

Corporate Governance Report

The Board of Directors of the Company ("Board") aims to achieve a high standard of corporate governance and business ethics in pursuing its mission of becoming the world's leader in the multimedia industry. The Group's ultimate goal is to maximize values for its shareholders and customers, and to provide opportunities for employees.

CODE ON CORPORATE GOVERNANCE PRACTICES AND CORPORATE GOVERNANCE REPORT

In April 2005, the Board adopted the code provisions (the "Code Provisions") of the "Code on Corporate Governance Practices" set out in Appendix 14 to the Listing Rules (the "Code") as the guidelines for corporate governance of the Group, and has taken steps to comply with the Code wherever appropriate. Throughout the year ended 31 December 2006, save for the deviations discussed below, the Group complied fully with the Code.

A. DIRECTORS

AI: The Board

The Board of Directors, led by the Chairman, steers the Group's business direction. It is responsible for formulating the Group's long-term strategies, setting business development goals, assessing results of management policies, monitoring the management's performance and ensuring effective implementation of risk management measures on a regular basis.

Regular Board meetings are attended to by a majority of the directors in person or through other electronic means of communication. Besides the regular Board meetings, special Board meetings are convened from time to time for the Board to discuss major matters that require the Board's timely attention. Since the special Board meetings are concerned with the day-to-day management of the Company which often requires prompt decisions, usually only the executive directors attend.

The majority of the Board met in person at 4 regular meetings in 2006, and the Board met on 9 other occasions when a Board decision is required for major issues. Attendance of individual directors is stated in the table below.

	Attendance	
	Regular Board Meeting	Special Board Meeting
<i>Executive Directors</i>		
Mr. LI Dongsheng (<i>Chairman</i>)	3/4	6/9
Ms. LU Zhongli	4/4	6/9
Mr. HU Qiusheng (resigned on 30 June 2006)	1/2	2/5
Mr. YAN Yong, Vincent (resigned on 20 July 2006)	2/2	5/6
Mr. ZHAO Zhongyao (retired on 8 June 2006)	1/2	1/4
Mr. WANG Kangping (appointed on 8 June 2006)	2/2	4/5
Mr. SHI Wanwen (appointed on 30 June 2006)	1/2	4/4
Mr. YUAN Bing (appointed on 12 October 2006)	1/1	1/1
<i>Non-Executive Directors</i>		
Mr. Albert Thomas DA ROSA, Junior	4/4	7/9
Mr. Alastair Kenneth Ruskin CAMPBELL (re-designated as non-executive Director on 20 July 2006 and resigned on 20 March 2007)	4/4	8/9
Mr. Didier TRUTT (re-designated as non-executive Director on 20 July 2006 and resigned on 20 March 2007)	3/4	5/9

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	Attendance	
	Regular Board Meeting	Special Board Meeting
<i>Independent Non-Executive Directors</i>		
Mr. TANG Guliang	4/4	7/9
Mr. WANG Bing	4/4	4/9
Dr. HON Fongming, Perry (retired on 8 June 2006)	2/2	2/4
Mr. Robert Maarten WESTERHOF (appointed on 8 September 2006)	1/1	2/2

A2. Chairman and Managing Director

The position of Chairman is held by Mr. LI Dongsheng, while the position of CEO had been taken up by the managing director Mr. YAN Yong, Vincent prior to his resignation on 20 July 2006. Since Mr. Yan's resignation, Mr. LI has assumed the role of managing director pending the identification of a suitable candidate to succeed this role, and this constitutes a deviation from Code Provision A.2.1.

A3: Board Composition

The Board comprises 9 directors, including 5 executive directors, 1 non-executive director and 3 independent non-executive directors, after the resignation of Mr. Didier Trutt and Mr. Alastair Kenneth Ruskin Campbell as non-executive directors on 20 March 2007. The biographies of the directors are given under the section "Directors and Senior Management" of this Annual Report. None of the directors is related to each other.

The non-executive directors, half of whom are independent, play an important role on the Board. Accounting for about half of the Board members, they are experienced professionals in their respective fields. They are responsible for ensuring that the Board maintains high standards of financial and other mandatory reporting as well as providing adequate checks and balances for safeguarding the interest of shareholders and the Group as a whole.

After Dr. Hon Fongming, Perry's resignation on 8 June 2006, the Board had only 2 independent non-executive directors ("INEDs"), which constitutes a non-compliance with Listing Rule 3.10(1). Subsequently, the Company actively took steps to identify a suitable candidate to take up this vacancy, and on 8 September 2006 Mr. Robert Maarten Westerhof was appointed as an INED.

