Notes to Financial Statements

31 December 2004

1. GROUP REORGANISATION AND BASIS OF PRESENTATION

The Company

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 26 February 2004 under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands.

The head office and principal place of business of the Company is located at Room 1502, Tower 6, China Hong Kong City, 33 Canton Road, Tsimshatsui, Kowloon, Hong Kong.

During the year, the Company and its subsidiaries (collectively referred to as the "Group") were principally engaged in the research, development, manufacturing and sale of mobile phones.

Comparative amounts have not been presented for the Company's balance sheet as the Company did not exist as at 31 December 2003.

Group reorganisation

Pursuant to a group reorganisation (the "Group Reorganisation") to rationalise the structure of the Group in preparation for the listing of its shares on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 27 September 2004, the Company became the holding company of all the wholly-owned subsidiaries now comprising the Group. This was accomplished by the Company acquiring the entire issued share capital of TCL Communication (BVI) Limited ("Communication BVI"), TCL Mobile Communication Holdings Limited ("Communication Holdings") and Alpha Alliance Enterprises Limited ("Alpha Alliance"), which are, subsequent to the Group Reorganisation, the intermediate holding companies of the other wholly-owned subsidiaries as set out in note 16 of this financial statements. The Group Reorganisation involved the following:

(a) On 26 February 2004, the Company was incorporated in the Cayman Islands.

(b) On 27 February 2004, Communication BVI allotted and issued one share to T.C.L. Industries Holdings (H.K.) Limited ("TCL Industries") at par credited as fully paid representing the entire issued share capital of Communication BVI.

(c) On 5 March 2004, the sole and nil paid subscriber share was transferred from Codan Trust Company (Cayman) Limited to TCL Industries.

(d) On 8 March 2004, TCL Mobile declared a dividend in the aggregate amount of RMB1,458,700,000 to its shareholders, TCL Corporation, TCL Holdings (BVI) Limited ("TCL BVI"), Cheerful Asset Investments Limited ("Cheerful Asset"), Jasper Ace Limited ("Jasper Ace") and Mate Fair Group Limited ("Mate Fair") on a pro rata basis to their equity interests in TCL Mobile.

(e) On 21 May 2004, Communication Holdings allotted and issued one share to TCL BVI credited as fully paid representing the entire issued share capital in Communication Holdings in consideration of the transfer from TCL BVI of a 40.8% equity interest in TCL Mobile to Communication Holdings.

(f) On 21 May 2004, Alpha Alliance allotted and issued 100 shares, 90 shares and 42 shares to Cheerful Asset, Jasper Ace and Mate Fair, respectively, credited as fully paid representing 10%, 9% and 4.2% of the enlarged issued share capital in Alpha Alliance, respectively, in consideration of transfer of their respective 10%, 9% and 4.2% equity interests in TCL Mobile to Alpha Alliance.

(g) On 21 May 2004, Communication BVI acquired a 36% equity interest in TCL Mobile from TCL Corporation for a cash consideration of RMB141,797,600.

1. GROUP REORGANISATION AND BASIS OF PRESENTATION (continued)

Group reorganisation (continued)

(h) On 10 August 2004, the Company allotted and issued 408 shares, 100 shares, 90 shares and 42 shares to TCL Multimedia Technology Holdings Limited ("TCL Multimedia") (formerly known as TCL International Holdings Limited) (which was acquired from TCL BVI, its wholly-owned subsidiary, through a distribution in specie of the entire issued share capital in Communication Holdings), Cheerful Asset, Jasper Ace and Mate Fair, respectively, credited as fully paid at par in consideration of the transfer to the Company of their respective interests in Communication Holdings and Alpha Alliance.

(i) On 10 August 2004, the Company allotted and issued 359 shares to TCL Industries credited as fully paid at par and credited one nil paid share held by TCL Industries as fully paid at par in consideration of the transfer to the Company its entire interest in Communication BVI.

(j) On 25 August 2004, the Company allotted and issued 1,153,619,592 shares, 282,749,900 shares, 254,474,910 shares and 118,754,958 shares to TCL Multimedia (which was acquired from TCL BVI, its wholly-owned subsidiary, by way of a distribution in specie, the entitlement of TCL BVI to receive the dividend declared by TCL Mobile referred to in paragraph (d) above), Cheerful Asset, Jasper Ace and Mate Fair, respectively, credited as fully paid at par in consideration for their transfer to the Company of their respective entitlements to receive the dividend declared by TCL Mobile referred to in paragraph (d) above.

