



Management Discussion and Analysis



The following discussion and analysis should be read in conjunction with the Group's audited financial statements and the notes in this annual report.

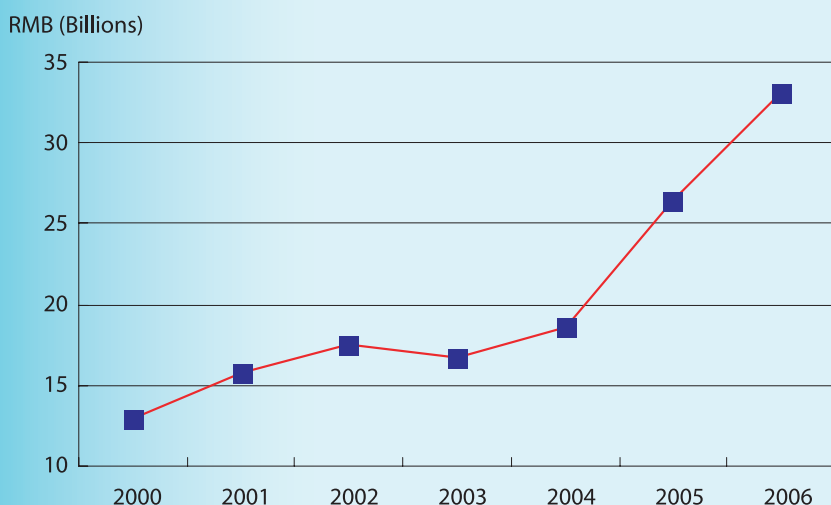
Industry Overview

According to the 2006 Railway Statistics Gazette issued by the Ministry of Railways on 15 March 2007, at the end of 2006, the total operational length of railway in the PRC was approximately 77,000 km, making it the third longest in the world. Of these, approximately 63,400 km were State railways, approximately 8,900 km were joint venture railways, while approximately 4,700 km were local railways. In 2006, there were approximately 17,800 locomotives in

the PRC, of which 99.3% were diesel and electric locomotives, operating on all major railway trunk lines. Also, there were approximately 42,600 passenger cars and approximately 566,700 freight cars in the PRC.

In 2006, spending for the acquisition of locomotives in the PRC amounted to RMB33.18 billion, including RMB9.2 billion for payment in relation to imported projects. With a focus on locomotives with speeds over 200 km/h, high-power alternating current locomotives and new freight cars, approximately 447 locomotives, 774 passenger cars and 25,490 freight cars were purchased by the MOR in 2006. Twenty-five EMUs capable of speeds over 200 km/h had passed the speed increase certification testing, and were found to comply with standards for existing and special passenger lines operations, meeting high speed operational requirements. During 2006, eleven high power eight-axle 9.6 MW locomotives and 68 units of six-axle 7.2 MW locomotives, primarily used on coal transportation lines and trunk lines, were put into operation. Additionally, trains with haulage capacity exceeding 20,000 tons were put into operation on the Daqin Line, indicating that the hauling capacity of freight cars in the PRC has reached world leading standard.

New locomotives procured by the Ministry of Railways



Source: 2000 to 2006 Railway Statistics Gazettes published by Railway Statistics Center

Revenue

| | 2006 (RMB million) | 2005 (RMB million) |
|--|-----------------------|-----------------------|
| Train power converters, auxiliary power supply equipment and control systems | 494.2 | 359.6 |
| Train operation safety equipment | 369.7 | 272.5 |
| Electrical control systems for large railway maintenance vehicles | 124.7 | 148.9 |
| Train-borne electrical systems | 988.6 | 781.0 |
| Power semiconductor devices | 96.1 | 90.1 |
| Sensors and related products | 89.0 | 57.0 |
| Others | 82.2 | 69.9 |
| Electric components | 267.3 | 217.0 |
| Total revenue | 1,255.9 | 998.0 |

Revenue increased by RMB257.9 million from RMB998.0 million for the year ended 31 December 2005 to RMB1,255.9 million for the year ended 31 December 2006. The increase in revenue was mainly due to the growth in the sales of power converters, control system and train operation safety equipment. Of these, growth in the sales of power converters and control system was mainly due to the increase in the sales of 200 km/h EMUs, while growth in the sales of train operation safety equipment was mainly due to new regulatory policies introduced by the Ministry of Railways at the end of 2005 to install LKJ2000 type train operation safety equipment on all trains operating in the PRC.

