

# Management Discussion and Analysis

## BUSINESS REVIEW

### Overview

The consolidated turnover and profit of the Company for 2006 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")	52.62%	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 2006, the Group recorded a consolidated turnover from continuing operations of approximately RMB2,629,794,000 (2005: RMB1,971,489,000), representing an increase of approximately 33.39% over the previous year. The total consolidated turnover from continuing operations and discontinued operations was approximately RMB2,629,794,000 (2005: RMB1,999,697,000), representing an increase of approximately 31.51% over the previous year. The profit after taxation for the year was approximately RMB180,362,000 (2005: RMB44,719,000), representing an increase of approximately 303.32% over the previous year. The Group's consolidated profit attributable to shareholders (after minority interests) amounted to approximately RMB123,095,000, representing an increase of approximately 626.18% compared with a profit of approximately RMB16,951,000 in 2005.

According to the share segregation reform requirements of the China Securities Regulatory Commission (中國證券監督管理委員會), the Company, being the holder of the non-circulating shares of the three A share issuers, namely Fiyta, Tian Ma and Shenzhen Nanguang (Group) PLC ("Nanguang") (深圳市南光(集團)股份有限公司), agreed the share segregation reforms proposed by the three companies. The share segregation reforms of Tian Ma and Nanguang were completed in April 2006 and the total consideration in relation thereto was RMB63,978,585 (RMB58,999,434 for Tian Ma and RMB4,979,151 for Nanguang). As CATIC Shenzhen Company, the controlling shareholder of the Company, was one of the Nanguang non-circulating shares shareholders, the transfer of shares of Nanguang by the Company to the Nanguang A shares holders constituted a connected transaction of the Company under Chapter 14A of the Listing Rules. The Company complied with the reporting and announcement requirements under the Listing Rules. The Company holds 52.62% shares of Tian Ma and 10.70% shares of Nanguang after the share segregation reforms. The share segregation reform of Fiyta was not approved by the shareholders of Fiyta. As at the date of this report, the new proposal of Fiyta has not been formulated yet. Fiyta will re-consider restarting the procedures of share segregation reform at a proper time according to relevant laws and regulations.

## Management Discussion and Analysis

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

The analysis of the Group's turnover from continuing operations and discontinued operations and contributions to profit for 2006 by principal activities with the comparative figures for 2005 are as follows:

<b>Turnover by activities</b>	<b>2006</b>	<b>2005</b>
		(Reclassified)
LCD	<b>57.72%</b>	55.68%
PCB	<b>21.76%</b>	22.57%
Timepieces	<b>17.24%</b>	15.16%
Other activities	<b>3.28%</b>	6.59%
<b>Total</b>	<b>100%</b>	100%

<b>Contributions to profit by activities (before allocation of expenses to respective segments) <i>(note 1)</i></b>	<b>2006</b>	<b>2005</b>
		(Reclassified)
LCD	<b>45.19%</b>	34.39%
PCB	<b>43.02%</b>	57.16%
Timepieces	<b>-3.6%</b>	-16.22%
Other activities	<b>15.39%</b>	24.67%
<b>Total</b>	<b>100%</b>	100%

*Note 1:* Contributions to profit by activities refer to ratios of the profit/ (loss) after taxation (including minority interests) of respective segments to the profit after taxation (including minority interests) (before allocate the corporate expenses to the segments) of the Group and the comparative figures of 2005 have been reclassified to conform to the current year's presentation.

**LCD**

The turnover of the LCD business of the Group for the year was approximately RMB1,518,021,000 (2005: RMB1,097,652,000), representing an approximately 38.3% increase over the previous year. The profit after taxation for the year increased by approximately 118.6% to approximately RMB91,048,000 (2005: RMB41,651,000) from the previous year.

During the past year, the focus of the Group's LCD business has been on the colour of the products, modules and tube size thin film transistor ("TFT"). Sophisticated organization and input of resources in aspects such as market development, product research and development, supply of raw materials and production have effectively enhanced the optimization of customer and product structure. Upon stabilizing the foundation of mobile phones' color display module and high-end STN products, we have swiftly entered into the businesses of color wireless phones and color MP3. In the meantime, with its rapid growth, TFT display module has become the new leading product of the Group.