(k) On 25 August 2004, the Company allotted and issued 1,017,899,640 shares to TCL Industries credited as fully paid at par in cash consideration of RMB525,132,079.

Further details of the Group Reorganisation are set out in note 27 to the financial statements and in the Company's listing document dated 20 September 2004 (the "Listing Document").

The shares of the Company were listed on the Main Board of the Stock Exchange on 27 September 2004 (the "Listing Date") by way of introduction.

Basis of presentation and consolidation

Except for the acquisition of the TCL & Alcatel Mobile Phones Limited ("T&A") and its subsidiaries (hereinafter collectively referred to as "T&A Group", which had been accounted for using acquisition accounting and were acquired subsequent to the Group Reorganisation, the consolidated financial statements have been prepared using the merger basis of accounting as a result of the Group Reorganisation. On this basis, the Company was treated as the holding company of its subsidiaries except for T&A Group for the financial years presented rather than from the date of their acquisition. Accordingly, the consolidated results of the Group for the years ended 31 December 2004 and 2003 include the results of the Company and its subsidiaries except for T&A Group with effect from 1 January 2003 or since their respective dates of incorporation, where this is a shorter period. The comparative combined balance sheet as at 31 December 2003 has been prepared on the basis that the existing Group had been in place at that date.

1. GROUP REORGANISATION AND BASIS OF PRESENTATION (continued)

Basis of presentation and consolidation (continued)

In the opinion of the directors, the consolidated financial statements prepared on the above basis present more fairly the results and state of affairs of the Group as a whole.

All significant intercompany transactions and balances within the Group are eliminated in the preparation of the consolidated financial statements.

Minority interests represent the interests of outsider shareholders in the results and net assets of the Company's subsidiaries.

2. IMPACT OF RECENTLY ISSUED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

The Hong Kong Institute of Certified Public Accountants has issued a number of new Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The Group has already commenced an assessment of the impact of these new HKFRSs but is not yet in a position to state whether these new HKFRSs would have a significant impact on its results of operations and financial position.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted by the Group in arriving at the financial information set out in this report, which conform with accounting principles generally accepted in Hong Kong, are as follows:

Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (which also include Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention.

Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

The results of subsidiaries are included in the Company's profit and loss account to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

Joint venture companies

A joint venture company is a company set up by contractual arrangement, whereby the Group and other parties undertake an economic activity. The joint venture company operates as a separate entity in which the Group and the other parties have an interest.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Joint venture companies (continued)

The joint venture agreement between the venturers stipulates the capital contributions of the joint venture parties, the duration of the joint venture and the basis on which the assets are to be realised upon its dissolution. The profits and losses from the joint venture company's operations and any distributions of surplus assets are shares by the venturers, either in proportion to their respective capital contributions, or in accordance with the terms of the joint venture agreement.

A joint venture company is treated as a subsidiary, if the Company has unilateral control, directly or indirectly, over the joint venture company.

Negative goodwill

Negative goodwill arising on the acquisition of subsidiaries represents the excess of the Group's share of the fair values of the identifiable assets and liabilities acquired as at the date of acquisition, over the cost of the acquisition.

To the extent that negative goodwill relates to expectations of future losses and expenses that are identified in the acquisition plan and that can be measured reliably, but which do not represent identifiable liabilities as at the date of acquisition, that portion of negative goodwill is recognised as income in the consolidated profit and loss account when the future losses and expenses are recognised.

To the extent that negative goodwill does not relate to identifiable expected future losses and expenses as at the date of acquisition, negative goodwill is recognised in the consolidated profit and loss account on a systematic basis over the remaining average useful life of the acquired depreciable/amortisable assets. The amount of any negative goodwill in excess of the fair values of the acquired non-monetary assets is recognised as income immediately.

Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

Impairment of assets

An assessment is made at each balance sheet date of whether there is any indication of impairment of any asset, or whether there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use and its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the profit and loss account in the period in which it arises, unless the asset is carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of assets (continued)

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is credited to the profit and loss account in the period in which it arises.

