TIME for style

We believe that stylish designs come inside out. While we are committed to offering products with attractive outlook, we also ensure that the functions of our products always outperform that of our rivals within the same price range, delivering true value-for-money.

Management Discussion and Analysis

OPERATIONAL HIGHLIGHTS

* Total handset sales reached 11.5 million units in 2006, representing 6% growth year-on-year and achieved overall profitability.

* Overseas business delivered progressive quarter-on-quarter improvements; unit sales surged by 32% to 9.9 million units respectively.

* The PRC business achieved breakeven starting from the third quarter of the year after business restructuring.

* A total of 38 handset models were launched worldwide in the year with a number of breakthroughs in application of new technologies.

INDUSTRY OVERVIEW

The global handset market continued to post double-digit volume growth across key markets, in particular in Asia Pacific and Eastern Europe where market demand rose by more than 30% in 2006. Leading global players, with their strong design and product development capabilities, extensive sales and marketing resources and internationally renowned brand names, dominated major markets. They continued to enlarge their market shares in 2006 by applying cutting-edge technology and rapidly introducing new products. At the same time, they enriched their portfolio of mid- to low-end products to penetrate the market. This accelerated a decline in product price and reduced profit margins for the industry as a whole.

The PRC is one of the growth drivers in the world's handset industry, and has attracted handset manufacturers from all parts of the world. Global giants were in an advantageous position to capture opportunities in this lucrative market with their wide product range catering to the needs of consumers with varying purchasing power. Taken together with the massive number of handsets manufactured by illegal manufacturers, plus parallel-imported handsets, both of which sold at relatively low prices. This further intensified market competition and diminished the competitiveness of smaller scale manufacturers.

With respect to different types of products, mega-pixel and MP3 handsets formed the mainstream demand in 2006. To pave the way for future growth, handset manufacturers invested heavily in the multimedia and 3G handset markets, which is expected to be the driving force in 2007.

BUSINESS REVIEW

Overall Performance

In such a competitive landscape, TCL Communication reinforced its position as a supplier of innovative and cost competitive entry level phones. It focused on the operator market and aspired to be a partner of choice for global telecom operators.

Through business reengineering, corporate and product re-positioning, and strengthening of research and development capabilities, the Company has achieved its target in attaining profitability in 2006. Overseas business recorded sustainable growth with considerable quarter-on-quarter improvements, while the PRC business achieved breakeven and regained sales growth in the third quarter of the year after clearing channel inventories.

In keeping with its objective of providing high-quality handsets offering good value at competitive prices, the Group strengthened its cost controls during the year. Gross margin improved tremendously, from 2% in the previous year, to 14% in the year under review.

Management Discussion and Analysis

Review of Operations

The Group's global sales volume rose by 6% year-on-year to 11.5 million units in 2006. This was driven by impressive performances in overseas markets, in particular in the EMEA and LATAM markets, which recorded volume growth of more than 66% as compared to 2005. With an operator-driven business model, over 86% of unit sales came from European and Latin American operators.

Notwithstanding this, total unit sales fell below the Group's expectation, partly because the growth in overseas market was offset by the decline in the PRC which was mainly due to sluggish sales business restructuring activities in the first half of 2006 when the PRC division underwent distribution channel restructure.

Total sales revenue for the Group decreased by 3% to HK$5,502 million, of which 76% came from overseas markets (2005: 64%), while the remaining 24 % came from the PRC market (2005: 36%).

In 2006 the three main regions, namely EMEA, LATAM and the PRC, demonstrated considerable quarter-on-quarter improvement. Overall speaking, the Group posted positive margins on a full year basis.

EMEA

Performance in France, the UK, Germany and Spain was encouraging, in particular in the second half of the year. Sales volume for EMEA increased by 104% year-on-year, to 5.1 million units, accounting for 44% of the Group's total handset sales.

The "Alcatel" brand made a remarkable comeback and regained the trust of major operators. This was particularly evident in the case of the UK where the Alcatel brand staged a strong return following its complete disappearance in 2005.

During the year under review the supply chain processing for EMEA was transferred to the Huizhou production base. All customer orders were processed and shipped directly from this production base, thus reducing cost substantially while shortening lead time and ensuring on-time delivery.

LATAM

Unlike EMEA which showed progressive quarter-on-quarter improvements, handset sales in LATAM experienced some ups and downs during the year. Performance in the fourth quarter fell below the Group's expectation and recorded a decline. Sales volume on a full year basis rose by 39% to 4.8 million handsets, accounting for 41% of the Group's total handset unit sales.

Focusing on entry level clamshell handsets and camera phones, the Group continued to increase its market share, with particularly good performance in countries like Argentina and Chile.

The PRC

In the PRC, the Group's business focus in the first half of 2006 was to restructure sales and distribution channels and assist its distributors in clearing inventories in the channels. After clearing the backlog, sales of TCL brand handsets, with emphasis on mid-range products, stabilized in the second half of the year. Improvements brought forth by the new quality control system was impressive.

