

### III. MANAGEMENT DISCUSSION AND ANALYSIS

#### (i) Industry Review

During the first half of 2006, the colour picture tubes (“CPTs”) industry in the PRC was in a stagnant state in the low level. On one hand, due to the fact that the market of cathode ray tube (“CRT”) television sets has been increasingly eroded by that of the flat panel display (“FPD”) television sets and was gradually substituted by the latter and that due to constantly decreasing prices of FPD television sets and the extensive marketing campaigns adopted by manufacturers and traders for FPD television sets, domestic demand in the PRC for CRT television sets was kept at a consistently lower level, thus leading to even greater pressure on manufacturers of CPTs. On the other hand, driven by the factors such as the World Cup being held as scheduled and global economic growth, the PRC’s exports of CRT television sets and CPTs grew rapidly in the first half of the year, which partially offset the negative effects brought to the CPTs industry by the declining demand for CRT television sets in the PRC and caused a resumptive growth in the PRC’s CPTs market in the first half of 2006.

To expedite the industry’s recovery from the depression, domestic CPTs enterprises generally implemented positive measures in the fields of cost control, marketing, overseas exploration and product development, which enabled to some extent the PRC’s CPTs enterprises to maintain its competitiveness in the world market. Meanwhile, faced with a shrinking market and increasing competition, some CPTs enterprises had opted to withdraw from the market in the first half of the year, which, to certain extent, eased the pressure from glut of the global CPTs of CPTs.

According to the data in the Company's possession, in the first half of 2006, the output and sales volume of the PRC's CPTs industry increased by 13% and 17% respectively while export of CPTs increased by 25% as compared with the corresponding period last year. CPTs export from China had, for the first time, represented over one-third of the total sales of CPTs while the monthly inventory of the entire industry remained at a lower level than the corresponding period last year. Although the domestic output and sales volume of CPTs increased in the first half of 2006, yet it was mainly attributable to the exceptionally poor sales performance in the corresponding period last year. Furthermore, the domestic CRT television market continued to shrink slowly. Despite the existence of favourable factors such as a dramatic increase in the number of newly-weds in China compared with the corresponding period last year and the holding of the World Cup as scheduled, the market share of CRT television sets in the domestic television market dropped by approximately five percentage points in the first half of 2006, while the penetration of liquid crystal display ("LCD") and plasma display panel ("PDP") television sets into the domestic television market increased to 9% and 2% respectively on the contrary. Therefore, the PRC's CPT industry has shown no obvious sign of recovery from depression.

In the second half of 2006, the LCD will face even greater pressure on price reduction because of the excessive inventory in the first half of 2006, this will likely accelerate the pace of FPD television sets to replace CRT television sets. In addition, the strong macro-economic control policy of the PRC government is cooling the demand on the real-estate market in middle & small cities, where represent the lion share in domestic CRT television market in the near future. The above unfavourable factors cause great pressure on the resumptive growth shown in the first half of the year in domestic CPTs industry although the second half of the year is normally a boom season for CPTs industry.

### Statistics of the CPTs Industry in the PRC for the First Half of 2006

	Six months ended 30th June 2006 ( <i>'000 units</i> )	Six months ended 30th June 2005 ( <i>'000 units</i> )	Increase / (decrease) ( <i>'000 units</i> )	Change in percentage
Production volume	<b>31,335</b>	27,760	3,575	12.9%
Sales volume	<b>30,048</b>	25,550	4,498	17.6%
Including: export	<b>10,345</b>	8,250	2,095	25.4%
Inventories	<b>3,419</b>	4,810	(1,391)	(28.9%)

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

## The Domestic Color Television Market in China for the First Half of 2006

	Six months ended 30th June 2006 ( <i>'000 units</i> )	Six months ended 30th June 2005 ( <i>'000 units</i> )	Increase / (decrease) ( <i>'000 units</i> )	Change in percentage
CRT television				
Output	<b>24,120</b>	22,114	2,006	9.1%
Domestic Sales	<b>14,413</b>	14,762	(349)	(2.4)%
Export	<b>13,063</b>	11,460	1,603	14.0%
Sales of domestic LCD television	<b>1,501</b>	467	1,034	221.4%
Sales of domestic PDP television	<b>293</b>	277	16	5.8%

Sources: *www.chinaccm.com* and “Quarterly Global TV Shipment and forecast Report (2006Q2)”, Displaysearch.

