Management Discussion and Analysis

Operational and Financial Review

Driven by the strong growth in the global economy, the worldwide mobile phone subscribers reached a total of 1.7 billion in 2004. According to the market researcher Strategy Analytics, the global sales of mobile phones in 2004 reached 684 million units. This represented a growth of 32% over 2003. Driving the growth was the surging market demand arising from handset replacements and trendy upgrades in the more matured markets, and the strong net subscriber growth in the developing regions like Brazil, Russia, India and China. China, in particular, has more than 330 million mobile users, representing 25% of the country's total population, out of which 64.87 million users are new subscribers in 2004. With the ongoing boom and widespread popularisation of 3G communication in 2005, the mobile phone market will continue to grow. Strategy Analytics forecasts 735 million units of mobile phones will be shipped in 2005.

Turnover

The results of the Group were encouraging. During the year under review, the Group sold approximately 8.4 million units of mobile phones, representing an increase of more than 3 million units over 2003. In terms of sales revenue, the Group achieved a turnover of HK$4,590.1 million; a remarkable increase of 60.4% as compared to the same period last year. The increase was contributed primarily from the strong market demand and the expansion of the production capacity of Sang Fei. Moreover, with the installation of the sixth and seventh SMA production lines in 2004, currently the Group has an annual production capacity of over 10 million units of mobile phones. The Group is well prepared towards the continuous growth in market demand in the future.

Philips branded

Sang Fei is the exclusive mobile phone manufacturer for the Philips group. The well-recognised *Philips* branded mobile phones in both China and overseas markets, together with the long-established relationship with the Philips Group, offer the Group a significant and sustainable source of revenue. During the year under review, the Group produced a total of 22 models of *Philips* branded mobile phones. The turnover from the *Philips* branded mobile phones increased by 59.9% to HK$4,149.4 million.

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Own-branded and other OEM branded

Sang Fei actively sought to develop an independent customer base on an OEM/ODM basis as well as its own-branded mobile phones. During the year under review, the Group produced a total of 70 models of own-branded and other OEM branded mobile phones. The turnover from own-branded and other OEM branded mobile phones was HK$440.7 million, representing a growth of 65.1% over last year.

Cost of sales

The cost of sales increased by 60.8% to HK$4,352.6 million. The primary component of the cost of sales was raw material cost, which represented approximately 94.7% of the total cost. The increase in cost of sales was primarily attributable to the growth in turnover, and was because more expensive components were being utilized when additional functions and more advanced features, like high resolution camera modules, were built into the new mobile phones, which resulted in higher average production costs of the new products. Despite the general increase in the average cost of materials, the Group was successful in implementing global material sourcing channels which effectively minimize the impact on the overall production costs of the Group.

Profitability

The Group achieved a gross profit of HK$237.5 million, which was 53.3% over the gross profit earned in 2003. The gross margin of 2004 was 5.2%. As compared to 5.4% in last year, the decrease in gross profit margin was primarily due to the general increase in material cost and the stiff market competition which imposed margin pressure on the overall handset industry.

The operating profit of the Group in 2004 was HK$97.6 million, representing an increase of 37.7% over the same period last year. The operating profit margin was 2.1%. The increase in operating profit was largely attributable to the remarkable growth in the Group's sales turnover, effective cost controls and the strengthening of overall management control. With the effective implementation of these policies, the Group had laid a solid foundation for sustained profitability in the future.

The Company completed the acquisition of the 65% equity interest in Sang Fei on 24 September 2004. For accounting purpose, the acquisition has been accounted for as a reverse acquisition. Provision for impairment on the carrying amount of the goodwill at year ended of HK$61.5 million was fully made in the year under review. As a result, the Group recorded a net loss of HK$19.3 million and the loss per share was HK cents 0.27.

In a business' perspective and if the extraordinary loss from the impairment of goodwill is not taken into consideration, the Group would have earned a profit attributable to shareholders of HK$42.2 million during the year under review, which was 9.7% over that of 2003. The corresponding earnings per share was HK cents 0.6.

