Management Discussion and Analysis

BUSINESS REVIEW

Overview

The consolidated turnover and profit of the Group for 2004 were primarily derived from the following subsidiaries:

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

In 2004, the Group recorded a consolidated turnover of approximately RMB1,757,642,000, representing an increase of approximately 48.83% over the previous year. The overall gross profit posted approximately RMB419,586,000, increased by 47.76% over the previous year. In view of developing the Group's electronic business during the year, the Group established a strategic alliance with one of the major purchasers of its LCD products, namely Amoi Electronics Company Limited ("Amoi"), whose A shares are listed and traded on the Shanghai Stock Exchange, and strategically held certain listed shares of Amoi. However, under the negative impacts from the sluggish stock market in the PRC and the declining price of mobile telecommunication terminal products, the stock price of Amoi was in a downward trend. The Group stated such stock investment at its fair value as at the end of the year, resulting in a loss of approximately RMB87,993,000, and thus making the overall performance of the Group to record a consolidated loss attributable to shareholders (after minority interests) amounted to approximately RMB20,609,000 (compared with a net profit of approximately RMB44,776,000 for the previous year). Nevertheless, the development of the Group's operations was on the track with the same gross profit margin comparable with that of the previous year. Excluding the above nonroutine loss stated, the Group's consolidated profit attributable to shareholders amounted to approximately RMB65,052,000.

The analysis of the Group's turnover and contributions to profit for 2004 by principal activities with the comparative figures for 2003 are as follows:

Turnover by activities	2004	2003
LCD	**60.67%**	53.66%
PCD	**20.00%**	22.98%
Timepieces	**14.27%**	17.64%
Other activities	**5.06%**	5.72%
Total	**100%**	100%

Contributions to profit by activities (before allocation of expenses to respective segments)	2004	2003
LCD	**47.68%**	51.89%
PCB	**60.60%**	45.50%
Timepieces	**0.13%**	5.93%
Other activities	**-8.41%**	-3.32%
Total	**100%**	100%

LCD

The turnover of the LCD operations of the Group for the year was approximately RMB1,066,291,000, representing a 68.24% increase over last year, and its net profit (after minority interests) increased by 18.03% to approximately RMB40,155,000 over previous year.

Following the market breakthrough of its mobile phone display module products in the previous year, the Group's LCD operations established extensive, stable and rational customer relationships with major domestic mobile phone manufacturers during the year. At the same time, in response to the change in the LCD market and customer demands, the Group promptly adjusted its market strategy, captured the market opportunities offered by screen colorization of mobile phones, enhanced its new product design and development capacity in a timely manner, expanded its production and delivery capacity of color display module products, and achieved a rapid growth in sales of mobile phone display module products, thus promoting a significant overall growth in the sale of LCD operations. This year the sales revenue of LCD module increased 86% over the previous year and represented approximately 80% to the overall sales of LCD operations, 50% was sales of the mobile phone display module and approximately 35% was color screen sales to the overall sales of LCD operations. The Group made a provision of approximately RMB23,774,000 for inventory impairment for the year. As a result, LCD operations recorded only a 20% growth in net profit as compared with the previous year.

The color STN-LCD production line invested by the Group was successfully put into batch production during the first half of the year. This became a new area of business growth of the Group's LCD operations. In addition, the color LCD module production line, expanded in response to the market demand of high-end mobile phone, was put into batch production, and the marketing of color STN-LCD module and TFT-LCD module, and the world's latest quick response color STN-LCD module product, namely "Super Fast Display Modules", jointly developed with manufacturer in Korea, was launched during the year. The LCD operations also successfully completed the implementation of Enterprise Resources Planning ("ERP") system in the year.

During the year, the Group successfully established a mobile station of LCD post-doctorate (液晶顯示專業博士後流動站) with the approval by the Ministry of Personnel, the PRC, while the "Research and Development of Color STN-LCD" project passed the technological achievement appraisal conducted by Shenzhen Municipal Science and Technology Appraisal Committee (深圳市科學技術評審委員會) and was recommended for the election of "Science and Technology Progress Award in Guangdong Province".

