

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW

Overview

The consolidated turnover and profit of the Company for 2005 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 2005, the Group recorded a consolidated turnover from continuing operations of approximately RMB1,918,584,000 (2004: RMB1,724,739,000), representing an increase of approximately 11.24% over the previous year. The total consolidated turnover from continuing operations and discontinued operations was approximately RMB1,946,792,000 (2004: RMB1,757,642,000), representing an increase of approximately 10.76% over the previous year. The profit after taxation for the year was approximately RMB44,719,000 (2004: RMB11,282,000), representing an increase of approximately 296.37% over the previous year. The Group's consolidated profit attributable to shareholders (after minority interests) amounted to approximately RMB16,951,000, compared with a loss of approximately RMB20,609,000 in 2004.

BUSINESS REVIEW (continued)**Overview** (continued)

The analysis of the Group's turnover and contributions to profit for 2005 by principal activities with the comparative figures for 2004 are as follows:

Turnover by activities	2005	2004
LCD	56.38%	60.67%
PCD	22.86%	20.00%
Timepieces	15.35%	14.27%
Other activities	5.41%	5.06%
Total	100%	100%

Contributions to profit by activities (before allocation of expenses to respective segments) (note1)	2005	2004
		(Restated)
LCD	35.54%	57.95%
PCB	57.98%	46.27%
Timepieces	14.27%	0.23%
Other activities	-7.79%	-4.45%
Total	100%	100%

Note 1: Contributions to profit by activities refer to rations of the profit after taxation (including minority interests) of respective segments to the profit after taxation (including minority interests) (before allocation of expenses to respective segments) of the Group, and the comparative figures of 2004 have been amended.

LCD

The turnover of the LCD business of the Group for the year was approximately RMB1,097,652,000 (2004: RMB1,066,291,000), representing an approximately 2.94% increase over the previous year. The profit after taxation for the year decreased by approximately 36.03% to approximately RMB43,039,000 (2004: RMB67,284,000) from the previous year.

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW *(continued)*

LCD *(continued)*

During the year, the LCD operations of the Group focused on markets for small and medium-sized displays and remained largely focusing on markets for mobile phones and automobile. Moreover, the Group also reinforced market diversification and emphasised on the research and development of new products. Personalised design and services were strengthened in accordance with the demands of different customers. Besides, production and delivery capabilities of products of various specifications were also enhanced. Income from mobile phone LCD and color-super twisted nematic (“CSTN”) accounted for approximately 49% and 34% of the total sales revenue of the Group’s LCD business respectively. The tube size thin film transistor (“TFT”) products were put into batch production and generated sales revenue of approximately RMB100,000,000 during the year. Currently, the Group has established a global sales network based in the PRC, Europe, US and Korea.

Thanks to the Group’s strong relationship with leading PRC mobile phone manufacturers and strengthened efforts in market diversification, the LCD business of the Group grew steadily during the year. However, intensified market competition and persistence low price trend resulted in a drop of approximately 30% on average in the prices of small and medium-sized LCD panels used in mobile phones. Despite the Group’s endeavour to actively tackle the issue, gross profit margin of LCD business for the year still decreased by approximately 22.10% from the previous year, leading to a fall of approximately 36.03% in the profit after taxation over the previous year.

To further enhance the competitiveness of the Group’s LCD business in the market for small and medium-sized displays, the Group decided to cooperate with certain business partners in establishing a 4.5-generation TFT production line in Shanghai with an aggregate investment of RMB3.1 billion (please refer to the paragraph headed “Other Significant Events” in the section of “REPORT OF THE DIRECTORS” below for details).

During the year, the Group’s “Research and Development of Color-STN LCD Module” project was recognised as “Key National New Product Project” (國家重點新產品項目) and “Key New Product Project of Guangdong Province” (廣東省重點新產品項目) and was awarded “First Class Award for Science and Technology Progress in Shenzhen” (深圳市科技進步一等獎). Moreover, the Group’s “Research, Development and Production of Automobile LCD” project also passed the Technological Achievement Appraisal (科技成果鑒定) conducted by the expert committee of Shenzhen Science and Technology Information Bureau (深圳市科技信息局) during the year and is currently applying for the “Award for Science & Technology Advancement in Shenzhen Municipal” (深圳市科技進步獎).

