

Management Discussion and Analysis

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Industry Review

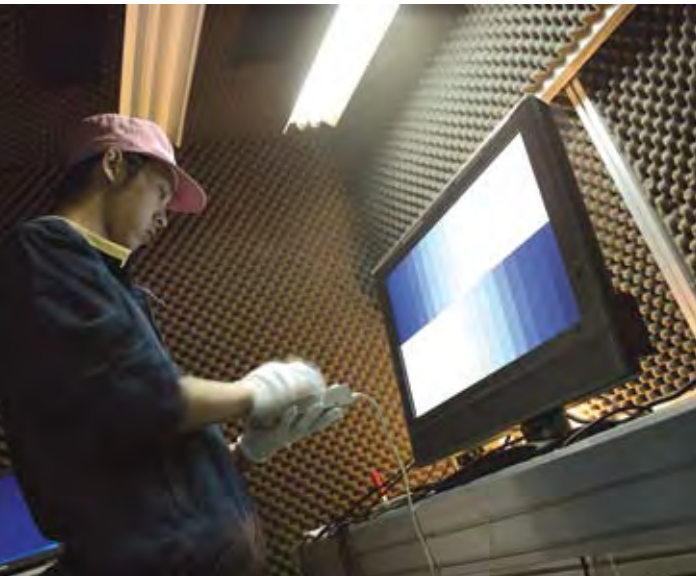
In 2006, the world economy continued to expand at over 4 percent despite the higher commodity prices, rising interest rates, and a bout of financial market volatility.

Yet, 2006 was one of the toughest years for the monitor industry. In spite of a healthy shipment growth of 23.4 percent to 131 million units, the operating environment for TFT-LCD monitor integrators was made difficult by the volatile panel prices and intensified competition. Panel prices continued with their ebb and flow through the year, began with a sharp drop due to over-supply, followed by an abrupt upswing in the summer when demand picked up, and stabilized towards the end of the year. Moreover, keen competition had forced players to absorb higher costs when component prices rose, hurting the sector's profitability.

However, the year was not without its positive aspects: for LCD TV, the next pillar of the LCD sector with an exponential growth prospects, worldwide shipment doubled to 46 million units. The 2008 Beijing Olympics and the introduction of new broadcasting standards in key markets of the world are expected to boost the demand for LCD TV to 128 million units in 2010, a compound annual growth rate of nearly 30 percent.

Performance Review

TPV shipped a total of 43 million units of displays in 2006, registering a solid growth of 45.4 percent year-on-year. TFT-LCD monitor shipment of 28.6 million units accounted for 66.5 percent of the total display shipment and contributed US\$4,956.8 million to the Group's consolidated turnover. LCD TV shipment accelerated at an impressive growth rate of 267.3 percent to 2.4 million units or US\$1,032.2 million in revenue terms. As for the faltering CRT monitor segment, the Group managed to hold its shipment at over 11 million units in view of its dominant market position and strong presence in the emerging markets.



For fiscal 2007, TPV targets to ship 36 million units of TFT-LCD monitor, 6 million units of CRT monitor and over 4 million units of LCD TV.

Over the years, the well-diversified clientele and geographical reach have helped the Group to mitigate the impacts of industrial and economic ups and downs. In 2006, North America and Europe remained the Group's two largest markets, contributing 32.4 percent and 25.1 percent respectively to the consolidated turnover. Sales in the PRC rose to account for 23.2 percent of total revenue in view of the strong presence of AOC-branded products in that market. The Group continued to make inroads in the emerging markets and saw strong sales growth in Brazil, Africa and India.

The volatile panel price environment and fierce competition had dented the Group's profitability in 2006. While gross margin on TFT-LCD monitor declined to 4.8 percent from 5.3 percent, gross margin on the high-flying LCD TV also dropped 60 basis points to 3.0 percent. CRT monitor was the only segment that had its margin lifted last year, from 9.0 percent to 9.6 percent. All in all, the Group's consolidated gross profit margin fell 70 basis points to 5.0 percent. In addition, the heavy spendings incurred for TV business had increased operating expenses and weighed on the operating profit margin which finished the year at 2.1 percent, versus 3.0 percent a year ago.

Production

As part of the restructuring of the Philips contributed business, production at the Dongguan plant was permanently shut down in March 2006 while production facilities at the Suzhou plant were revamped to focus solely on TV production.