Gross Profit Margin

	2004	2003	2002
	RMB'000	*RMB'000*	*RMB'000*
Sales income	**1,066,291**	633,780	327,574
Cost of sale	**834,836**	494,385	254,242
Gross profit	**231,455**	139,395	73,332
Gross profit margin	**21.71%**	21.99%	22.39%

Market Structure

	2004	2003	2002
PRC	**62%**	60%	30%
Hong Kong	**12%**	13%	25%
Europe and America	**21%**	27%	35%
Southeast Asia	**5%**	–	10%
Total	**100%**	100%	100%

Product Structure

	2004	2003	2002
Telecommunications equipment	**60%**	69%	23%
Electrical household appliance	**12%**	6%	23%
Apparatus and devices	**10%**	25%	46%
Others	**18%**	–	8%
Total	**100%**	100%	100%

PCB

The turnover of the PCB operations of the Group for the year was approximately RMB351,574,000, representing a 29.52% increase over last year, and its net profit (after minority interests) increased by 71.05% to approximately RMB51,032,000 over the previous year.

In the first half of the year, the faster pace of growth in investment in telecommunication facilities was followed by the rapid economic growth in the PRC while the raw materials' price surged due to a shortage of supply. However, in the second half of the year, the purchase orders from customer worldwide especially domestic telecommunication equipment manufacturers recorded a significant overall decline when the demand from global communication industry dropped and the macro-economic control was implemented in the PRC. In response to the change in demand of the telecommunication equipment market, the Group expanded the productivity of PCB and kept enhancing product quality and production efficiency in a timely manner during the first half of the year. In the second half of the year, the Group shifted to manufacture and deliver higher value-added high-end products with larger sizes. Besides, the Group continued its efforts to expand the market for its non-telecommunication equipment products (especially overseas high-end product market) and to improve its product and customer structure throughout the year. The sales revenue and profit from PCB operations for the year recorded overall an increase of 29.52% and 71.05% respectively over the previous year.

The Group's PCB output for the year was approximately 182,000 sq. m., decreasing by 6% over the previous year. This was mainly attributable to the adjustment of product structure with the output of higher value-added multi-layered products going up 10% over last year and its proportion in sales revenue increased to 92% (comparing with 87% in the previous year). Due to the Group's efforts on intensification of the internal market mechanism, optimization of the operating process, enhancement of cost control and adjustment of product structure, the consolidated gross profit margin of PCB operations reached 28% for the year, representing a 6% increase over the previous year.

Management Discussion and Analysis

During the year, further expansion of the overall production capacity of PCB operations was achieved through the optimization of the key production procedures and addition of inner layer PCB boring equipment. In addition, the Group enhanced its research and development on PCB operations. The high-frequency multilayered PCB made from blend & pressing materials, a product developed by the Group, was given a “Second Class Award for Advanced Technology in Shenzhen for 2004”, and was recognized as a “New Key Product of Shenzhen Municipality”.

Gross Profit Margin

	2004	2003	2002
	RMB’000	*RMB’000*	*RMB’000*
Sales income	**351,574**	271,449	216,129
Cost of sale	**253,232**	212,513	170,355
Gross profit	**98,342**	58,936	45,744
Gross profit margin	**27.97%**	21.71%	21.18%

Market Structure

	2004	2003	2002
PRC	**84.00%**	91.81%	88.04%
Europe and America	**5.50%**	7.33%	7.13%
Southeast Asia	**10.50%**	0.86%	4.83%
Total	**100%**	100%	100%

Product Structure

	2004	2003	2002
Telecommunications equipment	**75.53%**	84.72%	86.48%
Electronic devices	**6.84%**	7.67%	3.59%
Others	**17.63%**	7.61%	9.93%
Total	**100%**	100%	100%

Timepieces

The turnover of the timepiece business of the Group during the year was approximately RMB250,902,000, representing an increase of 20.45% as compared with the previous year and the net profit (after minority interests), was approximately RMB106,000, representing a decline of approximately 97.27% compared with the previous year.