Fixed assets and depreciation

Fixed assets, other than construction in progress, are stated at cost less accumulated depreciation and any impairment losses. The cost of an asset comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after fixed assets have been put into operation, such as repairs and maintenance, is normally charged to the profit and loss account in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on the straight-line basis to write off the cost of each asset over its estimated useful life less any estimated residual value. The principal annual rates used for this purpose are as follows:

Leasehold land	Over the lease terms
Buildings	2.86%
Plant and machinery	10% to 20%
Furniture, fixtures and office equipment	20%
Motor vehicles	16.67% to 20%

The gain or loss on disposal or retirement of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Construction in progress is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction and capitalised borrowing costs on related borrowed funds during the period of construction. Construction in progress is reclassified to the appropriate category of fixed assets when completed and ready for use.

Intangible assets

Software product licenses

Purchased software product licenses are stated at cost and are amortised on the straight-line basis over their estimated useful life of two years.

Computer software

Purchased computer software is stated at cost, less any impairment losses, and is amortised on the straight-line basis over its estimated useful life of five years.

Intellectual property

Purchased intellectual property is stated at cost, less any impairment losses, and is amortised on the straight-line basis over its estimated useful life.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Leased assets

Leases that transfer substantially all the rewards and risks of ownership of assets to the Group, other than legal title, are accounted for as finance leases. At the inception of a finance lease, the cost of the leased asset is capitalised at the present value of the minimum lease payments and recorded together with the obligation, excluding the interest element, to reflect the purchase and financing. Assets held under capitalised finance leases are included in fixed assets and depreciated over the estimated useful life of the assets. The finance costs of such leases are charged to the profit and loss account so as to provide a constant periodic rate of charge over the lease terms.

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessee, rentals payable under the operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate proportion of overheads. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

Accounts receivables

Accounts receivables are recognised and carried at original invoiced amount, less provisions for doubtful debts when the collection of the full amount is no longer considered probable. Bad debts are written off as incurred.

Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are repayable on demand and form an integral part of the Group's cash management. For the purpose of the balance sheet, cash and bank balances comprise cash on hand and at banks, including term deposits, and assets similar in nature to cash, which are not restricted as to use.

Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the profit and loss account.

Provisions for product warranties granted by the Group on certain products are recognised based on sales volume and past experience of the level of repairs and returns.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the profit and loss account, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognised for all taxable temporary differences:

— except where the deferred tax liability arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

— in respect of taxable temporary differences associated with investments in subsidiaries, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax assets and unused tax losses can be utilised:

— except where the deferred tax assets relating to the deductible temporary difference arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

— in respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carry amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow into the Group and when the revenue can be measured reliably, on the following bases:

(a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold; and

(b) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable; and

(c) subsidy income, when there is reasonable assurance that the subsidy will be received and all attaching conditions have been complied with; and

(d) value-added services income, upon the provision of the relevant services.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Employee benefits

Central Pension Scheme

Subsidiaries operating in Mainland China have participated in the Central Pension Scheme (the "CPS") operated by the government of the People's Republic of China (the "PRC") for all of their staff. These PRC subsidiaries are required to contribute a certain percentage of their covered payroll to the CPS to fund the benefits. The only obligation of the Group with respect to the CPS is to pay the ongoing required contributions under the CPS. Contributions under the CPS are charged to the profit and loss account as they become payable in accordance with the rules of the CPS.

Mandatory Provident Fund

The Company's subsidiaries, incorporated in Hong Kong, operate a defined contribution Mandatory Provident Fund retirement benefits scheme (the "MPF Scheme") under the Mandatory Provident Fund Schemes Ordinance, for all of its employees in Hong Kong. Contributions are made based on a percentage of the employees' basic salaries and are charged to the profit and loss account as they become payable in accordance with the rules of the MPF Scheme. The assets of the MPF Scheme are held separately from those of the Group in an independently administered fund. The employer contributions vest fully with the employees when contributed into the MPF Scheme except for the employer voluntary contributions, which are refunded to the Company and its subsidiaries which are incorporated outside the PRC when an employee leaves employment prior to the contributions vesting fully, in accordance with the rules of the MPF Scheme.

Retirement indemnities

A subsidiary of the Group incorporated in France operates a defined contribution plan (the "contribution plan") and a defined benefit pension plan (the "pension plan"). For the pension plan, corresponding to retirement indemnities relating to its employees, liabilities and prepaid expenses are determined as follows:

- using the "Projected Unit Credit Method", with projected final salary, which considers that each period of service gives rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. Actuarial assumptions comprise mortality, rates of employee turnover and projection of future salary levels; and
- recognising, over the expected average remaining working lives of the employees participating in the plan, actuarial gains and losses in excess of more than 10% of the present value of the defined benefit obligation or 10% of the fair value of any plan assets.

