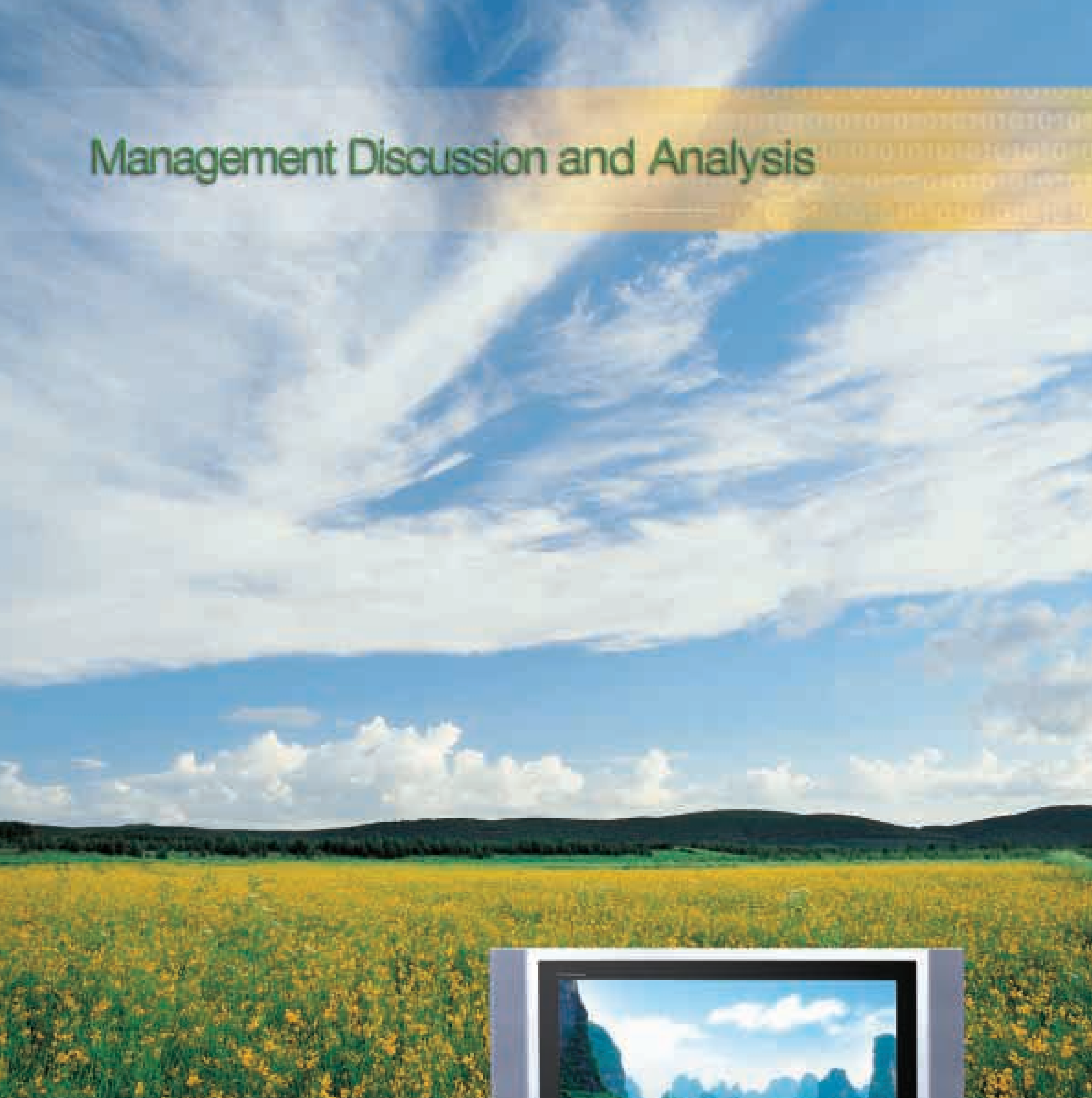
Management Discussion and Analysis



Healthy TV

Your right choice of healthy life

Management Discussion and Analysis

BUSINESS PERFORMANCE REVIEW

Steady growth in turnover

Turnover of the Group grew steadily by increasing 2.2%, reaching HK$10,699 million for the year ended 31 March 2006, compared with HK$10,466 million in the prior year. Since there was an overall switching in demand for cathode ray tubes ("CRT") television ("TV") to panel TVs, the quantities sold for CRT TVs were lowered. During the year, the Group witnessed the raging competition. The price cutting strategy initiated by the competitors quickened the Group to respond in the panel TV segment.

The Group, in response to the dynamic market momentum, has evaluated and revised its strategies from time to time. Therefore, upon recognition of the strategy to expand the market share in the PRC TV market would hinder long term profitability under the current unfavourable market condition, and taking into account one of the major duties of the management is to maximise shareholders' wealth, after careful consideration, the management decided to opt for profitability as the Group's direction of sales strategy.

Turnover analysis by geographical segment and product segment

PRC domestic market

The Group's sales derived from the PRC domestic market accounted for 86.2% of the total turnover for the year ended 31 March 2006. In the current year, turnover from the PRC domestic market amounted to HK$9,226 million compared with HK$8,917 million in the prior year, represented a 3.5% growth.