As Mr. Westerhof has had over 30 years' experience in the electronics industry, since about September 2004 until August 2006, the Company had engaged Mr. Westerhof as a consultant to give his general observations on the business sentiments and market acumens of the global electronics industry. Such services were of a general nature, and Mr. Westerhof had not been involved in any decision-making process regarding any aspect of the business of the Company or its subsidiaries. His remuneration from the Company was also rather immaterial in size. Therefore, Mr. Westerhof considers and the Company agrees that his consultancy services provided to the Company in the past are general and immaterial in nature, and thus does not affect his independence.

Save as aforesaid, throughout the rest of 2006, the Board at all times met the requirements for having at least 3 INEDs, and that at least one of them had appropriate professional qualifications of accounting or related financial management expertise. Pursuant to the Listing Rule 3.13, the Group has received a written confirmation from each INED of his/her independence to the Group. The Group considers all of the INEDs to be independent in accordance with the Listing Rules.

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A4: Appointment, Re-election and Removal Nomination of Directors

The Board has not established a Nomination Committee, and the selection and approval of new directors is undertaken by the Board. When there is a nomination to directorship, the Board will assess the suitability of the nominee and decide whether to accept the nomination. A director appointed by the Board is subject to election by shareholders at the first general meeting after the appointment.

In 2006, there were 5 Board meetings during which the Board considered matters regarding the nomination and/or appointment or re-appointment of directors, and the attendance record of the directors at these meetings is as follows:

Mr. LI Dongsheng (<i>Chairman</i>)	5/5
Ms. LU Zhongli	3/5
Mr. HU Qiusheng (resigned on 30 June 2006)	1/2
Mr. YAN Yong, Vincent (resigned on 20 July 2006)	3/3
Mr. ZHAO Zhongyao (retired on 8 June 2006)	0/1
Mr. WANG Kangping (appointed on 8 June 2006)	4/4
Mr. SHI Wanwen (appointed on 30 June 2006)	3/3
Mr. YUAN Bing (appointed on 12 October 2006)	0/0
Mr. Albert Thomas DA ROSA, Junior	4/5
Mr. Alastair Kenneth Ruskin CAMPBELL (re-designated as non-executive Director on 20 July 2006 and resigned on 20 March 2007)	5/5
Mr. Didier TRUTT (re-designated as non-executive Director on 20 July 2006 and resigned on 20 March 2007)	5/5
Mr. TANG Guliang	5/5
Mr. WANG Bing	5/5
Dr. HON Fongming, Perry (retired on 8 June 2006)	1/1
Mr. Robert Maarten WESTERHOF (appointed on 8 September 2006)	1/1

During these meetings, the Board considered the nomination of all the directors appointed within 2006 (including Mr. Wang Kangping, Mr. Shi Wanwen, Mr. Robert Maarten Westerhof and Mr. Yuan Bing), and the re-designation of Mr. Alastair Kenneth Ruskin Campbell and Mr. Didier Trutt as non-executive directors.

The Board adopted a "Procedure and Criteria for Nomination of Directors" in 2005, the details of which are set out below:

1. When there is a vacancy in the Board, the Board evaluates the balance of skills, knowledge and experience of the Board, and identifies any special requirements for the vacancy (e.g. independence status in the case of INED).
2. Prepare a description of the role and capabilities required for the particular vacancy.
3. Identify a list of candidates through personal contacts / recommendations by Board members, senior management, business partners or investors.
4. Arrange interview(s) with each candidate for the Board to evaluate whether he/she meets the established written criteria for nomination of directors. One or more members of the Board will attend the interview.
5. Conduct verification on information provided by the candidate.
6. Convene a Board meeting to discuss and vote on which candidate to nominate or appoint to the Board.

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Criteria for Nomination of Directors

1. Common Criteria for All Directors
 - (a) Character and integrity
 - (b) The willingness to assume broad fiduciary responsibility
 - (c) Present needs of the Board for particular experience or expertise and whether the candidate would satisfy those needs
 - (d) Relevant experience, including experience at the strategy/policy setting level, high level managerial experience in a complex organization, industry experience and familiarity with the products and processes used by the company
 - (e) Significant business or public experience relevant and beneficial to the Board and the company
 - (f) Breadth of knowledge about issues affecting the company
 - (g) Ability to objectively analyse complex business problems and exercise sound business judgment
 - (h) Ability and willingness to contribute special competencies to Board activities
 - (i) Fit with the company's culture

2. Criteria Applicable to NEDs/INEDs
 - (a) Willingness and ability to make a sufficient time commitment to the affairs of the company in order to effectively perform the duties of a director; including attendance at and active participation in Board and committee meetings
 - (b) Accomplishments of the candidate in his/her or her field
 - (c) Outstanding professional and personal reputation
 - (d) The candidate's ability to meet the independence criteria for directors established in the Listing Rules

In the annual general meeting ("AGM") held on 8 June 2006, all the then non-executive directors were elected to hold office for a specific term until the next AGM, subject to re-election by shareholders.