Sales Volume Breakdown by Geography

	Handset unit sales (in '000 units)		Change (%)
	2006	2005	
Overseas	**9,936**	7,500	+32%
The PRC	**1,566**	3,389	-54%
Total	**11,502**	10,889	+6%

Management Discussion and Analysis

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Although sales volume for mainly TCL-branded handsets decreased 54% on a full year basis, from 3.4 million units in 2005 to 1.6 million units in 2006, the Group achieved breakeven in the third quarter of the year under review. This has built a solid foundation for the Group to grow and prosper in the years to come.

Other Markets

Despite the relatively insignificant contribution from other markets such as APAC and India, they are emerging markets with immense potential.

The APAC region covers a number of countries including Thailand, Malaysia, Indonesia, Taiwan, Bangladesh, Australia, the Philippines, Laos and Nepal. The Group adopted different sales and marketing strategies in different locations. Sales volume for APAC decreased by 80% to 0.1 million units, accounting for 1% of total handset sales.

India offers enormous potential boosted by strong mobile phone subscriber growth. The Group entered this market in the second quarter of 2006. Given its cost competitive advantage, the Group is well poised to benefit from the potential of this market.

With respect to the provision of ODM services, the Group endeavors to foster long-term collaboration with its key partners so as to develop this business into one of the key revenue and profit contributors. As such, 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 in both GSM and CDMA markets.

Product Development

Product development strategy of the Group in 2006 was to streamline its product offering and focus on cost-competitive entry level products. During the year under review, a total of 38 handset models were launched worldwide, which included 17 models of "Alcatel" brand and 21 "TCL" brand.

During the year, the Group made a number of breakthroughs in the development and application of new technologies. These included:

* Launched the first metallic crystal effect cosmetic product, a brand new technology in the mobile handset industry;

* One of the first OEM manufacturers in the industry to fully support the application of latest storage media such as mega-SIM and trusted flash card;

Management Discussion and Analysis

* Applied NCVM coating is extended and widely used in new products of 2006 as lens and casing

* New handset models that support stereo Bluetooth, 2.2" QVGA display, auto focus Camera and TV-out

In 2007, the Group will continue to focus on its product development of multimedia handsets. At the same time, the Group will continue to invest in the development of CDMA and 3G technologies. Having established a solid platform, the Group is well positioned to launch new products to meet market demand.

FUTURE OUTLOOK

The outlook for TCL Communication in 2007 is positive. The Group's global sales target in 2007 is to grow volumes by 15% over 2006, against a market growth forecast of around 10%. All sales centers are expected to contribute to this growth, with China expected to be a major growth driver after the breakeven achieved in the third quarter of 2006.

The Group's corporate strategy remains unchanged. Its goal of providing products of 'Chinese Value @ World quality' will be further strengthened in 2007. The Group will consolidate its position in the voice segment, and start rolling out innovative and competitive multimedia products in EMEA and LATAM from the second quarter onwards.

On the operational level, the Group will focus on improving efficiency while continuing to identify areas for further cost reduction. Supply chain management, for instance, will make use of the low cost Huizhou plant, to further streamline it production process. Huizhou will be further developed as the worldwide base for new product introduction, and new processes will be put in place to further improve time to market.

Already a partner of choice to telecom operators, the Group will seek geographical expansion by working hand-in-hand with the operators to enter new markets, such as North America and Brazil. In addition, the Group, with strong CDMA expertise, has established a solid platform. It plans to further explore opportunities in Indonesia, Vietnam, Nigeria and New Zealand where the demand for CDMA handsets are expected to be strong.

The Group will continue to maximize its strength as a second-tier handset manufacturer. It will continue to strengthen its R&D and project management resources to further improve its capability to address the operator-driven markets. Spearheaded by a high-caliber management team,

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the Group has every confidence in achieving this goal, rewarding shareholders with impressive results in 2007 and the years ahead.

FINANCIAL REVIEW

Results

For the year ended 31 December 2006, the Group's audited consolidated revenue amounted to HK$5,502 million (2005: HK$5,664 million), representing a year-on-year decrease of 3% as compared to last year.

The Group's gross profit margin rose to 14% from 2% last year, despite keen competition and in general declining product prices.

Profit attributable to equity holders of the parent improved to HK$15 million (2005: loss attributable to shareholders was HK$1,608 million). Basic earnings per share was HK 0.3 cents (2005: basic loss per share were HK 55.6 cents).

Significant Investments and Acquisition

On 18 April 2007, (1) the Company and 5 subscribers ("Subscribers"), who are all independent third parties, entered into a Subscription Agreement pursuant to which the Company has agreed to issue and allot and the Subscribers have agreed to subscribe for 1,215,430,000 Subscription Shares in aggregate at a total consideration of HK$268,093,472, and (2) the Company and the Vendors entered into a Share Purchase Agreement pursuant to which the existing shareholders of JRDC other than the Company (the "Vendors") have agreed to sell and the Company has agreed to purchase an aggregate of 147,500,000 JRDC Shares at total consideration of US$39,313,017 (equivalent to approximately HK$306,641,533) (the "Acquisition").