BUSINESS REVIEW (continued)**LCD** (continued)**Gross Profit Margin**

	2005	2004	2003
	RMB'000	RMB'000	RMB'000
Sales income	1,097,652	1,066,291	633,780
Cost of sale	912,045	834,836	494,385
Gross profit	185,607	231,455	139,395
Gross profit margin	16.91%	21.71%	21.99%

Market Structure

	2005	2004	2003
PRC	48%	62%	60%
Hong Kong	14%	12%	13%
Europe and America	20%	21%	27%
Southeast Asia and others	18%	5%	—
Total	100%	100%	100%

Product Structure

	2005	2004	2003
Mobile phones	49%	53%	47%
Wireless phones	12%	8%	8%
Automobiles	8%	6%	6%
MP3	5%	4%	1%
Others	26%	29%	38%
Total	100%	100%	100%

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW *(continued)*

PCB

The turnover of the PCB business of the Group for the year was approximately RMB445,002,000 (2004: RMB351,574,000), representing an approximately 26.57% increase over the previous year. The profit after taxation for the year increased by approximately 30.72% to approximately RMB70,218,000 over the previous year (2004: RMB53,718,000).

Price competition remained keen during the year. Against this background, the Group adopted a flexible pricing strategy and increased the proportion of sales in medium and high-end products with higher value added. In addition, the Group further strengthened relationship with existing communication equipment manufacturers while expanding its customer base to upper-market customers in the fields of industrial control, medical and automobile electronics. During the year, the Group also placed great emphasis on technology research and development and cost control. As a result, the PCB business of the Group recorded an overall increase in sales revenue and the profit after taxation for the year of approximately 26.57% and 30.72% respectively as compared with last year. In particular, sales revenue of products with more than 10 layers increased by approximately 86.51% over the previous year.

During the year, the Group also actively prepared for further expansion of production capacity, so as to further enhance its technology standard and relieve the bottleneck of production capacity to cater for the increasing demands of customers.

The Group passed the certification of “Shenzhen Enterprise Technology Center” (深圳企業技術中心) by the expert committee which consists of the Shenzhen Bureau of Trade and Industry (深圳市貿易工業局), Shenzhen Municipal Bureau of Finance (深圳市財政局), Shenzhen State Tax Bureau (深圳市國家稅務局) and Shenzhen Local Tax Bureau (深圳市地方稅務局) during the year, and completed the research and development of 42-layered PCB, which was put into batch production. It passed the TS16949 standard certification for automobile electronics. The Group’s “high-frequency multi-layered PCB made from blend & pressing materials” received the “Third Class Award for Advanced Technology in Guangdong Province” (廣東省科學技術三等獎) and “Second Class Award for Science and Technology Progress in Shenzhen” (深圳市科技進步二等獎) during the year.

Gross Profit Margin

	2005 RMB'000	2004 RMB'000	2003 RMB'000
Sales income	445,002	351,574	271,449
Cost of sale	326,027	253,232	212,513
Gross profit	118,975	98,342	58,936
Gross profit margin	26.74%	27.97%	21.71%

BUSINESS REVIEW *(continued)***PCB** *(continued)***Market Structure**

	2005	2004	2003
PRC	82%	84%	92%
Europe and America	7%	6%	7%
Southeast Asia and others	11%	10%	1%
Total	100%	100%	100%

Product Structure

	2005	2004	2003
Telecommunications equipment	67%	75%	85%
Electronic devices	5%	7%	8%
Others	28%	18%	7%
Total	100%	100%	100%

Timepieces

The turnover of the timepiece business of the Group for the year was approximately RMB298,898,000 (2004:RMB250,902,000), representing an increase of approximately 19.13% over the previous year. The profit after taxation for the year was approximately RMB17,276,000 (2004: RMB267,000), representing an increase of approximately 63.7 times over the previous year.