The timepiece market in the PRC remained competitive during the year. During the year, the sales income from timepiece business recorded a substantial increase. As the Group focused efforts on developing its timepiece terminal outlets, strengthening the design and development of its new products, restructuring of internal procedures, and promoting brand marketing in a vigorous and continual manner. However, the profit margin of the Group's timepiece business reduced compared with that of the previous year, due to factors including the adjustment of sales structure, the establishment of operating new outlets and the launch of promotion activities, and as a result, the overall performance of the timepiece business was affected. During the year, in collaboration with Qinghua University, the Group successfully organised the first "Fiyta Timepiece Design Contest" in several tens of colleges on the mainland. Meanwhile, active effort were made to develop a cooperative relationship between "Harmony" and international brands, and a strategic cooperation relationship between "Harmony" and Mainland famous brands, such as "Beijing Harmony" and "Sanlian" (三聯); hence a significant enhancement of the brand value and brand influence of the timepiece business of the Group.

During the year, the number of "Harmony" chain stores increased to 36.

Gross Profit Margin

	2004 ***RMB'000***	2003 *RMB'000*	2002 *RMB'000*
Sales income	**250,902**	208,303	151,524
Cost of sale	**169,856**	133,928	96,180
Gross profit	**81,046**	74,375	55,344
Gross profit margin	**32.30%**	35.71%	36.52%

	2004	2003	2002
The gross profit margin of high-end timepieces	**53.48%**	50.70%	59.66%
The gross profit margin of low-to middle-end timepieces	**16.03%**	15.14%	16.74%

PROSPECT FOR 2005

The Group is optimistic about the prospect for its main businesses in 2005.

In 2004, the PRC Government adopted a series of macro-economic control measures to curb the economic overheating caused by excessive fixed assets investment; the GDP increased by 9.5%, and the economy basically grew steadily and relatively rapidly. In 2005, the PRC Government will continue to enhance and improve the macro-economic control to maintain a steady economic development. Although some factors, such as rise in raw material prices, will persist, given the impetus provided by the growing domestic consumption and demand, as well as the positive effect of the continuing export growth, the main businesses of the Group may continue to grow at a relatively fast pace.

In 2005, adjustment in the portfolio of the existing investment business will be made for the development strategies in the long run, with emphasis on and enhancement in the investment to existing business with market predominance, in order to further strengthen the core competitiveness of favourable businesses and establish long lasting competitive edges. In addition, the Group will also take this opportunity to restructure those businesses without competitive edges, development prospects or making insignificant contributions to the overall results of the Group, so as to improve the overall performance of the Group and create higher value for the Group and the shareholders of the Company.

LCD

In 2004, the electronic industry maintained a rapid growth both globally and domestically, and the demand for LCD products was growing steadily. The application market for small-to-medium-sized displays, such as mobile telephones and cordless telephones, maintains a relatively high rate of growth. According to the statistics from the Ministry of Information Industry, the number of mobile telephones produced in China reached 230,000,000, representing an increase of 23.7% over the previous year. The global and domestic market for small- and medium-sized displays is envisioned to maintain a rapid growth in 2005. However, product prices will remain under pressure.

In 2005, the Group will still focus on the mobile phone LCD module market. Based on the advantages of price, quality and services, as well as an even fuller play of its color STN-LCDs and module production lines, the LCD business of the Group is likely to maintain a fast growth rate. At the same time, the Group intends to study the feasibility of investment and establishment of a TFT-LCD production line and decide whether the investment and establishment of such production line would be made based on the conclusion of the analysis.