During the year, over 93.2% of the sales in the PRC domestic market was derived from the sale of TV products, while 2.7% was derived from the sale of audio visual ("AV") products and other electronic accessories; and 2.1% was derived from the sale of digital set-top boxes. Apart from the sales of the existing TV products, AV products and digital set-top boxes, the Group invested and explored several new markets, including electrical appliances, mobile phones, LCD modules and other related accessories. The sales contributed from these new markets amounted to approximately HK$200 million, represented 2.0% of the sales for the PRC domestic market.

TV products

For the year ended 31 March 2006, the sale of TV products in the PRC domestic market amounted to HK$8,602 million, represented an approximately 1.0% increase when compared with that in the prior year.

GFK Asia Pte. Ltd., a market research company, conducts regular research covering 100 major cities in the PRC. The research report stated that in March 2006, Skyworth's market share in terms of sales quantity and sales amount were 11.8% and 9.1%, respectively. It also indicated that Skyworth performed particularly well in the provinces located in the southern part of the country such as Guangdong and Guangxi, and in the middle part of the country such as Henan and Hubei.

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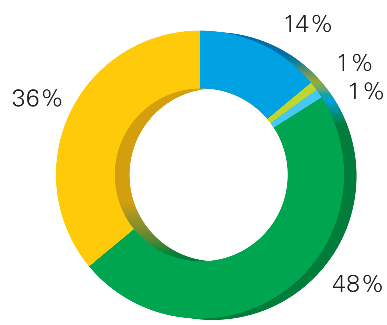
The analysis on the sales volume of different categories of TV products for the PRC domestic market is shown below:

	For the year ended 31 March 2006 Units'000	For the year ended 31 March 2005 Units'000	Increase/ (Decrease) %
Conventional CRT TV	2,576	3,173	(18.8)
Pure flat CRT TV	2,283	2,396	(4.7)
High-definition CRT TV	1,313	966	35.9
LCD and plasma TVs	251	76	230.3
Others	38	91	(58.2)
Total	6,461	6,702	(3.6)

