Management Discussion and Analysis

INDUSTRY OVERVIEW

The first half of 2006 was a challenging period for handset players around the world. Global giants gained additional market share, launched products at a faster rate which shortened the life cycle and sped up depreciation of old models. These narrowed the average profit margin and diminished the survival rate of smaller peers. Multimedia and 3G handsets attracted the keenest competition, whereby handset players around the world are making huge investments in these areas to develop cutting edge technologies and applications. Nevertheless, as 3G did not grow as rapidly as generally anticipated, mega-pixel and MP3 handsets captured the mainstream market demand in the developed countries.

The operating environment in the PRC was one of the most competitive in the world as international players continued to aggressively pursue a dominant share of this lucrative market. The pending issuance of 3G licenses was a source of uncertainty while illegal and parallel-imported handsets substantially weakened the competitiveness of domestic handset manufacturers.

Overall, the industry landscape was favorable to global giants with huge R&D budgets, rapid new product launches and strong marketing capabilities. Their smaller-scale rivals had to strategically navigate to survive in this highly competitive market.

BUSINESS REVIEW

Overall performance

The Group is pleased to report that it continued to successfully advance towards meeting its preset targets in the second quarter of 2006. Spearheaded by a seasoned international management team that aims to uplift product competitiveness, market position and profitability, the Group, for the first time in its corporate history since extending its global footprint through the Alcatel brand handsets, achieved a profitable quarter. The management team takes pride not only in bringing the overseas operations of the ex-Alcatel handset arm back to profitability, but also in steering its PRC operations on the path to recovery.

Overseas business served as the growth engine during the period under review. Leveraging on strengths of the Alcatel brand name in Europe and the low-cost manufacturing base in the PRC, the Company optimized its strategy of "Chinese value @ World quality" to capture worldwide market share with a full range of highly competitive entry level handsets. Following the first breakeven quarter in 2006, the Group's overseas operations continued to be profitable for the three months ended 30 June 2006.

The Group successfully migrated from a distributor-driven handset manufacturer that primarily delivered handsets to distributors in the PRC, to an operator-driven player whereby approximately 82% of its handsets unit sales went to overseas operators, emerging as one of the leading second tier global handset players.

Performance in the PRC, however, was not satisfactory as re-engineering was still underway. Additional resources were allocated to re-establish the TCL brand in the market. Meanwhile, the Group effectively narrowed its operating loss as it successfully managed to implement stringent cost control measures. Improvements in average handset unit prices as well as margins were also achieved.

During the period under review, the Group acquired additional stakes in JRDC, a R&D company jointly held by leading telecommunication and handset industry players. JRDC further strengthened its capital base with the introduction of two new strategic investors in June 2006. Through JRDC, the Group not only enhanced its technology know-how and platforms for its products, but also enjoys cost advantage through pooled R&D expertise and shared capital resources at JRDC.

Cost control has been effective in the first half of 2006, with operating costs declining in all markets. With respect to the cost structure, the Group made notable progress towards achieving its targets set at the beginning of the year.

In addition, following the completion of the fund-raising by way of open offer which issued a total of 2,968,875,000 new shares at HK$0.2 per share, the Group obtained net proceeds of HK$587.8 million to further strengthen its capital base for future business development. All of these developments contributed to a solid financial position.

Sales Volume Breakdown by Geography

	Unaudited Handset Unit Sales For the six months ended 30 June		
('000 units)	**2006**	2005	**Change**
Overseas	**4,843**	3,130	**+55%**
PRC	**601**	1,696	**-65%**
Total	**5,444**	4,826	**+13%**

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Review of Operations

The Group operates seven sales and marketing and customer services centres[1] around the globe, namely EMEA, LATAM, APAC, India and ODM in overseas markets, and Alcatel as well as TCL in the PRC. TCL brand is the primary brand in the PRC market, while Alcatel brand handsets are mainly sold to operators in overseas markets. Of the seven markets, India was originally under APAC. In anticipation of enormous growth potential, the Group established an individual centre to tap opportunities in this market.

For the six months ended 30 June 2006, the Group sold a total of 5.4 million units of handsets worldwide (1H2005: 4.8 million units) and generated a sales revenue of HK$2,505 million (1H2005: HK$2,971 million). Overseas markets formed the Group's major sales revenue stream, accounting for 89% of the total unit sales (1H2005: 65%) and 82% of the Group's total sales revenue (1H2005: 59%), while the PRC market accounted for 11% and 18% of the unit sales and sales revenue respectively (1H2005: 35% and 41%).

EMEA

Performance in EMEA was satisfactory. Unit sales almost doubled year-on-year to reach approximately 1.9 million units in the first half of 2006, representing approximately 34% of the Group's total sales. The Group addressed the needs of all the major telecom groups in Europe and developed a well-balanced customer portfolio between operators and distributors. During the period under review, Alcatel handsets restored and improved its share in the range of entry-level products in countries including the U.K, Spain, Italy, France, Russia as well as North Africa.