In the year, the Group saw a significant breakthrough in its "Large Client Development Strategy", succeeding in securing two renowned clients, and the Group becomes their major supplier by providing products with them in batch. At present, the number of large clients of the Group has increased from 2 to 8, accounting for over 60% of the total turnover. With the increased proportion of medium to large clients and the continuously decreased proportion of small clients, the client structure is gradually optimized and sales risk is increasingly lowered, and client management standard is increasingly enhanced.

## Management Discussion and Analysis

### BUSINESS REVIEW *(continued)*

#### LCD *(continued)*

On 1st December 2005, the Company, Tian Ma, Shanghai Industrial Investment (Group) Company Limited (上海工業投資(集團)有限公司), Shanghai State-owned Assets Management Company Limited (上海國有資產經營有限公司) and Shanghai Zhang Jiang (Group) Company Limited (上海張江(集團)有限公司) entered into a joint venture agreement to establish a joint venture named as Shanghai Tian Ma Microelectronics Company Limited (上海天馬微電子有限公司), for the purpose of engaging in the construction and operation of production line in the 4.5 generation tube size thin film transistor liquid-crystal display ("TFT-LCD"). The project as a whole is on schedule. The business license of the joint venture company was issued in April 2006. It is expected to put into production by the end of 2007.

During the year, the Group passed the TS16949:2002 quality management system recognition of TUV, an international accreditation organization in Germany. This lays the foundation for the Group's LCD products entering the automobile market. This year, the Group's "R&D and output of small-sized TFT-LCD module" project passed the "Technological Achievement Appraisal" (科技成果鑒定), and its "Car cradle LCD" project was recognized as the "Key National New Product Project 2006" (國家二零零六年度重點新產品計劃專案).

#### Gross Profit Margin

	2006 <i>RMB'000</i>	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
Sales income	<b>1,518,021</b>	1,097,652	1,066,291
Cost of sale	<b>1,257,567</b>	912,045	834,836
Gross profit	<b>260,454</b>	185,607	231,455
Gross profit margin	<b>17.15%</b>	16.91%	21.71%

#### Market Structure

	2006	2005	2004
PRC	<b>40%</b>	48%	62%
Hong Kong	<b>30%</b>	14%	12%
Europe and America	<b>9%</b>	20%	21%
Southeast Asia and others	<b>21%</b>	18%	5%
Total	<b>100%</b>	100%	100%

#### Product Structure

	2006	2005	2004
Mobile phones	<b>41%</b>	49%	53%
Wireless phones	<b>14%</b>	12%	8%
Automobiles	<b>8%</b>	8%	6%
MP3	<b>12%</b>	5%	4%
Others	<b>25%</b>	26%	29%
Total	<b>100%</b>	100%	100%

## Management Discussion and Analysis

**BUSINESS REVIEW** *(continued)***PCB**

The turnover of the PCB business of the Group for the year was approximately RMB572,236,000 (2005: RMB445,002,000), representing an approximately 28.59% increase over the previous year. The profit after taxation for the year increased by approximately 25.23% to approximately RMB86,676,000 over the previous year (2005: RMB69,215,000).

During the year, although price competition remained highly fierce, the PCB sector experienced an overall healthy development momentum and strong downstream demands. Affected by the surge of international copper price, the purchase price of raw materials has kept rising. Facing the huge pressure of the increase in cost, on one hand the Group promoted energy and consumption saving activities and strengthened its logistic control; on the other hand, it implemented the Lean Six Sigma Management practices to reduce products' abandon rate. During the year, the Group also adopted a flexible market strategy, proactively adjusted the product and client structure, and focused on orders of high-end products. Benefiting from the above, 70% of the sales revenue of the Group's PCB business in the past year came from the growth of products with 10 layers and above. The increased proportion in sales of medium to high-end products segment allowed the Group's PCB business a higher level of profitability among the industry.