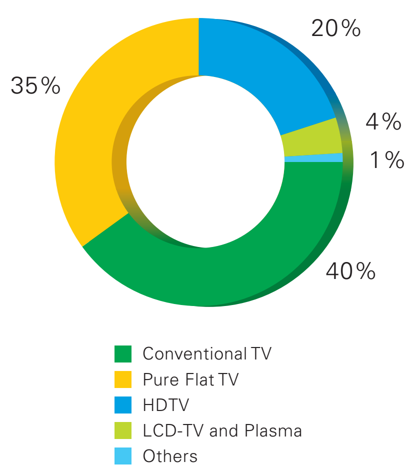
The above table categorically illustrated that the Group has followed its strategy being a manufacturer of high-end TV products. High-end TV products essentially comprise high-definition CRT TVs ("HDTVs"), including 16:9 TV, liquid crystal display TVs ("LCD-TVs") and plasma TVs, all of which bring in remarkable profit margins ranging from approximately 15% to 26%. During the year, the sales of HDTVs and LCD-TVs and plasma TVs contributed to 20.3% (2005: 14.4%) and 3.9% (2005: 1.1%) respectively of the Group's total sales volume of TV products in the PRC domestic market.

The PRC Government constantly publicises that analogue broadcasting will soon be phased over and be replaced by digital broadcasting, and announces the required digital TV standard. However, the digital transmission standard is expected to be announced soon. These inspire consumers' selection criteria towards high-end TV products for embracing the digital era. The Group believes that high-end TV product business opportunities are enormous. Skyworth is positioned in getting a promising high-end TV market.

Sales volume of TV products for the PRC domestic market in 2004/2005



Sales volume of TV products for the PRC domestic market in 2005/2006



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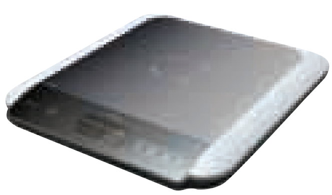
Apart from the above, the steady growth in turnover for TV products in the PRC domestic market is also attributable to the following factors:

- the continuing expansion of product range, including 16:9 and slim TVs;
- the recent expansion of large-scaled electrical and electronic chain stores in the PRC, which strengthened the Group's distribution network and deepened the Group's market penetration; and
- the extensive brand promotion and marketing campaigns launched by the Group in the past enhanced the public awareness and the recognition of Skyworth's brand and products.

AV products

For the year ended 31 March 2006, the sale of AV products in the PRC domestic market amounted to HK$248 million, represented an approximately 1% increase when compared with that in the prior year. AV products are positioned by Skyworth as only one of the accessories to the Group's core products. Despite the intense competition and the controlled marketing expenses spent in this product line, the Group managed to maintain a stable turnover on AV products during the year.



Digital set-top boxes

From 2004 onwards, the Group has continuously devoted its efforts in establishing "Skyworth" brand in the digital set-top box market which creates the momentum in achieving a good progress in the current financial year. For the year ended 31 March 2006, the sale of digital set-top boxes in the PRC domestic market amounted to HK$189 million, represented an over 100% increase when compared with HK$84 million recorded in the prior year.

The PRC Government's will to enter into a new era of full digitisation in 2015, together with the recent growth in popularity and coverage of digital broadcasting, contributed to the remarkable result attained from the sale of digital set-top boxes in the current year.

Other new products

During the year, the Group launched certain new products, such as electrical appliances, mobile phones, LCD modules and other related accessories, to the market. The sales of these products accounted for approximately HK$200 million or 2.0% of the Group's turnover in the PRC domestic market for the year. The Group will keep on evaluating the performance of these new products, and exploring opportunities for both vertical and horizontal expansions.

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Overseas markets

Turnover for the overseas markets accounted for 13.4% of the Group's total turnover for the year ended 31 March 2006. In the current year, turnover generated from the overseas markets amounted to HK$1,434 million compared with HK$1,514 million in the prior year, represented a 5.3% decline. Fierce competition and the slower than expected product development process were the major culprits of the decline.

TV products

Turnover of the Group's TV products for the overseas markets, accounted for 83.8% of the total overseas turnover, were primarily related to OEM customers. For the year ended 31 March 2006, it amounted to HK$1,201 million, represented a 2.1% decrease when compared with that in the prior year. With intensive competition, selling prices of TV products sold to overseas OEM customers were under downward pressure. The fierce competition started to take its toll in the Group's Asian market, where such turnover stumbled by 40.8% in the current year. Nonetheless, the Group's strategy of diversification was proved successful in that contributions from Europe, Middle East and Africa were all on a rise, and managed to make up for the downturn in Asia.