Cost of sales

Cost of sales increased 18.1% from RMB542.3 million for the year ended 31 December 2005 to RMB640.4 million for the year ended 31 December 2006, which was mainly due to increase in the Group's revenue.

Gross profit

Based on the above factors, the Group's gross profit increased 35.1% from RMB455.7 million for the year ended 31 December 2005 to RMB615.5 million for the year ended 31 December 2006. The Group's gross profit margin rose from 45.7% for the year ended 31 December 2005 to 49.0% for the year ended 31 December 2006, mainly due to changes in its product mix.

Other revenue and gains

Other revenue and gains of the Group increased 248.6% from RMB18.5 million for the year ended 31 December 2005 to RMB64.5 million for the year ended 31 December 2006. This was mainly due to interest income earned in connection with the Company's initial public offering.



Selling and distribution costs

The Group's selling and distribution costs increased 36.0% from RMB87.3 million (representing 8.7% of revenue for the whole year) for the year ended 31 December 2005 to RMB118.7 million (representing 9.5% of revenue for the whole year) for the year ended 31 December 2006. Increase in the selling and distribution costs was mainly due to the overall growth in the Group's business.

Administration expenses

The Group's administration expenses increased 57.4% from RMB154.8 million for the year ended 31 December 2005 to RMB243.7 million for the year ended 31 December 2006, which was mainly due to increase in expenditure in research and development.

Profit from operations

The Group's profit from operations increased 36.4% from RMB232.4 million for the year ended 31 December 2005 to RMB317.0 million for the year ended 31 December 2006, which was mainly due to increases in turnover and interest income. The Group's profit margins from operations for the years ended 31 December 2005 and 2006 were 23.3% and 25.2% respectively.

Finance costs

Finance costs increased 4.3% from RMB13.8 million for the year ended 31 December 2005 to RMB14.4 million for the year ended 31 December 2006, which was mainly due to the increase in the Group's borrowings and the overall increase in interest rates between 2005 and 2006. For the year ended 31 December 2006, the Group's bank loans carried annual interest rates ranging from 5.02% to 7.50%, while for the year ended 31 December 2005, bank loan interest rates ranged from 4.19% to 6.19%.

Profit before tax

Based on the above factors, the Group's profit before tax increased 38.4% from RMB218.6 million for the year ended 31 December 2005 to RMB302.6 million for the year ended 31 December 2006.



Income tax expense

The Group's income tax expenses decreased from RMB639,000 for the year ended 31 December 2005 to RMB313,000 for the year ended 31 December 2006. Income tax expenses in 2005 were mainly income taxes incurred by Times Electronics and Times Guangchuang. Income tax expenses in 2006 were mainly income taxes incurred by Times Guangchuang and which were recognized during the twelve months ended 31 December 2006. The Company, Ningbo Company and Times Electronics are exempt from PRC enterprise income tax up to 30 September 2007.

The Group's effective tax rates for the years ended 31 December 2005 and 2006 were 0.3% and 0.1%, respectively.

Net profit attributable to equity holders of the parent

The Group's net profit attributable to equity holders of the parent increased from RMB211.7 million for the year ended 31 December 2005 to RMB296.8 million for the year ended 31 December 2006. The Group's net profit margins for the years ended 31 December 2005 and 2006 were 21.2% and 23.6%, respectively.