For the past two years, TPV had invested in a number of backend integration projects to add in-house capability and capacities. These included TFT-LCD module assembly, backlight design and production, the making of inverter and transformer as well as an assortment of small mechanical parts and components. In fiscal 2006, the Group processed 4.7 million units of TFT-LCD modules in-house, representing 15.5 percent of panels consumed by the Group. This year, the Group targets to increase its output of TFT-LCD modules to 9.1 million units or 25.3 percent of its targeted requirement.

The Group plans to set up a manufacturing plant in Poland to better serve its customers in the EU countries and also to save the 14 percent import tariff levied on LCD displays. US\$50.0 million has been set aside for this project, covering the cost of land, construction and production lines. The new plant, with an initial capacity of 3 million to 4 million units, is scheduled to commence production in the second half of 2008. The long term plan is to expand the annual capacity there to 8 million units.

As at 31st December, 2006, the Group had an annual production capacity of 68.2 million units – 48.2 million units for TFT-LCD monitor, 6.2 million units for LCD TV, 12.8 million units for CRT monitor and 1 million units for PDP. Capital expenditure for the year was at US\$88.0 million. The Group planned to spend a further US\$100 million to US\$130 million to expand its capacities this year.

Research and Development (“R&D”)

During 2006, the Group broadened its product range with 570 new models of TFT-LCD monitor and 184 new models of LCD TV. To address the more sophisticated customer needs, TPV introduced flat wide monitors with multi-functions from 17-inch all the way up to 40-inch. The Group also made a head start in producing LCD TVs up to 50-inch, offering higher picture quality and bringing better enjoyment to consumers.

To enhance design efficiency, the R&D platform was realigned at the beginning of this year to free up the engineering resources in Taiwan for high end product development, giving the team in China greater responsibility to take charge of the development of more matured products.

The Group has implemented the following initiatives in relation to its R&D organization:

1. Integration of the R&D centres in Beijing, Wuhan and Suzhou with Fuqing to optimize resources and avoid duplication of efforts;
2. Standardization of chipset platform for LCD TV to lower the design cost and speed up product time to market; and
3. Conduct in-depth cost-benefit analysis before any new project implementation.

Liquidity, Financial Resources and Capital Structure

In view of the raising interest cost, the Group had utilized the surplus cash on hand to pay down debts last year. As a result, the Group's cash and bank balances (including pledged bank deposits) were lowered from US\$418.7 million as at 31st December 2005 to US\$96.0 million as at 31st December 2006. Credit facilities secured from banks amounted to US\$4.2 billion (2005: US\$3.0 billion) of which US\$1.1 billion (2005: US\$1.2 billion) were utilized.

All bank borrowings were borrowed on floating-rate basis, denominated in US dollar. The maturity profiles of bank borrowings are as follows:

Duration	2006 (US\$'000)	2005 (US\$'000)
Within one year	216,290	285,380
In the second year	-	96,000

As compared to 2005, the Group's inventory turnover days increased 13.1 days to 45.7 days. Accounts receivable turnover days were 62.3 days (31st December 2005: 53.2 days), while accounts payable turnover days lengthened to 72.2 days (31st December 2005: 63.4 days).

The Group's gearing ratio, representing the ratio of total borrowings to total assets, dropped to 13.6 percent from 18.9 percent in 2005. Current ratio stood at a satisfactory level of 141.6 percent as at the end of 2006.

To fund its expansion projects, the Group raised approximately US\$121.0 million through a top-up placement in February 2006. As for 2007, the Group plans to finance its estimated capital expenditure of US\$100 million to US\$130 million through internal cash flow and bank borrowings.

Workforce

As at 31st December 2006, the Group had approximately 25,000 employees worldwide. The remuneration terms of these employees were consistent with industry practice in the respective locations where the Group operates. The Group has adopted an employee share option scheme to motivate employees to achieve the Group's objective.



Functional Distribution of Workforce

Year	Production	R&D	Sales & Marketing	Others	Total
2004	7,356	640	257	3,101	11,354
2005	14,204	1,537	647	4,221	20,609
2006	17,685	1,857	578	5,462	25,582

Foreign Exchange Risk

As at 31st December 2006, the total notional principal amounts of the outstanding foreign exchange forward contracts were as follows:

	2006 (US\$'000)	2005 (US\$'000)
Sell Euros for US Dollars	7,862	10,732
Sell Japanese Yen for US Dollars	1,000	6,000
Sell US Dollars for Renminbi	1,737,000	1,035,000
Sell Renminbi for US Dollars	1,752,000	1,045,000