there has been market expectation for the Company to simplify its corporate structure and to consolidate its interest in GOME Appliance Co. Ltd. As announced by the Company on 29 March 2006, the Company has now entered into an agreement with Mr. Wong and its associate for the acquisition by the Company of this 35% interest to rationalize its structure and enjoy 100% of the profits generated by GOME Appliance Co. Ltd. Details of the acquisition are set out in the Company's announcement dated 29 March 2006