Minority interests

Minority interests decreased from RMB6.2 million for the year ended 31 December 2005 to RMB5.5 million for the year ended 31 December 2006. This was mainly due to the Group's acquisition of 10% interest in Times Electronics in June 2006, after which Times Electronics became a wholly owned subsidiary of the Group, while the Group recognized the minority interests of Times Electronics only for the six months ended 30 June 2006.

Liquidity and source of capital

Cash flow and working capital

The Group's working capital were mainly sourced from cash derived from operations and short-term loans. The Group's cash and cash equivalents increased substantially during the year, which was mainly due to the receipt of proceeds from the Group's initial public offering on the Stock Exchange of Hong Kong on 20 December 2006. All the Directors believe that the Group has sufficient liquidity to meet its present requirements for funds.

Net cash from operation activities

For the year ended 31 December 2006, the Group's net cash from operation activities increased to RMB198.0 million. The increase was mainly due to the increase in profit.

Net cash outflow from investment activities

For the year ended 31 December 2006, the Group's net cash outflow from investment activities was approximately RMB148.0 million, including RMB102.6 million for the purchase of properties, plant and equipment.

Net cash flow from financing activities

For the year ended 31 December 2006, the Group's net cash inflow from financing activities amounted to RMB2,046.2 million, which was mainly comprised of proceeds amounting to HK\$2,197,613,000 or RMB2,209,968,000 at the prevailing exchange rate on the date of payment raised from the Company's initial public offering of 414,644,000 H shares at HK\$5.30 per share, and interest income of approximately HK\$22,537,000 or RMB22,666,000 at the prevailing exchange rate on the date of payment, earned in connection with the Company's initial public offering.

Liquidity

The Directors agree that the Group has sufficient liquidity to meet the Group's present requirements for funds.

Commitments

The Group's capital commitments at the dates indicated were as follows:

| | As at 31 December | |
|--|-------------------|-------------------|
| | 2006 (RMB'000) | 2005 (RMB'000) |
| Contracted but not provided: | | |
| Acquisitions of properties, plants and equipment | 38,232 | 35,487 |

Indebtedness

The table below sets out the Group's indebtedness on the dates as indicated:

| | As at 31 December | |
|---|-------------------|-------------------|
| | 2006 (RMB'000) | 2005 (RMB'000) |
| Interest bearing loans and other borrowings | 364,537 | 252,521 |

In November 2006, the Group borrowed new short-term bank loans totaling RMB168 million, which were mainly used for payment of special dividends of RMB167,538,000 which the Company declared on 29 November 2006 and distributed on 30 November 2006.

Gearing ratio

As at 31 December 2005 and 31 December 2006, the Group's total borrowings were RMB252.5 million and RMB364.5 million, respectively. Increase in borrowings was mainly due to the new short-term bank loans totaling RMB168 million which the Group obtained in November 2006, and was used for the payment of special dividends of RMB168 declared on 29 November 2006 and distributed on 30 November 2006. The percentage of the Group's total borrowings to total assets as at 31 December 2005 was 17.0%, and 9.6% as at 31 December 2006. The decrease was mainly due to the inflow of the proceeds from the Company's initial public offering.

Contingent liabilities

The Group was not involved in any material litigation, and so far as the Group is aware, the Group has no pending or potential material litigation.

Employees and remunerations

The Group offers salary increments and bonuses to employees with outstanding performance. The bonus scheme is discretionarily determined with reference to the performance of the staff and the Group's operation results. The Group places great emphasis on on-the-job-training and development of its employees. Each staff member is required to participate in departmental training prior to his or her employment. In the subsequent years, all employees, including management representatives, are required to undergo further training as designated by the Group. As at 31 December 2006, the Group has 2,581 full-time employees, and the total salaries (including wages and allowances) paid to the employees in 2006 amounted to approximately RMB139,462,000.

Market risks

The Group is subject to various market risks, including interest rate risks, foreign exchange risks and inflation risks in the ordinary course of its business and those risks as detailed in note 36 to the financial statements.