Long service medals

In accordance with the local rules and regulations of France, an enterprise is required to make contributions to its employee benefits scheme as long service medals effective 1 January 2003. The cumulative effect of such change was recorded in other expenses.

Government grant

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the profit and loss account over the expected useful life of the relevant asset by equal annual instalments.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction on production of qualifying assets, i.e. assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sales. Investment income earned on the temporary investment of specific borrowings pending their expenditure qualifying assets is deducted from the borrowing costs capitalised.

Foreign currencies

Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable exchange rates ruling at that date. Exchange differences are dealt with in the profit and loss account.

On consolidation, the financial statements of overseas subsidiaries are translated into Hong Kong dollars using the investment method. The profit and loss accounts of overseas subsidiaries are translated into Hong Kong dollars at the weighted average exchange rates for the year, and their balance sheets are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. The resulting translation differences are included in the exchange fluctuation reserve.

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiaries are translated into Hong Kong dollars at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries which arise throughout the year are translated into Hong Kong dollars at the weighted average exchange rates for the year.

4. SEGMENT INFORMATION

The Group is principally engaged in the manufacture and sale of mobile phones and related components. All of the Group's products are of a similar nature and subject to similar risks and returns. Accordingly, the Group's operating activities are attributable to a single business segment.

The Group's operations are located in France, the PRC and Mexico. Each of the Group's geographical segment represents the location of the business divisions' production or service facilities which are subject to risks and returns that are different from those of the other geographical segments.

The following tables present revenue and certain asset and expenditure information for the Group's geographical segments.

	France		PRC		Mexico		Eliminations		Consolidated	
	2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
	HK$'000	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000	**HK$'000**	HK$'000
Segment revenue:										
Sales to external customers	**1,433,237**	—	**5,759,694**	9,019,503	**116,807**	—	**—**	—	**7,309,738**	9,019,503

Notes to Financial Statements

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4. SEGMENT INFORMATION (continued)

	France		PRC		Mexico		Eliminations		Consolidated	
	2004 HK$'000	2003 HK$'000	**2004 HK$'000**	2003 HK$'000	**2004 HK$'000**	2003 HK$'000	**2004 HK$'000**	2003 HK$'000	**2004 HK$'000**	2003 HK$'000
Other segment information:										
Segment assets	**1,730,545**	—	**4,048,946**	4,191,301	**127,428**	—	**(424,509)**	—	**5,482,410**	4,191,301
Capital expenditure	**15,685**	—	**173,741**	121,308	**—**	—	**—**	—	**189,426**	121,308

5. TURNOVER, OTHER REVENUE AND GAINS

Turnover represents the net invoiced value of goods sold net of value-added tax ("VAT"), and services rendered during the year, after allowances for returns and trade discounts. All significant intra-group transactions have been eliminated on consolidation.

An analysis of the Group's turnover and other revenue and gains is as follows:

	Notes	**2004 HK$'000**	2003 HK$'000
Turnover			
Sale of mobile phones and related components		**7,309,738**	9,019,503
Other revenue			
Interest income		**16,469**	9,091
Subsidy income		**48,315**	8,877
Value-added services income		**10,211**	1
Exchange gains		**82,465**	—
Other		**3,558**	3,232
		161,018	21,201
Gains			
Gain on disposal of a subsidiary	30(b)	**1,268**	—
Negative goodwill recognised	15	**2,760**	—
		4,028	—
Other revenue and gains		**165,046**	21,201

Negative goodwill recognised represents the portion of negative goodwill arising on acquisition in expectation of identified future losses and expenses, which did not represent identifiable liabilities as at the date of acquisition, recognised during the year.