Save for Mr. Shi Wanwen, all the directors appointed in 2006, including Mr. Wang Kangping, Mr. Robert Maarten Westerhof and Mr. Yuan Bing, were elected at the first general meeting held after their respective appointments. Appointed as a director on 30 June 2006, Mr. Shi Wanwen should have been but was not subject to election by shareholders at the general meeting held on 7 August 2006, and this constitutes a deviation from Code Provision A.4.2. This has been rectified as Mr. Shi was elected by shareholders at the general meeting of the Company held on 15 February 2007.

One-third (or such number nearest to and not less than one-third) of the directors are subject to retirement by rotation at the AGM in each year. A retiring director is eligible for re-election.

A5: Responsibilities of Directors

Directors' Securities Transactions

The Group has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") contained in Appendix 10 to the Listing Rules as the code of conduct regarding the directors and relevant employees' transactions in securities of the Group. All directors have confirmed, following specific enquiry by the Group, that throughout the year 2006 they complied with the required standard set out in the Model Code for securities transactions. The directors' interests in shares of the Group as at 31 December 2006 are set out in the section "Report of the Directors" of this Annual Report.

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B. REMUNERATION OF DIRECTORS AND SENIOR MANAGEMENT

BI. The Level and Make-up of Remuneration and Disclosures

Remuneration of Directors

The Remuneration Committee was established in April 2005 pursuant to the requirements of the Code. It meets from time to time to make recommendations to the Board on the Group's policy and structure for all remuneration of directors and senior management, and on the establishment of a formal and transparent procedure for developing policy on such remuneration.

The Committee is governed by its terms of reference, which are available at the Group's website www.tclhk.com.

The Committee now consists of 3 members, a majority of whom are INEDs, namely Mr. WANG Bing, who is also the chairman of the Committee, Mr. TANG Guliang and Mr. Albert Thomas DA ROSA, Junior. Dr. HON Fongming, Perry and Ms. LU Zhongli have been members of the Committee until 8 June 2006 and 12 October 2006 respectively. After Mr. HON's resignation but before Ms. LU's resignation as members of the Committee, the Committee consisted of four members, half of whom were INEDs. This constitutes a non-compliance with Code Provision B.1.1, which was thereafter ratified upon Ms. LU's resignation.

A Committee meeting was held on 24 November 2006 which all the current 3 members Mr. WANG Bing, Mr. TANG Guliang and Mr. Albert Thomas DA ROSA, Junior attended. The work performed during this meeting includes the following:

- Management of the Company explained to the Committee the remuneration research conducted by an independent consultant and the hierarchy and remuneration package for senior management which were implemented as a result of the research.
- The Committee reviewed the emolument policy and the levels of remuneration paid to the directors and senior management of the Group.
- The Committee recommended to align the review on remuneration together with the controlling shareholder of the Company, TCL Corporation, and requested management to provide information in this regard for consideration by the Committee.

Emolument Policy and Long-Term Incentive Plan

To attract and retain talent and calibre, the Group provides a competitive remuneration package to its executive directors and senior management. This comprises basic monthly salary, guaranteed cash benefits and allowances, special allowances, variable pay and long-term incentive plan. The amount of variable pay is set at a percentage of the fixed pay, and is paid half-yearly or yearly relative to performance delivered through plans and objectives which have pre-determined criteria and standards. Long-term incentive plan primarily consists of share options. The emoluments payable to the directors are determined with reference to their duties and responsibilities with the Company and the market rate for the positions.

The remuneration package of executives is designed so that a proportion is structured to link rewards to corporate and individual performance, and gives incentives to executives to perform at the highest standards. Through job evaluation and job matching, the Group ensures the pay is internally equitable. Besides, the Group ensures external competitiveness of the pay through reference to market survey and statistics.

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The non-executive directors' compensation takes into account the time commitment and responsibilities. They receive fees which comprise the following components:

- directors' fee, which is usually paid annually; and
- share options of the Group, which are awarded subject to the discretion of the Board.