During this year, for the purpose of a capability expansion and technical enhancement project of the PCB business, the Group has purchased a piece of land and the relevant planning and engineering permit was obtained. Infrastructure construction is currently under way.

During the year, the Group proudly received the awards of "Key National New Product Project" (國家重點新產品) by the Ministry of Science and Technology, "Outstanding Ethnic Brand of Printed Circuit in China" (中國印製電路優秀民族品牌企業) by the China Printed Circuit Association, "Second Class Award for Advanced Technology in Guangdong Province" (廣東省科學技術獎二等獎) by the Science and Technology Office of the Guangdong Province, the 4th "Leading Brands" (知名品牌) in Shenzhen by the Shenzhen Industry and Economy Association, "Outstanding Waste Reduction Enterprise in Pengcheng" (鵬城減廢卓越企業) by the Action Guiding Committee of Waste Reduction in Pengcheng of Shenzhen, and "Outstanding Innovation-Driven Enterprise" (深圳市自主創新優秀企業) by the Electronic Chamber of Shenzhen. In addition, following the signing of the "Green Purchase Declaration" (綠色採購宣言), the Group became one of the first 13 green purchase enterprises in Shenzhen.

**Gross Profit Margin**

	<b>2006</b> <b>RMB'000</b>	2005 RMB'000	2004 RMB'000
Sales income	<b>572,236</b>	445,002	351,574
Cost of sale	<b>418,483</b>	326,027	253,232
Gross profit	<b>153,753</b>	118,975	98,342
Gross profit margin	<b>26.87%</b>	26.74%	27.97%

## Management Discussion and Analysis

### BUSINESS REVIEW *(continued)*

#### PCB *(continued)*

##### Market Structure

	2006	2005	2004
PRC	<b>75%</b>	82%	84%
Europe and America	<b>14%</b>	7%	6%
Southeast Asia and others	<b>11%</b>	11%	10%
Total	<b>100%</b>	100%	100%

##### Product Structure

	2006	2005	2004
Telecommunications equipment	<b>64%</b>	67%	75%
Electronic devices	<b>5%</b>	5%	7%
Others	<b>31%</b>	28%	18%
Total	<b>100%</b>	100%	100%

##### Timepieces

The turnover of the timepiece business of the Group for the year was approximately RMB453,338,000 (2005: RMB298,898,000), representing an increase of approximately 51.67% over the previous year. The loss for the year was approximately RMB7,252,000 (loss of RMB19,645,000 in 2005).

During the year, the emphasis of brand strategy and value sales as well as the new focus on industrial design were consistently adopted for the Group's "Fiyta" timepieces. By constantly enhancing the chained effect of R&D, manufacturing and sales, and increasing its capability of product design and production and penetrating the market to enhance sales, its brand image is further enhanced. In the past year, the sales performance of leading products such as "Shenzhou 6 Space Watch" and "Qifu (祈福) Watch" was continuously robust.

As planned, the Group's "Harmony" chain stores are under continuous and active expansion and its chain network of renowned timepieces is steadily optimized. As the economy of scale gradually emerges, the brand image of renowned "Harmony" timepieces retailer is enhanced substantially. During the year, Harmony has 55 chain stores in major and medium cities nationwide. Meanwhile, 18 chain stores were partially renovated and more brands were sold. As a result, it saw an upward trend in both the scale of a single store and the quality of new stores. With the expansion of its chain network and the increase in market share, "Harmony" renowned timepieces retail business enjoyed a phenomenal growth during the year. Its collaboration with leading international brands was continuously strengthened.

## Management Discussion and Analysis

**BUSINESS REVIEW** *(continued)***Timepieces** *(continued)*

In the past year, "Fiyta" timepieces proudly received the recognition of "Top Sales in the Industry Nation-wide" by the State Statistics Bureau's Information Service Centre of Information Statistics of Industries in China for 12 consecutive years. It also became the exclusive sponsor of timepieces design and equipment in "The 6th Asian Winter Games". In the 4th "Product Creativity Design Award" of Chinese enterprises (CIDF Product Design Awards), Fiyta's "Tianji (天璣)" series proudly received the Golden Award while the "Shenzhou 6 Space Watch" proudly received "The Best Design in the Category of Daily Life". During this year, Fiyta proudly received the title of "Top 10 Best Enterprise Employers in China".