In 2005, in operating its LCD business, the Group will pursue the strategy of "leading technology, superior speed, and personalized service" to increase its research and development input; to improve its capability in product research, development and design as well as delivery speed and service feedback; to enhance its core competitiveness further; to expand its market actively; and to establish an even more extensive global sales network. The Group believes that its LCD operation would have a positive development prospect in 2005 should there be no dramatic changes in its business environment.

PCB

In 2004, owing to the rapid growth in the demand for electronic consumer goods, the global PCB industry recorded an increase of 30% plus in production value. Global PCB industry is expected to maintain rapid growth in 2005. With the enhancing influence from the rapid growth of domestic electronic processing industry and the increasing trend of domestic purchase, the PCB industry in the PRC will continue to grow rapidly. At the same time, the demand of high frequency, high speed transmission equipment and the 3G communication equipment, which may come into operation in the year, may provide impetus for the continuing innovation of PCB technology, but the prices are likely to face downward pressure.

There is both market opportunity and challenge for the PCB operations of the Group. The Group may make a good performance in 2005 on the basis of its capability for R&D, operation and management, which has been developed over the years; technological capability for sophisticated products manufacturing, quick delivery, stable quality, market image and its solid customer base in the domestic communication equipment market.

In 2005, the Group will still insist on its operating strategy to focus on high-end products, optimize the key production procedure of its existing production line with a view to enhancing production capacity, invest to build a backplane production line, optimize its customer structure and product mix, develop both domestic and overseas market actively, enhance its capability for quick delivery and technological services, and further enhance the competitiveness of its products.

Timepieces

In 2005, no significant changes are expected in the timepieces industry, and opportunities and challenges may coexist. On one hand, the upbeat macro-economy means an increase in people's income, and a growing brand awareness and symbolism in people's timepiece consumption. The keen competition in the domestic timepieces industry, on the other hand, means an increasing impact made by imported famous brands on the domestic mid-to high-end timepieces.

In 2005, the Group is going to persist on its brand strategy, continue to enhance its R&D and market operation capability, adopt new technology and new materials, develop new products, enhance product quality and customers' satisfaction, maintain and enhance the brand image of "Fiyta", and strengthen its leading position as the leading brand in domestic timepieces industry.

In 2005, the Group also will speed up the process of establishing "Harmony" chain stores, expand their scales to develop a large-scale and professional chain stores network from its regional cores of flagship stores to major cities throughout China, optimize its operating network and capability, strengthen its strategic cooperation with Swiss groups of renowned timepiece brands, and heighten the grade of its products.

FINANCIAL REVIEW

Capital Structure

	2004	2003
	RMB'000	*RMB'000*
Total loans	**585,475**	347,277
Total liabilities	**1,113,995**	714,810
Minority interests	**589,242**	549,964
Shareholders' equity	**1,157,009**	1,196,878
Total assets	**2,860,246**	2,461,652
Loan-to-equity ratio	**50.60%**	29.02%
Debt-to-equity ratio	**96.28%**	59.72%

Loan-to-equity ratio = total loans at the year end/shareholders' 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 2004, the Group had cash and bank deposits approximately totaling RMB371,961,000 (2003: RMB230,881,000), which was mainly derived from the following sources:

- Cash and bank deposits at the beginning of the year;
- Revenue from operations;
- Bank borrowings.

As at 31st December 2004, the Group had short-term loans totaling approximately RMB485,475,000 (2003: RMB347,277,000), which carried annual interest rates ranging from 1.70% to 6.64% (2003: 1.88% to 5.84%), and long-term loans totaling approximately RMB100,000,000 (2003: nil) with an annual interest rate of 3.51%.

Capital expenditure of the Group in 2004 amounted to approximately RMB191,005,000, of which approximately RMB65,997,000 were applied for expansion of color LCD module production lines and construction of production plant and staff dormitory for the LCD operations, approximately RMB34,819,000 were applied for the purchase of additional PCB production equipment, approximately RMB50,920,000 were applied for the construction project of Fiyta Technology Mansion, and another RMB39,269,000 were invested in other projects.