During the year, the Group maintained its emphasis on branding strategy for “Fiyta” timepieces with strengthened sales efforts at the outlet level. The Group also committed persistent efforts in enhancing the technical standard and added value of its products through adoption of new materials and technologies. With the successful launch and re-entry of the manned Shenzhou 6 spacecraft, “Fiyta” timepieces launched a series of promotional activities and significantly boosted its brand influence. During the year, the Group developed 49 new products, including the Shenzhou 6 Space Watch, and 28 of which were launched in the market.

The Group continued to commit efforts in building up “Harmony” chain stores and exploring the high-range timepiece market. During the year, the total number of “Harmony” chain stores of the Group reached 41, selling over 60 international brands that covered almost all Swiss brands imported to China. Benefited from the expanded scale of operation, gross profit margin of “Harmony” stores increased by 2.78% over the previous year. In the meantime, the Group also enhanced cooperation with leading international brands and the brand influence of “Harmony” also received a substantial boost.

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW *(continued)*

Timepieces *(continued)*

During the year, “Fiyta” received the honour of naming as “China Leading Brand” (中國名牌產品) again. Timepieces used by spacemen of China’s manned Shenzhou 5 spacecraft has passed the Technological Achievement Appraisal (科技成果鑒定) conducted by the Expert Committee of Science and Technology of Space Timepiece (航天鐘表科研技術專家組) and was recognised as being the first of its kind in the PRC and comparable to advanced products of a similar nature in the global market.

Gross Profit Margin

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>	2003 <i>RMB'000</i>
Sales income	298,898	250,902	208,303
Cost of sale	202,660	169,856	133,928
Gross profit	96,238	81,046	74,375
Gross profit margin	32.20%	32.30%	35.71%

	2005	2004	2003
The gross profit margin of Fiyta timepieces	47.46%	47.22%	47.39%
The gross profit margin of Harmony timepieces	21.31%	18.53%	17.41%

PROSPECT FOR 2006

The Group is optimistic about the prospect of its main businesses in 2006.

In 2005, the PRC economy grew steadily at a fast pace. According to the Annual Working Report of the State Council (國務院年度政府工作報告), gross domestic product for the year reached RMB18.23 trillion, representing an increase of 9.9% over last year. The consumer price level of PRC residents also increased by 1.8%. The national economy achieved higher growth rate and efficiency with a more stable price level. It is expected that the economy will remain robust in 2006. The increasing demand for domestic consumption and favourable macro-economic environment may enable the Group to maintain robust growth momentum of its core businesses.

In 2006, the Group will increase its investment with an emphasis on existing businesses with market predominance according to its long-term development strategies in order to establish its competitive edge for sustainable development. To improve its management standard and competitiveness, the Group introduced the Lean Six Sigma Management in 2005, and will further promote it in 2006 as a key measure of management reform to improve and optimise internal management as a whole. The Group intends to exert relentless efforts to improve its performance and profitability so as to reward the shareholders of the Group.

PROSPECT FOR 2006 *(continued)***LCD**

In 2005, demand for small and medium-sized LCD continued to increase both in the global and domestic markets. In particular, demand for medium and high-end products with higher added value showed significant growth. The market for small and medium-sized displays is anticipated to maintain a rapid growth rate in 2006. Given its high price to performance ratio and technology standard, CSTN products will still enjoy a considerable market share for a certain period. However, increasing market competition may bring pressure on product prices.

In 2006, the Group will steadily improve the production scale and qualification rate of CSTN production lines. In addition to achieving further growth in the mobile phone market, the Group will extend the application of CSTN to automobile, mobile phones, MP3 and others products. Through advancement of CSTN technology and development of TFT module technology, the Group plans to gradually expand to the medium and high-end markets for small and medium-sized displays. The Lean Six Sigma Management practices will be promoted in full-scale. Through improved internal management, the efficiency and quality of operation in various sections such as procurement, research and development and production will be enhanced, thereby elevating product quality and capability of prompt delivery, as well as satisfaction level of customers. The Group believes that the LCD business will enjoy a positive development prospect in 2006 in the absence of dramatic changes in its operating environment.

In 2006, the Group also push ahead the establishment of 4.5-generation TFT-LCD production line so as to achieve sustainable development in the long run.