## The Market Conditions for Global Television for the First Half of 2006

	Six months ended 30th June 2006 ( <i>'000 units</i> )	Six months ended 30th June 2005 ( <i>'000 units</i> )	Increase / (decrease) ( <i>'000 units</i> )	Change in percentage
CRT television	<b>63,641</b>	72,785	(9,144)	(12.6)%
LCD television	<b>16,768</b>	7,156	9,612	134.3%
PDP television	<b>3,897</b>	2,030	1,867	92.0%

Source: “Quarterly Global TV Shipment and forecast Report (2006Q2)”, Displaysearch

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

By taking measures such as reducing costs, strengthening marketing and implementing technology innovation, the Group achieved a turnaround from loss to profits in the operating results in the first half of 2006. The Group's turnover amounted to RMB1,887,894,000 representing an increase of 15%, as compared with the corresponding period in 2005, and the Group's profit for the period attributable to equity holders of the Company amounted to RMB34,738,000, as compared with the loss of RMB30,840,000 for the corresponding period in 2005.

**2. CPTs Business**

During the first half of 2006, the Group sold 7,527,000 units of CPTs in total, representing an increase of 2,258,000 units, or approximately 43%, as compared with the corresponding period in 2005. Sales revenue of CPTs was RMB1,679,582,000 in the first half of 2006, representing an increase of RMB265,107,000 or approximately 19%, as compared with the corresponding period in 2005.

In the first half of 2006, the Group continued to utilize the sales and marketing strategy; the Group perfected its market-stimulating plan and implemented flexible marketing strategy. The Group made every effort to drive the sales of CPTs such that in spite of the shift of demand from the traditional CRT television CPT volume to FPD televisions, the sales volume of the Group's CPTs achieved the best results ever. The group's share in the total shipments by Chinese CPT makers reached 25%, representing an increase of approximately 4% as compared with the corresponding period last year.

As to cost-saving, the Group implemented full-sale budget control by itemized budgeting ranging from procurement of raw materials, cost control on production process, optimization of the workflow, replacement of material, interchange of parts and components, technology innovation, inventory and expenses control, overall staffing planning etc. in order to reduce costs and enhance the Group's competitiveness in CPTs business. Among which, with the implementation of measures of optimizing internal workflow and scientific and reasonable staffing, the number of employees of the Group decreased from 18,289 as at 31st December 2005 to 14,557 as at 30th June 2006.

### **3. Research and Development**

In the first half of 2006, the Group mainly focused on the research and development of new tubes, new materials and new processes; of which the research and development of 25" AK flat CPTs, 29" AK flat CPTs, 28" 16:9 AK CPTs, and 21" and 29" super slim CPTs progressed smoothly. Some of these new tubes are expected to commence production in the second half of 2006. In line with the Group's policy of "cost-saving and potential-exploring", 102 innovation projects in materials, processing and technology are under progress, some of which have achieved the annual target. For research and development of PDP, the development of 60" XGA PDP has achieved its pre-set target.

### **4. CPT Components Business**

The Group's turnover of CPTs components amounted to RMB208,312,000, representing a decrease of RMB20,647,000, or approximately 9%, as compared with the corresponding period in 2005.

In the first half of 2006, the Group's subsidiaries engaging in the production of CPTs components focused on the Group's strategy in "strengthening CPTs and exploring new businesses" by developing new products and exploring related businesses to carry out diversification in development.

**(iii) Future Prospects**

Due to the material impact brought by FPD television sets, the global CPTs industry will continue to decline, but will continue to maintain a considerable market share for some time. The Group will focus on “strengthening CPTs” and “exploring new businesses” in order to persistently improve the operation results and realize ongoing development in future.