AV products

Turnover of AV products for the overseas markets was HK$53 million, represented a reduction of 73.0% when compared with that in the prior year. Given that the profit margin of the AV products continued to decline, the Group commenced to focus its attention from AV products to other high margin business opportunities. With this focus, the Group directed its resources to potentially more lucrative businesses, prompted the business scale of AV products shrank and in turn greatly reduced its impact on the Group.

Digital set-top boxes

Turnover of digital set-top boxes for the overseas markets was HK$180 million, represented an upsurge of almost 100% when compared with that in the prior year. The increase was the result of a breakthrough to the overseas markets through a newly established sales team and the launch of smaller but more capable models which attracted more customers.

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Geographical distribution

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

	For the year ended 31 March 2006 (%)	For the year ended 31 March 2005 (%)
Asia (including Japan, Korea, Vietnam, etc.)	36	57
Europe	30	16
America	18	18
Middle East	10	5
Australia and New Zealand	2	3
Africa	4	1
	100	100

Two of the Group's major overseas markets were Asia and Europe which in aggregate accounted for 66% of the Group's total sales for the overseas markets.

Improving gross margin

For the year ended 31 March 2006, the Group's overall gross margin increased by 3.6% point to 18.7%. The increase was primarily attributable to the change in sales product mix which tilted towards the high-end TV products that generate higher gross margins; and also thanks to the promotional effort and high quality and multifunctional products for maintaining the price level without following a market price cut.

Thanks to the recent expansion of the large-scaled electrical and electronic chain stores in the PRC, the Group apparently gained a wider distribution network, higher market penetration rate and greater publicity. However, these came with a cost of higher sales rebates which act as incentives to these distributors who promoted and sold Skyworth's products. As mentioned in prior year's annual report, such incentives are common in the industry in which the Group operates. During the year, the overall rate of rebate inflated by 2.2% to 8%.

Increase in other income

The Group's other income in the current year was HK$120 million, represented an increase of HK$44 million or 57.9% when compared with that in the prior year. The increase was mainly attributable to the net effect of the following:

- increase in exchange gain of HK$18 million resulting from the appreciation of Renminbi;
- the receipt of value added tax concession amounted to HK$19 million;
- net increase in miscellaneous income, including repair income, change in fair value of held-for-trading investments and other sales income, of about HK$22 million; and

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- reduction in interest income of HK$15 million, resulting from the significant decrease in pledged deposits throughout the year.

Increase in selling and distribution expenses

In comparison with the expenses in prior year, for the year ended 31 March 2006, the Group put in an extra of HK$415 million in selling and distribution expenses primarily on brand promotion and marketing activities in the PRC. The expenditure has proven to be rewarding, evidenced by the encouraging growth in sales volume of high-end TV products by over 50% for the PRC domestic market, the profit margins of which ranged from 15% to 26%.

Further, a report conducted recently by a professional market research company reported that Skyworth, both in CRT TVs and panel TVs perspective, is one of the top three leading home-grown PRC brands; for the panel TVs available from PRC domestic manufacturers, customers are most satisfied with Skyworth; regarding consumers' impression on Skyworth's advertisements, consumers find them attractive, assertive, distinctive, intensive and lively; as a brand, Skyworth scores high in image, popularity and satisfaction; and customers demonstrate strong loyalty to Skyworth. The above branding effect proved that the investment in selling and distribution expenses was sensible.

The branding effect lingered on well into 2006. On 9 July 2006, in Qingdao, at the first ever held News Conference for The Brand Values Of The Electronic Enterprises in the PRC, Skyworth brand, valued at RMB7,683 million up from RMB5,000 million in the prior year, won the Most Valuable Brand Award among 112 candidates. Again, the investment return is more than expected.