LATAM

The Group's presence in LATAM witnessed considerable enhancement in the period under review. Its strengths in entry-level clamshell handsets, camera phones as well as the premium ELLE series which targets ladies were well recognized by the market, evidenced by the surge in unit sales. The unit shipments surged over 84% year-on-year to approximately 2.4 million units in the first half of 2006, representing approximately 42% of the Group's total sales.

[1]Note: The 7 S&M/CS centres are: Europe, Middle East and Africa ("EMEA");
Latin America ("LATAM");
Asia Pacific ("APAC");
India ("India");
ODM ("ODM"):
Alcatel and TCL brand in the PRC ("Alcatel PRC") and ("TCL PRC")

APAC

In the APAC region, which mainly covered Thailand, Malaysia, Indonesia, Taiwan, Bangladesh, Australia, the Philippines, Laos and Nepal, the Group shifted its focus from mainly distributor-driven sales to an operator-driven model in which it targeted low to mid-level market segments for both GSM and CDMA markets.

India

Given the enormous potential in India, the Group entered this highly price sensitive market during the period under review. While unit sales and revenue from this new market was insignificant in the first half of 2006, the Group believes that it will be able to leverage on its strategy of "Chinese value @ World quality" and the highly recognized Alcatel brand to capture opportunities in this market.

ODM

The Group is engaged in the provision of ODM services to customers in LATAM, North America, EMEA and APAC. Emphases were placed on the manufacture of multimedia and VGA handset models. The Group endeavours to foster long-term collaboration with its key partners and to develop the ODM business into one of the key revenue and profit contributors.

The PRC – TCL and Alcatel

In the PRC market, the Group was in the process of undergoing a series of reengineering during the period under review to re-establish its brand recognition, regain market share and to establish a solid foundation for future growth. As such, total unit shipments decreased by approximately 65% year-on-year to approximately 0.6 million units in the first half of 2006 and they were predominately sold under TCL brand.

The Group's strategy and efforts primarily focused on reorganization and streamlining the sales network in order to improve the overall cost structure and enhance competitiveness. Its target customers were mainly urban wage earners, owners of small private companies, rural spenders, young people and first time buyers in the developing cities. The Group also tailored multimedia handsets with entertainment functions for students and PDA handsets for businessmen.

PRODUCT DEVELOPMENT

A total of 6 new Alcatel brand models and 7 TCL brand models were launched in the first half of 2006. New technologies such as MP4 player, email function, t-flash and FM-radio system have been included within these new products.

TCT achieved some technology breakthroughs during the period under review. It launched the world's first mobile handset with built-in stereo 2.1 audio system which guarantees superior BASS performance. It is also the first handset manufacturer to launch a brand new model using non-conductive vacuum metallic coating technology (NCVM) on the entire product.

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In view of the growing popularity of high-resolution multimedia handsets and smartphones, TCT also planned to gradually apply the EDGE technology to its products.

Cost efficiency is crucial in winning market share and maintaining profit margin, thus TCT adopted multiple applications of the main circuit boards. The Group has also set standardized key designs and certain components of its products to create the "TCT style" in user platform, battery and data plug-in. The uniform features not only saved production costs but also enhanced the quality of critical parts such as the LCD screen and camera.

OUTLOOK

Looking ahead, although the global handset market is expected to be extremely competitive, nevertheless handset demand will continue to grow in both overseas and PRC markets. Average selling price is expected to stabilize in the second half of 2006.

For overseas markets, the Group anticipates a strong come back in Germany, Central Europe and Southern Africa in the second half of the year. Continually strong performance is expected from the EMEA centre. Its strategy is to foster cooperation with large operators to secure the market position and brand recognition of Alcatel. It will simultaneously consolidate its existing sales channels and explore new opportunities such as Brazil and the US markets.

In the area of new product strategy, the Group plans to launch a series of the most competitive VGA camera handsets in the second half of the year. Positive responses from the major European and Latin American operators have been received.

In the PRC market, the Group will develop new sales channels and strengthen cooperation with nationwide consumer electronics and telecommunication devices retailers. Growth is expected to come from mid-range handsets that target the mass market. In the third to fourth tier cities, the Group will work with operators to offer bundled packages to handset subscribers.

Going forward, the Group's focus on streamlining its global operations, rationalizing the business model, realizing synergies and formulating growth strategies to turn 2006 into a profitable year remains firm. While the overseas operation is expected to remain on a profitable track, the Group also endeavours to turnaround the PRC business by the end of this fiscal year. The management team is confident that the Group's performance will continue to show improvements in the coming quarters.

FINANCIAL REVIEW

Results

For the six months ended 30 June 2006, the Group's unaudited consolidated revenue amounted to HK$2,505 million (2005: HK$2,971 million), representing a year-on-year decrease of 16% as compared to the same period last year.

The Group's gross profit margin rose to 12% from 2% in the same period last year, despite keen competition and in general declining product prices.

Loss attributable to shareholders improved to HK$ 71 million (2005: loss attributable to shareholders was HK$853 million). Basic loss per share was HK1.4 cents (2005: basic loss per share were HK30.2 cents).

Inventory

The Group's inventory turnover period was 28 days.