	<b>2006</b> <b>RMB'000</b>	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
Sales income	<b>453,338</b>	298,898	250,902
Cost of sale	<b>306,412</b>	202,660	169,856
Gross profit	<b>146,926</b>	96,238	81,046
Gross profit margin	<b>32.41%</b>	32.20%	32.30%

**Gross Profit Margin**

	<b>2006</b>	2005	2004
The gross profit margin of Fiyta timepieces	<b>51.52%</b>	47.48%	47.22%
The gross profit margin of Harmony timepieces	<b>21.95%</b>	21.31%	18.53%

**PROSPECT FOR 2007**

With regard to the outlook of 2007, the Group is highly confident in the prospect of the development of its core businesses, and it will strive to reach a new stage.

According to the Annual Working Report of the State Council (國務院年度政府工作報告), in the year of 2006, the national economy ran smoothly, demonstrating a sound performance of rather fast-paced growth, favourable economic efficiency and rather low price level, and realizing a good start for "Eleventh Five Years". The gross domestic product for the year reached RMB20.9407 trillion, representing an increase of 10.7% over last year. Inflation rate was stabilized at a relatively low level, the utilization rate of resources in economic activities was increased and economic conditions were noticeably improved. It is expected that the economy will remain robust in 2007. Benefiting from the increasing demand for domestic consumption and favorable macro-economic environment, the Group may maintain robust growth momentum of its core businesses.

In 2007, the Group will continue to act according to the needs of its long-term development strategy, maintain the existing successful tactics of various business units, restlessly improve and perfect its unique profit earning model, and establish sustainable long-term competitive advantages. In the meantime, through advanced management concepts and tools such as Balance Score Card and Lean Six Sigma, the Group will strive for ability cultivation and management enhancement, and to congregate business management and technical talents of the same goals through the pro-active, people-oriented and harmony corporate culture. The Group wishes to reward its shareholders through persistent efforts in improving results and profitability.

## Management Discussion and Analysis

### **PROSPECT FOR 2007** *(continued)*

#### **LCD**

It is estimated that the flat LCD market value in 2007 will close to US\$100 billion. There is considerable room for improvement in the small to medium size products, which will account for over 28% of the market share. In 2007, the Group's LCD business will be positioned at two major markets, namely, markets of electronic consumers' goods and industrial products, which can be further subdivided into seven detailed segments namely mobile phones, wireless phones, MP3/MP4/PMP, video game consoles/learning consoles, pre-installation of car cradle, post installation of car cradle, GPS, and equipment and display panels.

In 2007, the Group's target markets will continue to grow. In particular, the usage of TN/STN products will be stable while the market competition will be intense and the pressure on price will be high. Overall, the market demands of CSTN products in 2007 will be similar to that of 2006. With the decrease in price, the Group's TFT products saw a rapid growth in market share in 2006. Currently, it accounts for over 60% of the mobile phone market. In 2007, TFT products' proportion in the mobile phone market and the MP3/MP4 market will continue to expand, while the demands from car cradle navigation and audio visual systems will become the new growth impetus for TFT.

In 2007, the Group will strengthen the research and development of its industrial technology in two dimensions. Firstly, it will expedite the R&D of display technology for automobiles, including the technology of ASTN, DSTN and TFT modules so as to increase the Group's competitiveness in the pre-installation of car cradle and post installation of car cradle markets. Secondly, it will strengthen the R&D of the technology of high value added color module for electronic consumers' products so as to increase the Group's competitiveness in the market of portable consumers' products.

#### **PCB**

Due to the rapid growth of the electronic market and the equipment demands driven by the possible launch of 3G communication in the coming year, it is estimated that in 2007 the PCB market's robust development momentum will continue. Meanwhile, market competition will still be fierce, and the pressure on cost will remain due to the price of raw materials is not expected to decrease substantially.

