Management Discussion and Analysis

BUSINESS REVIEW

Overview

The consolidated turnover and profit of the Group for 2001 were primarily derived from the following subsidiaries:

Name of subsidiary	Percentage of equity held by the Group	Principal activities
Shenzhen Shennan Circuit Corporation ("Shennan")	95.00%	Manufacture and sale of printed circuit boards ("PCB")
Shenzhen Tian Ma Microelectronics Co., Ltd. ("Tian Ma")	59.85%	Manufacture and sale of liquid crystal displays ("LCD")
Shenzhen Fiyta Holdings Limited ("Fiyta")	52.24%	Manufacture and sale of mid-to high-end timepieces

In 2001, the Group recorded a consolidated turnover of approximately RMB829,038,000, a decrease of approximately 9.96% over last year. Consolidated profit attributable to shareholders was approximately RMB52,939,000, a decrease of approximately 23.78% over last year. During the year, PCB operations contributed further significant profit.

The analysis of the Group's turnover and contributions to profit for 2001 by principal activities and the comparative figures for 2000 were as follows:

Turnover by activity	2001	2000
PCB	**28.62%**	25.43%
LCD	**34.16%**	34.69%
Timepieces	**19.49%**	19.17%
Other activities	**17.73%**	20.71%
Total	**100%**	100%

Contributions to profit by activity (before allocation of Corporate expenses to respective segments)	2001	2000
PCB	**80.73%**	74.67%
LCD	**8.30%**	18.01%
Timepieces	**12.22%**	20.86%
Other activities	**–1.25%**	–13.54%
Total	**100%**	100%

PCB

Turnover of the PCB operations of the Group for the year was RMB237,252,000, representing a 1.34% increase over the previous year, and its net profit after minority interests declined by 13.41% year on year to RMB62,316,000.

Overshadowed by the disillusionment in the network economy, the global electronic industry experienced a substantial decline, sending chills to the overall PCB industry. Though the major customers of the Group's PCB operations are telecommunication equipment manufacturers, who were only slightly affected by the aforesaid factors, investments in domestic telecommunication infrastructure were materially influenced by the implementation of the China Telecom spin-off program during the year, resulting in decreased orders from telecommunication customers. The Group's output of PCB for the year was 113,000 sq. meters, representing a 24.67% decline over the previous year. Orders from Europe and America experienced a substantial decline during the year. Nevertheless, new orders from Hong Kong and Southeast Asia partially balanced the decrease in orders from Europe and America.

During the year, the product structure was further optimized and sales of multi-layered boards amounted to RMB184,000,000, which was a 26.9% increase over the previous year and accounted for 80.79% of the sales of PCB as compared with 61.97% over the same period last year. Though the output of PCB decreased significantly, its sales still recorded a slight increase of 1.34% this year due to the increase in the proportion of multi-layered boards.

Clouded by the overall depression in the industry, the price competition for PCB this year was more intensive as compared with that in the past few years. The average sales price of PCB products decreased approximately 20% over last year. In spite of lower prices of major raw materials and substantial increase in the proportion of high value-added multi-layered boards during the period, the overall gross profit margin still dropped by 5.93% over last year.

The Group completed the major parts of its PCB expansion project by the mid of 2001 which enabled an annual output capacity of 250,000 sq. meters with substantially upgraded products. During the year, the Group's characteristic impedance PCB obtained the new products accreditation of Shenzhen Science and Technology Bureau.