6. PROFIT/ (LOSS) FROM OPERATING ACTIVITIES

The Group's profit/ (loss) from operating activities is arrived at after charging/(crediting):

	Notes	2004 HK$'000	2003 HK$'000
Cost of inventories sold		**6,124,561**	7,127,920
Depreciation	13	**65,121**	39,340
Amortisation of intangible assets	14	**1,292**	12,433
Advertising and promotion expenses		**443,749**	647,138
Brand management fee/TCL Brand Common Fund		**27,816**	26,906
Research and development costs:			
Software expenses		**44,026**	22,921
Minimum lease payments under operating leases in respect of land and buildings		**20,024**	1,918
Auditors' remuneration		**1,922**	292
Staff costs (excluding directors' remuneration (note 8)):			
Salaries and wages		**343,408**	151,934
Pension scheme contributions:***			
Defined contribution scheme		**14,018**	11,628
Defined benefit scheme	24	**3,098**	—
		360,524	163,562
Provision for doubtful debts		**4,355**	2,025
Provision against inventory obsolescence and net realisable value*		**156,881**	942
Product warranty provisions		**88,472**	53,998
Loss on disposal of fixed assets		**901**	238
Reversal of impairment of fixed assets**	13	**(239)**	(1,512)

* The provision against inventory obsolescence and net realisable value is included in "Cost of sales" on the face of the consolidated profit and loss account.

** The reversal of impairment of fixed assets is included in "Other operating expenses" on the face of the consolidated profit and loss account.

*** During the year, there were no forfeited contributions available to offset the Group's pension contributions.

7. FINANCE COSTS

	Group 2004 HK$'000	2003 HK$'000
Interest on discounted notes	**5,361**	8,734
Interest on bank loans and other loans wholly repayable within one year	**14,620**	402
Interest on finance leases	**271**	812
	20,252	9,948

8. DIRECTORS' REMUNERATION AND FIVE HIGHEST PAID EMPLOYEES

Directors' remuneration for the year, disclosed pursuant to the Listing Rules and Section 161 of the Hong Kong Companies Ordinance, is as follows:

	Group	
	2004	2003
	HK$'000	HK$'000
Fees	**94**	—
Salaries, allowances and benefits in kind	**1,986**	2,100
Pension scheme contributions	**42**	35
	2,122	2,135

Fees include HK$94,000 (2003: Nil) payable to the independent non-executive directors. There were no other emoluments payable to the independent non-executive directors during the year (2003: Nil).

The number of directors whose remuneration fell within the following band is as follows:

	Number of directors	
	2004	2003
Nil to HK$1,000,000	**10**	6

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

The five highest paid employees during the year included two (2003: two) directors, details of whose remuneration are set out above.

Details of the remuneration of the remaining three (2003: three) non-director, highest paid employees for the year are as follows:

	2004	2003
	HK$'000	HK$'000
Salaries, allowances and benefits in kind	**1,810**	1,689
Pension scheme contributions	**77**	51
	1,887	1,740

The number of non-director, highest paid employees whose remuneration fell within the following band is as follows:

	Number of non-director, highest paid employees	
	2004	2003
Nil to HK$1,000,000	**3**	3

During the year no emoluments were paid by the Group to the directors or any of the five highest paid employees as an inducement to join or upon joining the Group or as compensation for loss of office.

9. TAX

Group:

	2004 HK$'000	2003 HK$'000
Current year provision:		
Hong Kong	**348**	3,645
Mainland China		
Charge for the year	**48,106**	6,325
Overprovision in prior years*	**(45,950)**	—
Elsewhere	**(4,181)**	—
Deferred (note 26)	**(1,321)**	257
Tax charge/(credit) for the year	**(2,998)**	10,227

* The overprovision in prior years included a refund of approximately HK$35,695,000 (2003: Nil) in respect of the re-investment to TCL Mobile by the then shareholders in 2002.

Hong Kong profits tax has been provided at a rate of 17.5% (2003: 17.5%) on the estimated assessable profits arising in Hong Kong during the year.

Taxes on profits assessable elsewhere have been calculated at the rates of tax prevailing in the countries in which the Group operates, based on existing legislation, interpretations and practices in respect thereof.

The normal national income tax rate in China is 30%. However, China provides a number of tax benefits to foreign investment enterprises. Those foreign investment enterprises accredited as high and new technology enterprises in the high and new technology development parks designated by the State Council enjoy a national income tax rate of 15%. Those foreign investment enterprises located in the designated western areas of China (including Inner Mongolia) also enjoy a national income tax rate of 15% from 2001 to 2010. In addition, foreign investment enterprises that are in manufacturing business and scheduled to operate no less than 10 years are exempt from national income tax for two years starting from the first profit-making year and enjoy a 50% reduction in the applicable national income tax rate for the following three years. Furthermore, those manufacturing foreign investment enterprises designated as advanced technology enterprises enjoy additional three years' 50% reduction in the applicable national income tax rate subject to a minimum rate of 10%. Local enterprise income tax is often waived or reduced during this tax incentive period.