Globalisation and the successful entry to the WTO prompt the PRC Government to open the lucrative and multi billion dollars worth of consumer market to the world. As it is inevitable that competition can only be intensified, the management of the Group is convinced that public awareness of the brand and products of the Group is absolutely essential.

To put the said belief into action, the Group conducted aggressive and extensive brand promotion and marketing campaigns in the current year as follows:

- carried out more brand promotion and marketing campaigns which focused on publicising the "Six Digital Colour" technologies of the Group;

- conducted more brand promotion activities on television channels;

- mounted more signs, billboards and other outdoor advertisements in busy airports, train stations, bus stops, public transportation and highways in major cities;

- published more advertisements in popular local magazines and newspapers;

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- distributed more promotional leaflets, brochures and outdoors posters; and
- offered more attractive promotional gifts to customers of high-end TV products.

In order to facilitate the above brand promotion and marketing campaigns, the Group recruited 2,000 more sales activities related staff, both permanent and temporary.

Other than the reasons mentioned above, the increase in selling and distribution expenses can also be explained by the increase in warranty allowance during the year. Warranty allowance, calculated as a percentage of total sales, has reported a decline in the year ended 31 March 2005 but increased in the year ended 31 March 2006, primarily due to the strategic initiative in the production of 16:9, panel TV products and mobile phones. Despite the continued efforts at improving the quality of the products, there can be no assurance that the Group can keep down the same defective product rates. New product introductions, changes to existing products or changes in material vendors and manufacturing subcontractors could all have a negative impact on the defective rates of the Group that could result in additional charges to the warranty allowance.

Decrease in general and administration expenses

For the year ended 31 March 2006, the Group had general and administration expenses amounted to HK$270 million, represented a decline in HK$111 million or 29.1% from that of the prior year. Majority of the reduction can be explained by the one-off tax related penalty and surcharge recorded in 2005 amounted to HK$61 million and the Group's adherence to the effective general cost control measures (e.g. stricter control over all sorts of reimbursements, encourage tender from different service providers, implementation of performance related bonuses scheme) implemented throughout the year.

Inventory control

As at 31 March 2006, the Group's inventories had a net carrying value of HK$1,747 million, which represented an increase of HK$68 million or 4.1% as compared with the balance as at 31 March 2005.

As at 31 March 2005, some of the Group's subsidiaries which engaged in businesses of small electrical appliances, mobile phones and digital set-top boxes were all at preliminary stages. During the year, these subsidiaries evolved into critical business units of the Group, in the sense that their revenues and net assets accounted for a considerable part of the Group's total. Despite the centralised logistics management resulted in a lower average level of TV related inventories, the growth in inventories at emerging business units boosted the overall amount of inventories.

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As at 31 March 2006, the inventory turnover days (calculated with reference to the average inventory balance net of provision) for raw materials and finished goods were 20 days and 46 days respectively; while as at 31 March 2005, the inventory turnover days for raw materials and finished goods were 15 days (restated) and 41 days (restated) respectively. The lengthened inventory turnover days as at 31 March 2006 were largely because of the rise in inventories at those business units mentioned above.

Trade receivables and bills receivable

As at 31 March 2006, trade receivable and bills receivable of the Group amounted to HK$517 million and HK$3,181 million respectively. As compared with that as at 31 March 2005, the amounts of trade receivable and bills receivable rose by HK$160 million or 44.8%, and HK$353 million or 12.5% respectively.

The significant increase in trade receivable was primarily attributable to the recent expansion of the large-scaled electrical and electronic chain stores which strengthened their bargaining power, and in turn generally purchased from the Group in large volume but with longer credit terms. Also, the increase was partly driven by the growth in the sales of high-valued TV products throughout the year.

During the year, the Group paid more attention to the credit risk assessment relating to the small to medium sized customers. With the principle of controlling credit risk in mind, the Group tends to demand for more bills receivable or third party guarantee from, instead of granting credit terms to, those customers.