Gross Profit Margin

	2001 ***RMB'000***	2000 *RMB'000*	1999 *RMB'000*
Turnover	**237,252**	234,122	147,915
Cost of sales	**169,051**	152,918	102,273
Gross profit	**68,201**	81,204	45,642
Gross profit margin	**28.75%**	34.68%	30.86%

Market structure

	2001	2000	1999
PRC	**89.82%**	89.40%	75.06%
Europe and America	**1.38%**	10.60%	21.59%
Southeast Asia	**8.80%**	–	3.35%
Total	**100%**	100%	100%

Product structure

Sales by number of PCB layers	**2001**	2000	1999
Double-layered boards	**19.30%**	38.03%	59.36%
Multi-layered boards	**80.70%**	61.97%	40.64%
Total	**100%**	100%	100%

Sales by product applications	**2001**	2000	1999
Telecommunications equipment	**79.46%**	87.56%	83.37%
Electronic devices	**15.17%**	10.03%	15.40%
Others	**5.37%**	2.41%	1.23%
Total	**100%**	100%	100%

LCD

Turnover and net profit after minority interests of the LCD operations for the year were approximately RMB283,202,000 and RMB6,410,000 respectively, representing respective decreases of approximately 11.33% and 63.07% over last year.

During the year, the Group's LCD operations were adversely affected by the substantial decline in global information product and electronic industry, resulting in the decreasing orders quarter by quarter since the second quarter. Market environment worsened especially after the "911 Event" in the USA. During the year, demand for mid- to low-end Twisted Nematic Liquid Crystal Displays (TN-LCD) products decreased substantially, whereas sales in TN-LCD focused Hong Kong declined by 20% with a decrease of 20%-30% in price, which directly diminished the overall results of LCD operations and its product gross profit margin for the year.

Facing such an adverse market situation, the Group was committed to upgrade its products, optimize products structure, and strengthen marketing of mid- to high-end TN-LCD and STN-LCD products, with the focus on development of COG (Chip on Glass) and TAB (Tape Automatic Bonding) modules. After the COG module production line was in stable production condition, the Group introduced the TAB module production line. Presently, the monthly output of modules has reached 200,000 pieces. Sales from module products for the year increased by 60% year on year, partly protecting the results from a substantial decline. During the year, the Group received orders for batch production of modules from multiple mobile phone manufacturers in the PRC.

During the year, Tian Ma's quality management level was further enhanced and it was granted a QS9000 certificate issued by Germany's TÜV, becoming the only company granted a certificate of this kind in its industry in the PRC so far.

In early 2001, Tian Ma completed a public offer of 16,500,000 A Shares in the PRC and raised net proceeds of RMB352,981,000. During the year, Tian Ma applied part of the proceeds in setting up a color STN-LCD production line and in expansion of a module production line.

Gross Profit Margin

	2001	2000	1999
	RMB'000	*RMB'000*	*RMB'000*
Turnover	**283,202**	319,375	271,812
Cost of sales	**232,576**	248,634	220,753
Gross profit	**50,626**	70,741	51,059
Gross profit margin	**17.88%**	22.15%	18.79%

Market structure

	2001	2000	1999
PRC	**33%**	29%	30%
Guangdong Province	**20%**	17%	18%
Other regions	**13%**	12%	12%
Hong Kong	**35%**	45%	35%
Europe and America	**30%**	24%	34%
Southeast Asia	**2%**	2%	1%
Total	**100%**	100%	100%

Product structure

Sales by product	2001	2000	1999
STN-LCD	**19%**	24%	21%
TN-LCD	**44%**	55%	66%
Liquid crystal display modules ("LCM")	**37%**	21%	13%
Total	**100%**	100%	100%

Sales by product applications	2001	2000	1999
Telecommunications equipment	**28%**	30%	20%
Electrical household appliances	**26%**	15%	35%
Apparatus and devices	**41%**	40%	35%
Electronic games machines	**5%**	15%	10%
Total	**100%**	100%	100%

Timepieces

The Group's turnover and net profit after minority interests for the timepiece operations for the year were approximately RMB161,593,500 and RMB9,433,000 respectively, representing respective decreases of approximately 8.44% and 53.08% over the previous year.

In 2001, the Group's management, after prudent consideration, made a provision of approximately RMB7,500,000 for stagnant inventory and bad trade receivables of the timepiece operations resulting in substantial drop in its net profit.

During the year, demand for the timepiece industry market saw no significant improvement. In the year, the Group reshuffled its major distribution network and actively strengthened the recovery of trade receivables and disposal of inventories. Meanwhile, the Group attached importance to the operation of brand name "Fiyta", particularly technical innovation in product design and development.