In order to well position the Company to face keen competition worldwide, the directors considered the business model of outsourcing product development activities to other entities such as JRDC may no longer be beneficial to the Group. Though after the completion of the Acquisition, the Group will have to take over the entire operating costs of JRD Group, in view of the royalty saving and the ability of the Group to gain full control of JRDC, the Board considers that the Acquisition is beneficial to the Group as it can significantly enhance the Group's capability in research and development of mobile technology which will better equip the Group to face the operating environment of the handset industry which remains tough both globally and domestically. For further details of the Acquisition and subscription of new shares, please refer to the announcement of the Company dated 18 April 2007.

Except for the significant investments and acquisition as disclosed above and in the Company's interim results announcement dated 30 August 2006 as well as in the Company's announcement dated 27 October 2006, there was no significant investments and acquisition for the year ended 31 December 2006.

Management Discussion and Analysis

Fund Raising
On 19 March 2007, the Company entered into a subscription agreement (the "Subscription Agreement") with DBS Bank Ltd. ("DBS"), pursuant to which DBS agreed to subscribe for the Convertible Bonds at an aggregate principal amount of US$27 million (the "Firm Bonds"). The Company has also granted to DBS an option to require the Company to issue up to a further US$18 million in principal amount of the Convertible Bonds (the "Optional Bonds").

The net proceeds from the issue of the Convertible Bonds (excluding the issue of the Optional Bonds), amounting to approximately HK$204.6 million will be used for general corporate working capital purposes and refinancing of some existing indebtedness.

The option can be exercised by DBS in whole or in part, at any time within a period of 90 calendar days after the increase of sufficient authorized share capital of the Company for issuing of new shares of the Company upon conversion of the Optional Bonds has been approved by Shareholders. An extraordinary general meeting has been held and such approval was obtained on 20 April 2007.

The conversion price per share was initially set at HK$0.3275 subject to adjustment, which represents a premium of approximately 26.2% of the average closing price per share as quoted on the SEHK of HK$0.2595 per Share for the ten consecutive trading days up to and including the last trading day from the announcement date referred to below. The maturity date is 2 April 2012 and the yield to maturity is 5.709%.

For further details of issuance of Bonds, please refer to the announcement of the Company dated 20 March 2007.

Except for fund raising as disclosed above and in the Company's interim results announcement dated 30 August 2006, there was no fund raising for the year ended 31 December 2006.

Inventory
The Group's finished goods turnover period was 23 days during the year under review.

Liquidity and Financial Resources
The Group maintained a healthy liquidity position throughout the year. The cash and cash equivalents balances as at 31 December 2006 amounted to HK$531 million, of which 25% were in Renminbi, 56% in US dollars, 11% in Euro and 8% in Hong Kong dollars & others for the operations. The Group's financial position remains healthy, with total assets of HK$3,670 million and a gearing ratio of 13% at the end of year under review. The gearing ratio is calculated based on the Group's total interest-bearing borrowings over total assets.

Pledge of Deposits
No discounted notes (31 December 2005: HK$118,156,000), were secured by pledge of deposits (31 December

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2005: HK$35,447,000). Deposit balance of approximately HK$36,603,000 (31 December 2005: HK$18,870,000) represented the retention guarantee for factored trade receivables.

Capital Commitment and Contingent Liabilities

As at 31 December 2006, the Group had no capital commitments contracted, but not provided for (31 December 2005: HK$18,111,000). US$1.5 million was 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 proceeding has been resolved.

According to the legal opinion from the Group's PRC lawyer, the judgment in favor of T&A Suzhou. Accordingly, no provision was made for such litigation in the financial statements.

In October 2006, two subsidiaries of the Group, T&A Mobile Phones Europe SAS and T&A Mobile Phones International Limited, were involved in an European claim for disputed amount for patent royalty payment bought by a GSM essential patents holder (the "plaintiff"). The case is proceeding in the European courts as of the date of this report. No judgment or decision has been made in favor or against either party on the merit of the case.

In preparation for the potential claims against T&A Mobile Phones Europe SAS and T&A Mobile Phones International Limited, the Group has made provisions sufficiently to meet the demands pleaded by the plaintiff. The parties have engaged in settlement discussions and continue to meet to settle the disputed royalty amounts amicably.

The directors have estimated that the maximum financial impact to the Group relating to the above claim and have accrued in the Group's financial statements for the year ended 31 December 2006 to provide for the claims and proceedings. In the opinion of the directors, based on legal advice from the Company's lawyers engaged in this action, any resulting liabilities to the subsidiary of the Group regarding the aforesaid claims would not have material or adverse impact on the Group's financial position given the current provisions provided to date. Therefore, no further provision in respect of royalty payment was considered necessary to be made 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 31 December 2006. Total staff costs for the period under review were approximately HK$334 million. The remuneration policy was in line with current legislation, market conditions and both individual and company performance.