TCL Mobile, a subsidiary of the Company in the PRC, has a high and new technology enterprise accreditation effective until 28 May 2005. It was exempt from the national income tax in 2000 and 2001 and has been subject to a national income tax rate of 7.5% since 2002. The 7.5% income tax rate for TCL Mobile expired at the end of 2004. By the end of 2004, TCL Mobile obtained its advanced technology enterprise accreditation and hence would be subject to a national income tax rate of 10% from 2005 to 2007.

9. TAX (continued)

Group: (continued)

According to the Income Tax Law of the PRC on the Enterprises with Foreign Investment and Foreign Enterprises, TCL Mobile Communication (Hohhot) Co., Ltd. ("Mobile Hohhot"), a subsidiary of the Company in the PRC, is entitled to exemption from the PRC corporate income tax for two years commencing from its first profit-making year and thereafter is entitled to a 50% reduction in its PRC corporate income tax for the subsequent three years. Mobile Hohhot also enjoys preferential tax treatment granted to foreign investment enterprises located in the western region of China, including a 50% reduction in national corporate income tax until 2010. As Mobile Hohhot commenced to make profits in 2002, it was exempt from PRC corporate income tax in 2002 and 2003, and the applicable PRC corporate income tax rate in 2004 to 2006 is 7.5%. If Mobile Hohhot received its advanced technology enterprise accreditation at or before the end of 2006 and the relevant PRC tax law remains effective, Mobile Hohhot would enjoy a PRC corporate income tax rate of 10% for three years starting 2007. Otherwise, Mobile Hohhot would be subject to the PRC corporate income tax rate of 15% from 2007 to 2010 and 30% thereafter.

A reconciliation of the tax expense applicable to profit/(loss) before tax using the statutory rates for the countries in which the Company and its subsidiaries are domiciled to the tax expense at the effective tax rates, and a reconciliation of the applicable rates (i.e., the statutory tax rates) to the effective tax rates, are as follows:

	2004		2003	
	HK$'000	**%**	HK$'000	%
Profit/(loss) before tax	**(342,843)**		794,391	
Tax at the applicable rates:				
33%	**(128,631)**	**37.5**	259,007	32.6
17.5%	**8,224**	**(2.4)**	1,666	0.2
Sub-total	**(120,407)**	**35.1**	260,673	32.8
Lower tax rate for specific provinces or local authority	**25,292**	**(7.3)**	(253,833)	(31.9)
Income not subject to tax	**(23,789)**	**6.9**	(1,677)	(0.2)
Expenses not deductible for tax	**275**	**(0.1)**	5,064	0.6
Tax loss not recognised	**161,581**	**(47.1)**	—	—
Adjustments in respect of current tax of previous periods	**(45,950)**	**13.4**	—	—
Tax charge/(credit) at the Group's effective rate	**(2,998)**	**0.9**	10,227	1.3

10. NET LOSS ATTRIBUTABLE TO SHAREHOLDERS

The net loss attributable to shareholders for the year ended 31 December 2004 dealt with in the financial statements of the Company, was HK$62,934,000 (note 29(b)).

11. DIVIDENDS

No dividend has been paid or declared by the Company since the date of its incorporation.

In 2004, TCL Mobile declared an interim dividend of HK$1,376,132,000 (RMB1,458,700,000) to its then shareholders. Subsequently on 25 August 2004, all the shareholders had reinvested this dividend into the Company except for TCL Industries whose reinvestment was in the form of cash.

A final dividend in the amount of HK$271,098,000 (RMB287,363,000) were declared and paid by TCL Mobile to its then shareholders for the year ended 31 December 2003.

The dividend rates and the number of shares ranking for dividends are not presented because such information is not considered meaningful for the purpose of this report.

12. EARNINGS/(LOSS) PER SHARE

The calculation of basic loss per share is based on the net loss attributable to shareholders for the year of HK$223,535,000 (2003: net profit of HK$784,164,000), and the weighted average of 2,827,500,000 (2003: 2,827,500,000) ordinary shares in issue during the year. The weighted average of 2,827,500,000 ordinary shares for 2003 was deemed to have been in issue.