During the year, the Group set up four new timepiece chain stores in the cities of Kunming, Lanzhou, Xi'an and Urumchi. The Group has two chain stores in Urumchi so far.

Gross Profit Margin

The gross profit margin of mid- to low-end timepieces increased about 5%. However, as a result of the decreases in the gross profit margins of high-end timepieces and the heavy weight of the high-end timepieces in the product sales structure, the gross profit margin of the timepieces operations for the year went down by approximately 5%.

	2001	2000	1999
Gross profit margin of high-end timepieces	**52.18%**	53.18%	54.71%
Gross profit margin of mid-to low-end timepieces	**29.75%**	24.70%	26.86%

	2001	2000	1999
	RMB'000	*RMB'000*	*RMB'000*
Turnover	**161,594**	176,491	179,559
Cost of sales	**102,304**	102,365	95,166
Gross profit	**59,290**	74,126	84,393
Gross profit margin	**37%**	42%	47%

Market structure

During the year, the Group's timepiece operations were mainly located in the PRC with no noticeable changes in respect of market structure.

Prospects for 2002

The Group is cautiously optimistic about the prospects for 2002 with respect to its principal operations.

Subsequent to the eleventh rate cut of US during the year 2001, economic releases show that the US economy is reviving gradually. The PRC also announced a rate cut in early 2002 and indicated that it would continue to adopt positive fiscal and stable monetary policies in adjusting the policy for the reallocation of revenue in order to further stimulate the swift growth of consumption. Hence, it is expected that high economic growth will be maintained in 2002.

With respect to the mid- to long term, the Group is of the view that the business demands for telecommunication, consumer electronic products, computer and mobile phone will continue to increase. After the accession of the PRC into the WTO, it is expected that the advantages of manufacturing cost in China and the robust growth of economy will attract more and more electronic product manufacturers to produce or purchase in the PRC, which will contribute to further market potential for the Group's major business. Meanwhile, more international competitors will be motivated to develop in China. Over the past years, the Group was committed to improving its technical level and the quality of the products, and expanding the production scale at an appropriate time to enhance its competitiveness. For the coming years, the Group will adhere to its consistent strategy and further invest in product research and development, and seize market opportunities actively for further development.

PCB

Following the completion of the Group's expansion project of PCB operations, a significant improvement in the Group's production capacity was shown. The Group will further enhance the auxiliary production capacity of inner layer of multi-layered PCB as a result of its significant increases in the proportion of multi-layered boards. As required by its customers, the Group will continue to enhance the capacity of design and batch production for such high value-added products as characteristic impedance PCB, special PCB and HDI-PCB, so as to improve the product structure of the Group's PCB operations. In order to further improve product quality of the Group's PCB, Shennan passed the QS9000 Quality Systems certification by DNV (Norway) in early 2002.

Looking forward, domestic PCB industry will see further development in the new year. According to the information provided by China PCB Association, the current output of PCB in China accounts for less than 10% of the overall output worldwide, indicating a positive prospect for development potential. A number of foreign manufacturers have focused their investments in the industry in China mainland or expanded their production facilities. It is predicted that China will see swift development in the PCB industry amid increasing competition.

In the new year, the Group will aggressively develop new customers and establish extensive cooperation with some international purchasers and OEM. Meanwhile, with foothold in the domestic telecommunication equipment market, the Group will continue to exploit its advantages in quick reaction and timely service, to meet the personalized demand of its customers. China Telecom will complete its spin-off program in 2002, and the Group is expected to benefit from the expected apparent increase in the investment in telecommunication infrastructure network.

Raw material prices are expected to rebound slightly in 2002 as they posted a considerable decline during the year. However, the prices of PCB are likely to drop further as required by customers. Only by improving technical level and product structure and grades can the Group maintain sound profitability. The Group believes that its PCB operation has a positive prospect of development based on its considerable production scale and technical level.