Trade payables and bills payable

As at 31 March 2006, trade payable and bills payable of the Group amounted to HK$2,738 million and HK$8 million respectively. As compared with that as at 31 March 2005, the amount of trade payable grew by HK$945 million or 52.7%, whereas the amount of bills payable reduced by HK$973 million or 99.2%. Adding up together both the amounts of trade payable and bills payable as at 31 March 2006, the total payable balance decreased by HK$28 million, from HK$2,774 million to HK$2,746 million.

During the year, the Group discontinued the practice of issuing bills payable to suppliers, which in turn led to the significant decline in the amount of bills payable. The Group changed its payment method from issuance of bills payable to conventional credit terms granted by suppliers in order to reduce the financial expenses.

During the year, certain suppliers of flat panels and integrated circuits requested for sight letter of credit or cash settlement, which consequently led to shortening the payment cycle. It is evidenced by the surge in amount of trade payable aged within 30 days by HK$31 million, whereas total trade payable aged over 30 days showed a decline.

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LIQUIDITY AND FINANCIAL RESOURCES

As at 31 March 2006, the Group had bank balances and cash of HK$760 million, represented a decline of HK$125 million or 14.1% when compared with that as at 31 March 2005, while pledged bank deposits amounted to HK$38 million as at 31 March 2006 against HK$1,055 million as at 31 March 2005. The overall reduction in bank balances and cash is consistent with the above analysis on working capital management.

In the past, the Group had arrangements with banks which required pledging of the Group's liquid cash for issuance of bills payable to the Group's suppliers (the "Arrangements"). The Group terminated the Arrangements during the year, resulting in a significant reduction in pledged bank deposits by HK$1,017 million from the balance as at 31 March 2005. The release of cash from these pledged bank deposits were partly utilised for additional investments in property, plant and equipment, and settlement of trade payable and bills payable during the year.

Excluding the remaining balance of the associated financial liabilities amounted to HK$151 million, arising from discounted bills receivable with recourse which would be released upon maturity, bank borrowings of the Group represented a mortgage loan of HK$3 million in respect of the land and buildings located in Hong Kong, and a bank loan of HK$163 million for the development of a new production plant in Shiyan of Shenzhen. By agreement in principle, part of the interest of the construction loan would be subsidised by the PRC Government due to the high-technology nature of the project.

As at 31 March 2006, the gearing ratio of the Group was 10.3%. The ratio is calculated with reference to the total bank borrowings of HK$317 million and shareholders' fund of HK$3,088 million. In comparison with companies operated in the same industry, the Group maintained a healthy gearing position during the year.

For other key financial ratios, such as current ratio, trade receivables turnover days and inventories turnover days, please refer to financial highlights on page 2 to the annual report.

As at 31 March 2006, the Group has utilised certain trade facilities granted by the banks in the PRC. Such trade facilities were secured by certain of the Group's land and properties in the PRC with net book value of HK$137 million.

TREASURY POLICY AND CASH FLOW MANAGEMENT

The Group's investments are mostly in the PRC and its main revenue stream generates Renminbi. Other than Renminbi assets, other Group's assets and liabilities are denominated either in Hong Kong dollars or in US dollars. Management believes that the operations of the Group are not subject to significant and adverse 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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As mentioned in the above section, the Group has terminated the Arrangements; accordingly, the management will continue to review new financial products which will assist the Group to build in flexibility in managing its cash flow.

SIGNIFICANT INVESTMENTS AND ACQUISITION

During the year, the Group had invested HK$329 million on the construction of two new production plants located in Shiyan of Shenzhen, Guangdong Province and in Ruyi of Huhhot, Inner Mongolia, the funding of which was derived from internal resources and bank loans as described above. The status of these two plants is further discussed in the section headed "Future Prospects" below.

In addition to the above capital investment, the Group has entered into a joint venture agreement with four strategic investors to set up a company in Shenzhen called Shenzhen Julong Optronics Co., Ltd. in January 2006. This joint venture was established with the business objective to carry out research on the feasibility of entering into the TFT-LCD industry.