The Group's capital expenditure for 2005 is estimated to be approximately RMB246,000,000, of which approximately RMB111,000,000 will be used for the expansion of color LCD module production lines for the LCD operations and construction of product plant and staff dormitory, approximately RMB99,000,000 will be used for the purchase of production equipment and production land and construction of new production plant for the PCB operations, approximately RMB24,000,000 will be invested in the subsequent construction of Fiyta Technology Mansion, and approximately RMB12,000,000 will be invested in other projects. The proposed capital expenditure will be financed by bank deposits and the cash generated from the Group's operations.

OTHER EVENTS

Formation of Joint Venture Company CAERO

On 24th September 2004, the Company entered into a joint venture agreement ("Joint Venture") with K-Bridge Electronics Co., Ltd. ("K-Bridge Limited") and Shenzhen CATIC Commerce & Trading Corporation ("CATIC Commerce") to establish a Sino-foreign equity joint venture company, namely Shenzhen CAERO Inc. ("CAERO"), to principally carry out the business of manufacturing and sales of flat panel display terminal products, and providing the related repair services. The total investment amount and the registered capital of CAERO is RMB10,000,000 (approximately HK$9,434,000), of which the Company will invest RMB5,100,000 (approximately HK$4,811,000). CAERO is owned as to 51% by the Company, 40% by K-Bridge Limited and 9% by CATIC Commerce. Given that CATIC Commerce is a wholly owned subsidiary of CATIC Shenzhen Company ("CATIC Shenzhen"), the promoter and controlling shareholder of the Company, and thus a connected person of the Company, the Joint Venture is considered as a connected transaction under Chapter 14A of the Listing Rules. As the consideration ratio and asset ratio of the Joint Venture are less than 2.5%, it is exempt from the independent shareholders' approval requirements of Chapter 14A of the Listing Rules, and an announcement was made on 30th September 2004. As at the date of this Annual Report, registration procedures for CAERO are in progress.

SUBSEQUENT EVENTS

Acquisition of Certain Legal Person Shares in Shenzhen Nanguang

On 20th January 2005, the Company entered into share transfer agreements respectively with each of China New Era Group Corporation, Huangshi Economic and Co-operation Company, Agricultural Construction Division 10 of Xinjiang Production and Construction Group and Beijing Exhibition Centre to acquire 12.06% of the legal person shares of Shenzhen Nan-guang (Group) PLC ("Shenzhen Nanguang") held by the said companies ("the Acquisition") at a total consideration of RMB47,050,080. Given that Shenzhen Nanguang is owned as to 32.84% by CATIC Shenzhen, the promoter and controlling shareholder of the Company, the Acquisition was considered as a connected transaction under Rule 14A.13(1)(b)(i) of the Listing Rules. As the consideration ratio and asset ratio of the Acquisition were more than 5% but less than 25%, the Acquisition was required to be disclosed and was subject to independent shareholders' approval in accordance with Chapters 14 and 14A of the Listing Rules. An announcement in respect of the connected transaction on the Acquisition was made on 21st January 2005 and a circular containing details of the Acquisition was dispatched on 8th February 2005. An extraordinary general meeting of the Company was held on 29th March 2005, at which independent shareholders' approved the Acquisition and granted an authority for the Board of the Company to sign, process and complete the related documents on behalf of the Company.

Change of Non-Executive Director

At the First Extraordinary General Meeting 2005 convened on 29th March 2005, Mr. Ji Gui Rong resigned as a non-executive director of the Company due to his busy working schedules and his resignation was approved at the meeting. It was also resolved that Mr. Li Cheng Ning be elected as a non-executive director of the Company for a term of office expiring at the conclusion of the 2005 annual general meeting held in 2006.