LCD

In the new year, the Group will continue the construction of the color STN-LCD production line to further expand the COG-LCM and TAB-LCM production lines and to introduce a COF-LCM production line. Upon completion of the whole project, the Group's STN-LCD production capacity will be nearly doubled and the production capacity of module products will be able to reach approximately 800,000 pieces per month with enhanced technical level. However, the STN-LCD production line and the expanded module production line will not be completed and put into batch production until the end of 2002. Accordingly no immediate contribution to the Group's LCD operations is expected in the new year.

In 2002, the Group will continue to adjust the distribution strategy for LCD products and expand the sales channels, with a focus on development of the domestic market, especially the high-end LCD module market for such products as mobile phone, PDA, etc. Meanwhile, the Group will gradually reduce the proportion of low-end TN-LCD products and aggressively expand foreign markets for its mid- to high-end TN, STN-LCD and module products.

The Group will continue to adopt effective measures to strengthen cost control and increase investments in new products and technology development as well as development efficiency. The Group will strictly implement the QS9000 quality assurance system and enhance its comprehensive competitive edge in the quality and technology of its LCD operations.

TIMEPIECES

It is expected that there will be no significant changes in the market situation of the domestic timepieces market in 2002 after the accession of China into WTO.

The Group will, under the policy of "seeking force with focus and proficiency, and obtain success with the force", continue to sustain the market image of "Fiyta" as a domestic mid- to high-end brand name of timepieces by improving the technology in new product development and continuously enhancing and optimizing its sales and distribution network.

Riding on the existing chain stores and past operation experiences, the Group will continue to conduct market research actively and be prudent in establishing new shops so as to maintain an optimal pace of expansion of its timepiece chain stores, and form a network of timepiece chain stores in major cities throughout the country.

After the approval by the State Asset Bureau and completion of the partial disposal of its stake in Fiyta by the Company to Peking University Founder Group Corporation ("Peking Founder"), Fiyta will form a joint venture with a wholly owned subsidiary ("Founder Subsidiary") of Founder Holdings, a Hong Kong listed branch of Peking Founder, to launch information products distribution operations and system integration operations.

FINANCIAL REVIEW

Capital Structure

During the year, the Group's Debt-to-equity ratio dropped substantially as a result of the proceeds of approximately RMB352,000,000 from additional new issue by Tian Ma and the Group's strengthened control of fund application.

	2001	2000
	RMB'000	*RMB'000*
Total loans	**255,797**	438,328
Total liabilities (excluding minority interests)	**485,660**	733,832
Minority interests	**586,828**	414,989
Shareholders' equity	**1,238,330**	1,035,256
Total assets	**2,310,818**	2,184,077
Loan-to-equity ratio	**20.66%**	42.34%
Debt-to-equity ratio	**39.22%**	70.88%

Loan-to-equity ratio = total loans at the year end/shareholder's equity at the year end.

Debt-to-equity ratio = total liabilities at the year end/shareholders' equity at the year end.

Liquidity and Capital Resources

As at 31st December, 2001, the Group had cash and bank deposits totaling RMB864,162,000, which were mainly derived from the following sources:

- Cash and bank deposits at the beginning of the year;
- Proceeds from new issue by Tian Ma;
- Revenue from operating activities.

As at 31st December, 2001, the Group's total short-term loans were RMB255,797,000 with floating interest rates ranging from 5.36% to 6.435% per annum.

Capital expenditure by the Group in 2001 amounted to approximately RMB160,962,000, of which RMB77,356,000 and RMB47,579,000 were applied for the purchase of production equipment for the PCB and LCD operations respectively. During this period, Fiyta invested approximately RMB28,207,000 in the construction project of Fiyta Mansion in Shenzhen Hi-tech Zone and a newly established watch chain store.

The Group's capital expenditure for 2002 is estimated to be approximately RMB490,000,000, of which approximately RMB48,000,000 and RMB370,000,000 will be used for the purchase of additional production equipment for the PCB and LCD operations respectively, and RMB60,000,000 will be invested in the construction project of Fiyta Mansion in Shenzhen Hi-tech Zone. Planned capital expenditure will be financed by bank deposits, the proceeds from a shares issue by Tian Ma and the cash inflows from the Group's operating activities.