CONTINGENT LIABILITIES

The Group had no material contingent liabilities as at 31 March 2006. The details of certain patent disputes are disclosed in the note to the consolidated financial statements in the annual report.

HUMAN RESOURCES CAPITAL

As at 31 March 2006, the Group had over 14,500 employees in the mainland China and Hong Kong, including salespersons spread throughout more than 170 sales points. This extensive and strong human resources capital fuels the successful expansion and development of Skyworth's branding and businesses.

Details of the remuneration policy of the directors and employees of the Group, and the duties and work performed by the Remuneration Committee and the Nomination Committee during the year will be disclosed in the Corporate Governance Report of the annual report of the Company.

FUTURE PROSPECTS

With the improvement in the operating income margin and maintaining a vigilant watch over selling and distribution expenses, the management is confident that the Group will have another successful financial year 2006/07.

Building on the successful launch of "V12 Digital Engine" and "Six Digital Colour" technologies in the previous years, the Group has focused on improving the product designs, combination of audio device and the improvement in the audio effects on the TV products. The well received launch of the Recordable TV, a TV carried with a recordable device for TV programs in an external hard disk evidences our success in research and development efforts.

The opportunities from Beijing Olympic 2008 and the digital TV broadcasting would be one of our growth drivers in the coming years. However, competing in the international platform to secure more OEM business is also one of the major targets of the Group.

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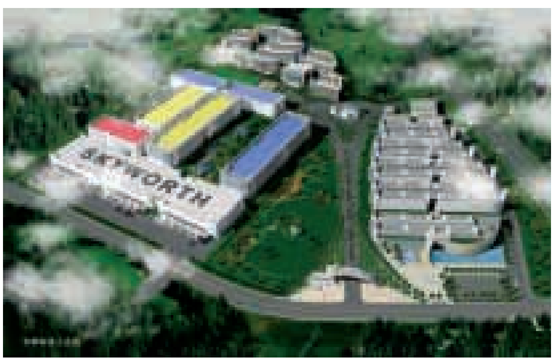
The Group expects that, in the second half of the financial year 2006/07, the completion of the first phase of the new production plants in Shiyan of Shenzhen, Guangdong Province and Ruyi of Huhhot, Inner Mongolia will contribute to the Group's production flexibility by shortening the production time and reducing the inventory level, especially for the TV panels. The new Shiyan production plant will provide the Group with additional production facilities for TV products, in particular the panel TV production capability, and other electronic products. The set up of the Huhhot production plant would enhance the Group's competitiveness in its sale of TV products in the northern region in the PRC by improving working capital control and logistic costs and management.



During the financial year, the Group has also started its manufacturing and marketing of "Skyworth" brand mobile phones.

It is expected that the Group will continue to grow in the coming financial year as a result of the expected growth of the mobile phone business sector and other business units. Again, the Group will continue to invest in the electronic industry to broaden the revenue stream and assist the development of the related business units. With a healthy gearing ratio, the management will consider to utilise bank funding for future profitable and strategically required projects.

Recognising the growth potential for the semi-conductors business, the Group proposes to build a research, design and testing centre for semiconductor capital control and logistic costs and management. This again will follow the Group's strategy to expand our associated electronic business.

The management recognises that the human resources capital is vital to the growth of the Group. The management has invested extensively in training the core management team in technical (supply chain, factory management, etc), financial and leadership (strategy development and team work, etc) facets in order to cultivate a good foundation for future growth.

Skyworth's re-positioning is best portrayed through its new logo which advocates sagacity, amiability and prosperity. This symbolises Skyworth is determined to take on the world.

In summary, our product technological advancement, market expansion in both the mainland China and overseas, enhanced production flexibility, continuous investment in associated electronic industries and our consistent investment in human resources capital will bring us into another new successful era.

Skyworth 创维