The Group will actively and effectively implement sales and marketing strategies, cost-led strategy and support by new technology strategy to reinforce the existing CPTs business and increase its competitiveness. In other words, to enlarge the market and market share through an active marketing strategy; to further optimize product mix by new technology; and to enhance product competitiveness by cost reduction.

In exploring new businesses, the Group will actively keep track of and conduct research and development of new display components such as PDP, LCD and polymer light-emitting diode (“PLED”). It will also seek appropriate business partners to speed up the pace of industrialization to realize sustainable development of the Group through sound market research, technological and economic feasibility studies. Further, the Group will fully explore its competitive strength in specialized production of parts and components to expand the business beyond CPTs components and accelerate new resource-related product development by means of putting more effort into research and development of cathode materials and glass products, and will launch new products constantly in order to increase diversified development and improve the Group’s operations steadily.

The Group also endeavours to optimize resources fully to secure a better development for businesses with good profitability by eliminating businesses of lesser profitability.

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

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

	Six months		Increase / (decrease)	Change in percentage
	ended 30th June 2006	2005		
Turnover	<b>1,887,894</b>	1,643,434	244,460	14.9%
– Sales of CPTs	<b>1,679,582</b>	1,414,475	265,107	18.7%
– Sales of CPT components	<b>208,312</b>	228,959	(20,647)	(9.0)%
Cost of sales	<b>(1,633,472)</b>	(1,472,891)	(160,581)	10.9%
Gross profit	<b>254,422</b>	170,543	83,879	49.2%
Other revenues	<b>16,540</b>	23,321	(6,781)	(29.1)%
Operating expenses				
Administrative expenses	<b>(110,057)</b>	(111,679)	1,622	(1.5)%
– General administrative expenses	<b>(96,300)</b>	(91,332)	(4,968)	5.4%
– Research and development expenses	<b>(13,757)</b>	(20,347)	6,590	(32.4)%
Selling and marketing costs	<b>(71,318)</b>	(52,972)	(18,346)	34.6%
Other operating expenses	<b>(15,315)</b>	(34,671)	19,356	(55.8)%
Operating profit	<b>84,446</b>	3,188	81,258	2,548.9%
Finance costs	<b>(30,233)</b>	(34,859)	4,626	(13.3)%
Profit / (Loss)				
for the period	<b>44,279</b>	(40,950)	85,229	NA
Attributable to:				
Equity holders of the Company	<b>34,738</b>	(30,840)	65,578	NA
Minority interests	<b>9,541</b>	(10,110)	19,651	NA

2) Turnover

Turnover by product (RMB'000)

	Six months ended 30th June		Increase / (decrease)	Change in percentage
	2006	2005		
CPTs	<b>1,679,582</b>	1,414,475	265,107	18.7%
Including: Small-size CPTs	<b>308,779</b>	373,725	(64,946)	(17.4)%
Medium-size CPTs	<b>1,367,659</b>	1,027,007	340,652	33.2%
Large-size CPTs	<b>3,144</b>	13,743	(10,599)	(77.1)%
CPT components	<b>208,312</b>	228,959	(20,647)	(9.0)%
Total	<b><u>1,887,894</u></b>	<b><u>1,643,434</u></b>	244,460	14.9%

Sales volume by product (Units)

	Six months ended 30th June		Increase / (decrease)	Change in percentage
	2006	2005		
Small-size CPTs	<b>2,219,114</b>	2,215,103	4,011	0.2%
Medium-size CPTs	<b>5,301,679</b>	3,034,615	2,267,064	74.7%
Large-size CPTs	<b>5,921</b>	19,128	(13,207)	(69.0)%
Total	<b><u>7,526,714</u></b>	<b><u>5,268,846</u></b>	2,257,868	42.9%

Average selling price by product (RMB / Unit)

	Six months ended 30th June		Change in (decrease) percentage
	2006	2005	
Small-size CPTs	<b>139</b>	169	(30) (17.8)%
Medium-size CPTs	<b>258</b>	338	(80) (23.7)%
Large-size CPTs	<b>531</b>	718	(187) (26.0)%