Trade Receivable

Credit period was 60 to 90 days on average and the trade receivable turnover was 72 days (same period 2005: 49 days).

Significant Investments and Acquisition

On 9 March 2006, TCL Corp. entered into the Investment Agreement with TCL Mobile Communication (Hohhot) Co., Ltd. ("Mobile Hohhot") (an indirect wholly-owned subsidiary of the Company) in relation to the establishment of the Finance Company. Pursuant to the Investment Agreement, Mobile Hohhot contributed RMB20 million as capital contribution to the Finance Company, representing 4% of the registered capital of the Finance Company. The establishment of the Finance Company is subject to the obtaining of the approval from the relevant PRC authorities, including but not limited to the China Banking Regulatory Commission. Further details of this transaction were set out in the Company's announcement dated 9 March 2006.

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On 31 March 2006, the Company entered into the Share Purchase Agreement with Power Century Investments Limited ("Power Century") pursuant to which the Company agreed to purchase from Power Century 771,500 shares of JRD Communication Inc. ("JRDC"), representing 38.54% equity interest in JRDC, at a cash consideration of US$12.3 million (equivalent to approximately HK$95.33 million). The consideration payable by the Company under the Share Purchase Agreement was financed by the proceeds from the open offer of the Company completed on 27 February 2006 ("Open Offer"). The Share Purchase Agreement was completed in April 2006. JRDC was initially held by the Company and Power Century as to approximately 9.45% and approximately 90.55% respectively. Immediately after the completion of the Share Purchase Agreement, the shareholding of the Company and Power Century in JRDC changed to approximately 46.25% and 35% respectively. The aggregate of the investment in JRDC constituted a discloseable transaction for the Company under Rule 14.06 of the Listing Rules. For further details of the Share Purchase Agreement, please refer to the Company's announcement dated 3 April 2006 and the Company's circular dated 8 May 2006.

Fund Raising

On 22 December 2005, the Company proposed to issue 2,968,875,000 new shares ("Offer Shares") at a price of HK$0.2 per Offer Share by way of Open Offer, on the basis of one Offer Share for every one share of the Company held by the shareholders on 6 February 2006. The open offer was completed on 27 February 2006 having received application for 4,768,225,969 Offer Shares, representing approximately 160.6% of the total number of Offer Shares. For further details of the Open Offer, please refer to the prospectus of the Company dated 7 February 2006.

Of the net proceeds from the Open Offer of about HK$587.8 million, the Group has utilized approximately HK$150 million to settle the payables incurred in its ordinary business, about HK$237.8 million as general working capital and about HK$200 million in research and development activities of advanced technology of the industry.

Liquidity and Financial Resources

The Group maintained a healthy liquidity position throughout the period. The cash and cash equivalents balances as at 30 June 2006 amounted to HK$274 million, of which 23% were in Renminbi, 62% in US dollars, 14% in Euro and 1% in Hong Kong dollars & others for the operations. The Group's financial position remains healthy, with total assets of HK$3,339 million and a gearing ratio of 19% at the end of the period under review. The gearing ratio is calculated based on the Group's total interest-bearing borrowings over total assets.

Pledge of Deposits

Discounted notes of approximately HK$20,327,000 (31 December 2005: HK$118,156,000), were secured by the pledge of deposits amounting to approximately HK$5,923,000 (31 December 2005: HK$35,447,000). Deposit balance of HK$18,173,000 (31 December 2005: HK$18,870,000) represented the retention guarantee for factored trade receivables.

Capital Commitment and Contingent Liabilities

As at 30 June 2006, the Group had capital commitments of approximately HK$0.4 million (31 December 2005: HK$18,111,000) contracted, but not provided for; and US$1.5 million contracted for an investment at 31 December 2005. The Group had the following contingent liabilities:

One of the Group's subsidiaries, T&A Mobile Phones Suzhou Limited ("T&A Suzhou") was involved in a patent infringement litigation brought by Hubin, Huxuanhua and Dalian Hanpu Applied Technology Co., Ltd. (the "plaintiff") in March 2001. In May 2002, the PRC trial court rendered civil judgment in favor of T&A Suzhou with no damages or expenses to be borne by them. In the same month, the plaintiff appealed to the High Court and up to date, the appellate proceedings is still in progress.

According to the legal opinion from the Group's PRC lawyer, it is very likely for the appellate court to render judgment in favor of T&A Suzhou again. Accordingly, no provision was made for such litigation in the financial statements.

Foreign Exchange Exposure

The Group has transactional currency exposures. Such exposures arise from sales or purchases by operating units in currencies other than the units' functional currency, where the revenue is predominately in Euro, USD and RMB. The Group tends to accept foreign currency exchange risk avoidance or allocation terms when arriving at purchase and sales contracts. The Group takes rolling forecast on foreign currency revenue and expenses, matches the currency and amount incurred, so as to alleviate the impact to business due to exchange rate fluctuation.

Employees and Remuneration Policy

The Group had approximately 3,600 employees as at 30 June 2006. Total staff costs for the period under review were approximately HK$137.5 million. The remuneration policy was in line with current legislation, market conditions and both individual and company performance.