In 2007, the Group will continue to persist on the business strategy of medium to high-end products. It will also further the capability expansion and technical enhancement projects of the PCB business as planned. Meanwhile, the Group will further enhance its development of strategic clients, and minimize costs through various means such as improving internal management standard, increasing output, and reducing products' abandon rate. The Group believes that in 2007 the PCB business's turnover will maintain a healthy trend of continued growth.

## Management Discussion and Analysis

**PROSPECT FOR 2007** *(continued)***Timepieces**

The continuously rapid growth of the domestic economy and the steady growth of people's spending power in the PRC have driven market demands for medium to high-end timepieces, which has provided much development space for luxury products such as prestigious watches. In recent years, the development momentum of the timepieces market has been desirable. As overseas prestigious brands have been actively entering into the Chinese market, market competition is rather intense. Meanwhile, in order to gain from the rapid growth of the domestic retail market of renowned timepieces, domestic renowned timepieces retailers and overseas prestigious brands are actively expanding their networks or opening new stores so as to increase their market share. Compared with the huge potential the domestic market would offer to the industry, the competition model of the retail business of renowned timepieces is still developing.

In 2007, the Group will continue utilizing its brand strategy, steadily developing the "Fiyta" brand and gradually increasing its overseas sales, improving technical R&D and industrial design capability, as well as focusing on the planning of the "Pansy" brand through the preparation for the stylish third brand and the introduction of top-tier brands.

In 2007, the Group will further develop the establishment of "Harmony" chain stores, and continue to strengthen shop front optimization and upgrade of existing retail network, and the expansion of renowned brands. Meanwhile, the Group will optimize the Company's internal management structure, strengthen human resources management, establish a highly efficient business team, and increase its overall operation efficiency and profit level.

**FINANCIAL REVIEW****Capital Structure**

	<b>2006</b> <b>RMB'000</b>	2005 RMB'000
Total loans	<b>948,548</b>	463,950
Total liabilities	<b>1,760,834</b>	921,880
Minority interests	<b>997,943</b>	607,893
Shareholders' equity	<b>1,297,354</b>	1,165,614
Total assets	<b>4,056,131</b>	2,695,387
Loan-to-equity ratio	<b>73.11%</b>	39.80%
Debt-to-equity ratio	<b>135.72%</b>	79.10%

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.



## Management Discussion and Analysis

### FINANCIAL REVIEW *(continued)*

#### Liquidity and Capital Resources

As at 31st December 2006, the Group had cash and cash equivalents approximately totaling RMB740,912,000 (2005: RMB259,610,000), which was mainly derived from the following sources:

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

As at 31st December 2006, the Group had current borrowings totaling approximately RMB938,548,000 (2005: RMB393,950,000), which carried annual interest rates ranging from 1.56% to 6.31% (2005: 1.80% to 6.14%), and non-current borrowings totaling approximately RMB10,000,000 (2005: RMB70,000,000) with an annual interest rate of 5.18% (2005: 5.76%).

Capital expenditure of the Group in 2006 amounted to approximately RMB528,561,000, of which approximately RMB419,939,000 was applied for the purchase of production equipment and the construction of production plant and staff dormitory for TFT-LCD operations, approximately RMB83,423,000 was applied for the purchase of production equipment and the construction of new production plant for the PCB operations, and approximately RMB25,112,000 was applied for the purchase of production equipment for the Timepieces operations and the new chain stores of "Harmony".

The Group's capital expenditure for 2007 is estimated to be approximately RMB3,571,000,000, of which approximately RMB2,224,000,000 will be used for the purchase of production equipment and the construction of new production plant for the TFT-LCD operations, approximately RMB247,000,000 will be used for the purchase of production equipment and the construction of staff dormitory for the LCD operations, approximately RMB600,000,000 will be used for the purchase of production equipment and the construction of new production plant for the PCB operations, approximately RMB300,000,000 will be used for the acquisition of the equity of 廣東國際大廈實業有限公司 (Guangdong International Building Industrial Company Limited), and approximately RMB200,000,000 will be used for the subscription of Nanguang new shares. The proposed capital expenditure is expected to be financed by bank borrowings, bank deposits and the cash generated from the Group's operations.