Capital Resources and Liquidity

The capital resources for the Group's operations were primarily generated from its operations and short term bank borrowings. As at 31 December 2004, the Group had net current assets of HK$371.2 million, representing an increase of 93.8% over those of the previous year. The overall gearing ratio, which is calculated as the total liabilities over total assets of the Group, was approximately 70.2% (2003: 79.5%).

As at 31 December 2004, the Group had cash and cash equivalents amounted to HK$217.4 million (2003: HK$23.4 million), and were primarily denominated in Hong Kong dollar, Renminbi and United States dollar.

The Group's exports sales are predominantly invoiced in United States dollar and its domestic sales are invoiced in Renminbi. The Group imports some of its raw materials and SMA and testing equipments from overseas suppliers, which are paid in United States dollar, Japanese Yen and Euro. The Group will make use of hedging contracts, when appropriate, to leverage the risk of foreign exchange fluctuation arising from its operations.

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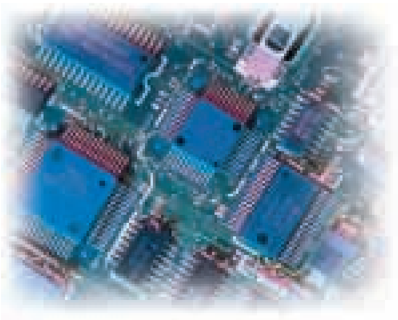

Bank Borrowings

As at 31 December 2004, the Group had unsecured short term bank borrowings of HK$392.2 million (2003: HK$309.3 million). The bank borrowings were all denominated in Renminbi, and were borrowed at contracted fixed interest rate. As at 31 December 2004, the Group had available bank facilities of approximately RMB800 million.

As at 31 December 2003 and 2004, the Group did not have any pledged assets or guarantee.

Capital Commitment and Contingent Liabilities

As at 31 December 2004, the Group had contracted but not provided for capital commitment of HK$8.7 million (2003: HK$13.3 million) for the purchase of fixed assets and computer software.

The Group did not have any material contingent liabilities outstanding as at 31 December 2003 and 2004.

Employee and Remuneration Policies

As at 31 December 2004, the Group had approximately 2,650 employees (2003: 1,580), majority of them were based in China.

The Group recognizes the importance of high calibre and competent staff and has a strict recruitment policy and performance appraisal scheme. Remuneration packages are largely in line with industry practices, and are formulated on the basis of performance and experience and will be reviewed regularly. Bonus and other merit payments are linked with the performance of the Group and of the individuals as incentive to optimize performance. The Company has in place a share option scheme, pursuant to which share options may be granted to selected personnel of the Group, with a view to encouraging employees to work towards enhancing the value of the Group.

Major Acquisition and Disposal

On 10 December 2003, the Company, CEC and Winsan International Holdings Limited, the then controlling shareholder of the Company, entered into a sale and purchase agreement to acquire CEC's 65% equity interest in Sang Fei, a Sino-foreign joint venture company established in the People's Republic of China (the "PRC") principally engaged in the manufacturing and sale of mobile phones, at a consideration of HK$260 million. The consideration was satisfied by the issuance of 6,500,000,000 shares of the Company at HK$0.04 per share.

The acquisition was completed on 24 September 2004. Upon completion of the acquisition and the placing of shares referred below, CEC was interested to 74.98% of the issued share capital of the Company, and became the controlling shareholder of the Company. The Company also changed its name from Winsan (China) Investment Group Company Limited to China Electronics Corporation Holdings Company Limited with effect from 28 September 2004.

As part of the business reorientation, the Company entered into agreements to sell the entire interests in the Transonline Group and DICO Group on 29 September 2004 and 11 October 2004 respectively to an independent third party for HK$1 each. As both groups of companies had been recording losses and were at net liabilities position, the dispose of the two groups of companies were at the interests of the Company as a whole.

Placing of Shares

On 17 September 2004, the Company entered into the placing agreements to place 420,000,000 shares and 190,000,000 shares of the Company to Wellful Holdings Limited and Ready Finance Limited respectively at HK$0.233 per share, raising a net proceed of HK$142.1 million. The placing of shares was completed on 24 September 2004. As at 31 December 2004, the unused proceed was HK$137.3 million and were reserved as the working capital of the Group and for future opportunistic investments by the Group.