The fees and any other reimbursement or emolument payable to the Directors are set out in details in the section "Report of the Directors" of this Annual Report.

C. ACCOUNTABILITY AND AUDIT

CI: Financial Reporting

The Board is also responsible for the integrity of financial information. The directors acknowledge their responsibility for the preparation of the accounts for each financial period which give a true and fair view of the state of affairs of the Group and of the results and cash flows for that period.

As at 31 December 2006, the Group had net current liabilities of approximately HK\$1,010 million that included bank loans of approximately HK\$1,115 million (the "Syndication Loans") which were repayable on demand due to the breach of certain financial covenants of the relevant bank loan agreements. The Group also incurred a loss attributable to equity holders of the parent of approximately HK\$2,497 million for the year ended 31 December 2006.

In order to strengthen the capital base of the Group and to improve the Group's financial position, immediate liquidity and cash flows, or otherwise to sustain the Group as a going concern, the directors of the Company have taken the following measures:

- (i) On 12 October 2006, the Company, TTE Corporation ("TTE"), a wholly-owned subsidiary of the Company, and TTE Europe SAS ("TTE Europe"), a wholly-owned subsidiary of TTE (collectively the "TCL Parties"), entered into a settlement term sheet with Thomson S.A. ("Thomson") and certain of its subsidiaries (collectively the "Thomson Parties") regarding the resolution of the Group's loss-making European operation (the "EU Business"), which was mainly conducted by TTE Europe, whereby the TCL Parties and the Thomson Parties have agreed to certain reciprocal concessions to alleviate the financial difficulties of the EU Business and pave the way for an amicable winding-down of this loss-making EU Business.
- (ii) On 15 May 2007, the Company announced its plan to raise not less than approximately HK\$781 million (before expenses) by issuing not less than approximately 1,951 million new ordinary shares of the Company (assuming no outstanding options of the Company are exercised on or before 21 June 2007) and to raise not more than approximately HK\$808 million by issuing not more than approximately 2,019 million new ordinary shares of the Company (assuming all outstanding options of the Company are exercised on or before 21 June 2007) at a subscription price of HK\$0.4 per share (the "Rights Share") on the basis of one Rights Share for every two existing shares (the "Rights Issue"). Any Rights Share not taken up by the existing shareholders will be fully underwritten by T.C.L. Industries pursuant to the terms of the Underwriting Agreement dated 15 May 2007.
- (iii) On 17 May 2007, TCL Corporation gave an undertaking to the Company that TCL Corporation together with T.C.L. Industries and TCL Finance, would make available to the Group loans of not less than HK\$469 million, in aggregate, at each month end for the period from 17 May 2007 to 30 June 2008 or the date on which the issuance of convertible bonds discussed in (iv) below is completed, whichever is earlier.

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- (iv) On 18 May 2007, the Company entered into a purchase agreement (the "Purchase Agreement") with Deutsche Bank AG, London (the "Purchaser"), whereby the Company agreed to issue and the Purchaser, subject to the satisfaction of the conditions precedent of the Purchase Agreement, agreed to subscribe and pay for or to procure subscribers to subscribe and pay for the secured convertible bonds due 2012 (the "Bonds") with an aggregate principal amount of US\$140 million (equivalent to approximately HK\$1,095 million).

In the opinion of the directors of the Company, in light of the measures taken to date, together with the expected results of the fund raising exercises in progress, the Group will have sufficient working capital for its current requirements and it is reasonable to expect the Group to return to a commercially viable going concern. Accordingly, the directors of the Company are satisfied that it is appropriate to prepare the financial statements on a going concern basis, notwithstanding the Group's financial and liquidity position at 31 December 2006.

C2: Internal Controls

Each year, the Audit Committee of the Company reviews the findings made by the external auditors in respect of issues encountered by them in preparation of the audit report, which often cover issues relating to internal control. The Committee also reviews the internal control report submitted by the Company's internal audit department. The Committee will then review the actions performed or the plans to be carried out by the management in addressing the issues. The issues identified and the corresponding remedial plans and recommendations are then submitted to the Board for consideration. For the year of 2006, no critical internal control issues have been identified and efforts have been made in implementing changes to resolve the issues in questions.

C3: Audit Committee

The Audit Committee is accountable to the Board and assists the Board in meeting its responsibilities in ensuring an effective and adequate system of internal controls and for meeting its external financial reporting obligations and compliance with other legal and regulatory requirements. The Committee also reviews and monitors the scope and effectiveness of the work of external auditors.