Others

As the majority of the Group's products are sold in the PRC and exports sales are settled in US dollars or Hong Kong dollars, the Group does not have any significant foreign exchange risk.

As at 31st December, 2001, the Group did not have any significant contingent liabilities save as those disclosed in the accounts.

OTHER SIGNIFICANT EVENTS

Tian Ma's public offer of new shares

– In the first quarter of 2001, Tian Ma completed its public offer of new shares and listing of the new shares. 16,500,000 shares of RMB1 each were offered under the public offer at RMB22.00 (approximately HK$20.75, HK$1=RMB1.06, the same in what follows) per share. Net proceeds (after deduction of expenses) from Tian Ma's public offer of new shares were approximately RMB352,981,000 (approximately HK$333,001,000). Such proceeds are intended to be applied for the following purposes:

– as to approximately RMB197,880,000 (approximately HK$186,679,000) for the purchase of a color STN-LCD production line;

– as to approximately RMB80,000,000 (approximately HK$75,472,000) for the expansion of the LCM production lines;

– as to approximately RMB75,101,000 (approximately HK$70,850,000) for the general working capital of Tian Ma.

After the completion of Tian Ma's public offer, the Company still held approximately 79,464,000 shares in Tian Ma, representing approximately 59.85% of the enlarged issued share capital of Tian Ma.

The new shares of Tian Ma were listed on the Shenzhen Stock Exchange on 23rd February, 2001.

Pursuant to Paragraph 19(1)(a)(ii) of the Listing Rules and Paragraph 5.5 of Practice Note 13, the transaction involving Tian Ma's issue of new shares constituted a material dilution of the interests in a major subsidiary which required the approval by an extraordinary general meeting before implementation. The public offer of new shares by Tian Ma was approved by the extraordinary general meeting of the Company.

SIGNIFICANT SUBSEQUENT EVENTS

Disposal of Fiyta Shares

The Company and Peking Founder entered into an agreement on 7th December, 2001 to dispose 72,302,000 unlisted shares of Fiyta to Peking Founder. The disposed shares accounted for approximately 29% of Fiyta's total issued share capital. The total consideration payable by Peking Founder was approximately RMB206,495,083 (approximately HK$194,806,682), which will be paid in cash.

Upon completion of the disposal, Fiyta will ceased to be a subsidiary of the Company, and Peking Founder and the Company will become two largest single shareholders of Fiyta, holding 29% and 23.24% of the total issued share capital of Fiyta respectively. The Company now intends to hold the remaining 23.24% interest in Fiyta. Upon completion of the disposal, three of the seven directors will continue to be nominated by the Company.

Pursuant to chapter 14 of the listing rules, the disposal constituted a major transaction. The Company has obtained a written approval from CATIC Shenzhen Company ("CATIC Shenzhen") in respect of the disposal. CATIC Shenzhen is the controlling shareholder of the Company, holding over 50% of shares entitled to attend and vote in the Company's general meeting. CATIC Shenzhen has no interest in the disposal. The Company has applied to the Stock Exchange for exemption from holding a general meeting with the written approval given by CATIC Shenzhen.

However, the disposal shall be subject to the approval by the State Assets Bureau without any additional terms or deletion of any terms of the agreement. As at the date of this annual report, the Company has not been granted the approval and the agreement has not formally come into effect.

Fiyta and Founder proposed to set up a joint venture

Fiyta entered into a structural agreement on 7th December, 2001 with Founder Subsidiary, pursuant to which, Fiyta and Founder Subsidiary principally agreed to form a joint venture company ("Joint Venture") which will engage in development and sales of software and hardware and system integration business. The structural agreement is subject to further formal contracts between the two parties regarding the joint venture. The Joint Venture will have a registered capital of RMB100,000,000, and Fiyta will hold a 60% shareholding in the Joint Venture.

Up to the date of this annual report, the parties thereto have not entered into any formal contract on the Joint Venture.