PCB

According to information of the China Printed Circuit Association ("CPCA"), the aggregate PCB production value in the PRC should have reached US\$10 billion in 2005, surpassing that of Japan and making the PRC the largest PCB manufacturer in the world. Given the rapid growth of the electronics industry and the possible launch of 3G communication equipment in 2006, the PCB business of the PRC is expected to maintain a growth rate of over 10% during the year. It is also expected that prices of raw materials will not decline significantly and cost pressure will thus remain.

In 2006, the Group will continue to adopt an operating strategy with a focus on medium and high-end products, committing increased efforts on the research and development and market expansion work in medium and high-end products. The Group will maintain its technological capability and market image for sophisticated product manufacturing, quick delivery and stable quality. The Lean Six Sigma Management practices will be fully implemented to increase manufacturing efficiency and product competitiveness. Given its years of experience in the research, development, design and operational management and established relationship with communication equipment manufacturers, the Group believes that PCB business will achieve outstanding performance in 2006.

In order to cater for the rapid growing market demands, the Group will implement production capacity expansion in 2006 and further consolidate its market position in the medium and high-end markets.

MANAGEMENT DISCUSSION AND ANALYSIS

PROSPECT FOR 2006 *(continued)*

Timepieces

No significant changes are expected in the timepieces industry in 2006. Nevertheless, the consumption tax policy promulgated by the Ministry of Finance (國家財政部) and State Administration of Taxation (國家稅務總局) of the PRC on 20th March 2006 and effective from 1st April 2006 may produce a negative impact on the sales of high-end timepieces of the Group.

In 2006, the Group will persist on its brand strategy, continue to enhance its research and development and market operation capability, develop new products and enhance product quality and the brand name of “Fiyta”. In 2006, the Group will also speed up the process of establishing “Harmony” chain stores and optimise its operating network and capability. While consolidating its strategic cooperation with Swiss groups of renowned timepiece brands to boost its brand influence, the Group will also explore new channels and strengthen complementary cooperation with other market players.

FINANCIAL REVIEW

Capital Structure

	2005 RMB'000	2004 RMB'000
Total loans	463,950	585,475
Total liabilities	921,880	1,113,995
Minority interests	607,893	589,242
Shareholders' equity	1,165,614	1,157,009
Total assets	2,695,387	2,860,246
Loan-to-equity ratio	39.80%	50.60%
Debt-to-equity ratio	79.10%	96.28%

Loan-to-equity ratio = total loans at the year end to shareholders' equity at the year end.

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

Liquidity and Capital Resources

As at 31st December 2005, the Group had cash and bank deposits approximately totaling RMB259,610,000 (2004: RMB371,961,000), which was mainly derived from the following sources:

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

FINANCIAL REVIEW *(continued)***Liquidity and Capital Resources** *(continued)*

As at 31st December 2005, the Group had current borrowings totaling approximately RMB393,950,000 (2004: RMB485,475,000), which carried annual interest rates ranging from 1.80% to 6.14% (2004: 1.70% to 6.64%), and non-current borrowings totaling approximately RMB70,000,000 (2004: RMB100,000,000) with an annual interest rate of 5.76% (2004: 3.78%).

Capital expenditure of the Group in 2005 amounted to approximately RMB67,950,000, of which approximately RMB12,821,000 was applied for the purchase of additional LCD production equipment and construction of staff dormitory, approximately RMB35,922,000 was applied for the purchase of additional PCB production equipment, approximately RMB17,911,000 was applied for the purchase of additional timepieces production equipment and the new establishment of "Harmony" chain stores, and another RMB1,296,000 was invested in other projects.

The Group's capital expenditure for 2006 is estimated to be approximately RMB1,270,000,000 of which approximately RMB1,018,000,000 will be used for the purchase of production equipment of TFT-LCD, purchase of production land and construction of new production plant for the TFT-LCD operations, approximately RMB80,000,000 will be used for the purchase of production equipment of LCD and staff dormitory, approximately RMB169,500,000 will be used for the purchase of production equipment and production land and construction of new production plant for the PCB operations, and approximately RMB2,500,000 will be invested in other projects. The proposed capital expenditure will be financed by bank borrowings, bank deposits and the cash generated from the Group's operations.