The Audit Committee currently comprises 3 members, namely Mr. TANG Guliang, Mr. WANG Bing and Mr. Albert Thomas DA ROSA, Junior, while Dr. HON Fongming, Perry has been a member until he retired on 8 June 2006. Mr. TANG Guliang is the chairman of the Committee. He is a certified public accountant in the PRC and a professor at Beijing Technology and Business University. The Committee meets at least 4 times a year to review the Group's quarterly, interim and annual results.

During year 2006, the Committee met 6 times, and details of the members' attendance are as follows:

	Attendance
Mr. Albert Thomas DA ROSA, Junior	6/6
Mr. TANG Guliang	6/6
Mr. WANG Bing	5/6
Mr. HON Fongming, Perry (retired on 8 June 2006)	2/2

Other attendees at the Audit Committee meetings include the Group's financial controller, the vice general manager, and the external auditors for discussion of the audit of the annual results only.

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The work completed by the Audit Committee during 2006 included consideration of the following matters:

- the completeness and accuracy of the 2005 annual and 2006 quarterly and interim financial statements;
- the Group's compliance with statutory and regulatory requirements;
- developments in accounting standards and the effect on the Group;
- the audit report submitted by the external auditors summarizing matters arising from their audit of the Group for year 2005;
- the audit fees payable to external auditors, the scope and timetable of the audit for year 2006;
- recommendations to the Board, for the approval by shareholders, for the reappointment of Messrs. Ernst & Young as the external auditors, which the Board agreed and accepted;
- recommendations to the Board to close down the European business upon review of its prospects and the substantial loss incurred; and
- review of the Group's ability to continue operation as a going concern upon breach of certain financial covenants under two loan agreements, the lending banks of which were entitled to declare that the outstanding loans were immediately due and payable.

For the year under review, the remuneration paid for services provided by the auditors is roughly as follows:

Audit services	HK\$20,494,000
Non-audit services (which include taxation compliance and agreed upon procedures)	HK\$6,453,000

D. DELEGATION BY THE BOARD

D1: Management functions

The types of decisions which are to be taken by the Board include those relating to:

- corporate and capital structure;
- corporate strategy;
- significant policies affecting the Group as a whole;
- business plan, budgets and public announcements;
- delegation to the Chairman, and delegation to and by Board Committees;
- key financial matters;
- appointment, removal or reappointment of Board members, senior management and auditors;
- remuneration of directors and senior management; and
- communication with key stakeholders, including shareholders and regulatory bodies

D2: Board Committees

Executive Committee

The Board established the Executive Committee in October 2005 with specific written terms of reference, which are available at the Group's website www.tclhk.com. The Board has delegated responsibilities to the Executive Committee for making certain decisions for the management of the Group.

E. INVESTOR RELATIONS

The Company endeavours to uphold a high level of corporate transparency. Keeping shareholders, investors, analysts, bankers and other stakeholders informed of our corporate strategies and business operations has been one of the key objectives of our investor relations team.

Headed by the chief financial officer, the investor relations team receives full support from the Company. It maintains close contact and interactive dialogue with its key communication groups via different channels such as one-on-one meetings with analysts and fund managers, corporate presentations, teleconferences, company visits, press conferences and distribution of press releases.

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To offer investors accurate information to investors and shareholders on a timely and fair disclosure basis, a series of public events were hosted by directors and senior management right after results announcements. These served as interactive platforms for the management to address questions from investors and the media.

The Company has a diversified shareholding structure with a 61% public float. Details are shown in the section entitled "Corporate Structure"

Key investor events in 2006

Events	Date
Extraordinary General Meeting ("EGM") (Proposed increase in authorized share capital, continuing connected transactions and re-election of directors)	27 February
EGM (Financial Service Framework Agreement)	13 April
2005 Annual and 2006 1st Quarter Results Announcement – Press Conference and Analyst Briefing	27 April
2006 AGM	8 June
2006 Interim Results Announcement – Press Conference and Analyst Briefing	30 August
2006 3rd Quarter Results Announcement – Investor Conference Call	20 October

Going forward, the investor relations team will continue to work diligently to maintain the highest level of corporate transparency. To facilitate easy access to the Company's latest corporate developments, all published information of the Group, including statutory announcements, corporate presentations, press releases and event calendars is promptly posted on the corporate website www.tclhk.com. Enquiries can also be sent to the Board or senior management by contacting the Investor Relations Department at telephone +852 2437 7481 or via email to hk.ir@tcl.com, or directly through the questions and answers session at shareholder meetings.