## 2. Changes as Compared with the Corresponding Period in 2005 and Analysis of Reasons

### 1) Turnover and Gross Profit Margin

The Group's turnover for the first half of 2006 amounted to RMB1,887,894,000, representing an increase of RMB244,460,000 or 15%, as compared with the corresponding period in 2005, including the turnover of CPTs of RMB1,679,582,000, representing an increase of RMB265,107,000 or 19%, as compared with the 2005 corresponding period in 2005, and the turnover of CPT components of RMB208,312,000, representing a decrease of RMB20,647,000 or 9%, as compared with the corresponding period in 2005. The overall gross profit margin of the Group increased from 10% in the first half of 2005 to 13% in the first half of 2006. This was mainly due to a decline in product costs as the Group strengthened target cost management in the first half of 2006.

### 2) Administrative Expenses

The Group's administrative expenses for the first half of 2006 were RMB110,057,000, representing a decrease of RMB1,622,000 or approximately 1%, as compared with RMB111,679,000 of the corresponding period in 2005. This was primarily due to a reduction of research and development expenses.

### 3) Finance Costs

The Group recorded RMB30,233,000 of finance costs for the first half of 2006, representing a decrease of RMB4,626,000 or approximately 13%, as compared with RMB34,859,000 of the corresponding period in 2005. The decrease in finance costs was mainly due to a reduction of borrowing.

### 3. Current Assets and Financial Resources

As at 30th June 2006, the cash and bank balances of the Group amounted to RMB581,352,000, representing a decrease of 7% as compared with RMB622,737,000 as at 30th June 2005. For the six months ended 30th June 2006, the capital expenditure paid by the Group amounted to RMB64,000,000. The net cash generated from operating activities amounted to RMB261,763,000 and the net cash used in financing activities and investing activities were RMB197,615,000 and RMB70,634,000 respectively.

The borrowings of the Group as at 30th June 2006 totalled RMB1,069,294,000 as compared with RMB1,260,177,000 as at 31st December 2005. The borrowings were all due in one year. Short-term bank borrowings as at 30th June 2006 of approximately RMB190,000,000 (31st December 2005: RMB280,000,000) are secured by certain buildings and machines.

The short-term bank borrowings guaranteed by the ultimate controlling company amounted to RMB490,000,000 (31st December 2005: RMB440,000,000) as at 30th June 2006.

The turnover period of account receivables for the six months ended 30th June 2006 was 143 days, representing an increase of 9 days as compared with 134 days for the six months ended 30th June 2005. The increase in the turnover period was mainly attributable to the increase in CPT sales in June 2006. The inventory turnover period of the Group was 69 days for the six months ended 30th June 2006, representing a decrease of 74 days as compared with 143 days for the six months ended 30th June 2005, which was mainly attributable to the increase in sales and adjustment in the inventory level according to market conditions.

#### **4. Capital Structure**

As at 30th June 2006, the borrowings of the Group were mainly denominated in Renminbi and US dollar while its cash and bank balances were mainly denominated in Renminbi, Hong Kong dollar and US dollar. The Group will continue to maintain a suitable ratio of share capital to liabilities so as to ensure an effective capital structure at all times. The total liabilities including bank borrowings as at 30th June 2006 amounted to RMB2,543,181,000 while the cash and bank balances were RMB581,352,000 with the debt ratio (total liabilities / total assets) being 45%.

#### **5. Interim Dividend**

The Company's dividend distribution policy remains unchanged. As there was no retained earnings in the first half of 2006, 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 30th June 2006, there was no material impact on the Group's operations or working capital resulting from exchange rate fluctuations.

#### **7. Commitments**

As at 30th June 2006, the commitments on capital expenditures for the Group amounted to RMB213,052,000 (31st December 2005: RMB234,810,000). Details of commitments are set out in note 15 of the condensed consolidated interim financial information of the report. The sources of funding for such commitments were mainly from the Group's working capital and bank loans.

#### **8. Contingent Liabilities**

As at 30th June 2006, apart from the material litigations stated in below, the Group had no material contingent liabilities.

#### **9. Charge on Assets**

As at 30th June 2006, short-term bank borrowings of approximately RMB190,000,000 were secured by certain property, plant and equipment of the Group.