The calculation of diluted loss per share for the year is based on the net loss before minority interests of HK$339,845,000 of which the minority shareholder of the Group will become the shareholder of the Company upon the exercise of the option for converting its interest in the T&A into the shares of the Company. Details of the respective option agreement are disclosed in note 28 to the financial statements.

The weighted average number of ordinary shares used in the calculation is 2,827,500,000 ordinary shares in issue during the year, as used in the basic loss per share calculations; the weighted average of 131,409,915 ordinary shares assumed to have been issued upon the exercise of the option by the minority shareholder to convert its interest in the T&A into the shares of the Company.

Diluted earnings per share have not been disclosed for the year ended 31 December 2003 as no dilutive potential ordinary shares existed.

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13. FIXED ASSETS

Group

	Leasehold land and buildings HK$'000	Plant and machinery HK$'000	Furniture, fixtures and office equipment HK$'000	Motor vehicles HK$'000	Construction in progress HK$'000	Total HK$'000
Cost:						
At 1 January 2004	35,186	244,558	21,718	11,174	10,833	323,469
Additions	46,368	121,234	12,116	987	4,865	185,570
Acquisition of subsidiaries (note 30(a))	—	72,889	44,811	882	319	118,901
Transfer in/out	14,173	337	—	—	(14,510)	—
Disposals	—	(2,318)	(1,459)	(583)	—	(4,360)
Exchange realignment	—	5,594	1,086	2	18	6,700
At 31 December 2004	95,727	442,294	78,272	12,462	1,525	630,280
Accumulated depreciation and impairment:						
At 1 January 2004	1,860	57,013	5,572	3,385	—	67,830
Acquisition of subsidiaries (note 30(a))	—	25,785	31,541	823	—	58,149
Provided during the year	1,837	53,451	7,165	2,668	—	65,121
Written back on disposal	—	(503)	(525)	(361)	—	(1,389)
Reversal of impairment during the year recognised in the profit and loss account	—	(239)	—	—	—	(239)
Exchange realignment	—	938	192	2	—	1,132
At 31 December 2004	3,697	136,445	43,945	6,517	—	190,604
Net book value:						
At 31 December 2004	92,030	305,849	34,327	5,945	1,525	439,676
At 31 December 2003	33,326	187,545	16,146	7,789	10,833	255,639

The Group's land and buildings, included above at cost, were valued at HK$120,950,000 as at 30 June 2004 in the Listing Document issued on 20 September 2004 in connection with the listing by way of introduction of the Company's shares on 27 September 2004 (note 27). Had the Group's land and buildings been included in these financial statements at such valuation amount throughout the year ended 31 December 2004, an additional depreciation charge of HK$1,054,000 would have been charged to the consolidated profit and loss account for the year ended 31 December 2004.

13. FIXED ASSETS (continued)

Group (continued)

The net book value of the Group's fixed assets held under finance leases included in the total amount of plant and machinery as at 31 December 2004, amounted to nil (2003: HK$20,186,792).

During the year, impairment provision was made in respect of assets that the directors believe the respective recoverable amount in the future is lower than the carrying amount.

The Group's land and buildings are situated in Mainland China and are held under the following lease terms:

	HK$'000
At cost:	
Long term leases	95,727

Company

	Leasehold improvements HK$'000	Furniture, fixtures and office equipment HK$'000	Motor vehicles HK$'000	Total HK$'000
Cost:				
At 26 February 2004 (date of incorporation)	—	—	—	—
Additions	256	466	429	1,151
At 31 December 2004	256	466	429	1,151
Accumulated depreciation and impairment:				
At 26 February 2004 (date of incorporation)	—	—	—	—
Provided during the period	42	30	14	86
At 31 December 2004	42	30	14	86
Net book value:				
At 31 December 2004	214	436	415	1,065

14. INTANGIBLE ASSETS

Group

	Software product licenses HK$'000	Computer software HK$'000	Intellectual property HK$'000	Total HK$'000
Cost:				
At 1 January 2004	21,574	4,909	—	26,483
Acquisition of subsidiaries	—	1,274	23,510	24,784
Additions	—	3,856	—	3,856
Disposals	(21,574)	—	—	(21,574)
Exchange realignment	—	143	2,687	2,830
At 31 December 2004	—	10,182	26,197	36,379
Accumulated amortisation:				
At 1 January 2004	21,574	1,220	—	22,794
Provided during the year	—	1,292	—	1,292
Disposals	(21,574)	—	—	(21,574)
At 31 December 2004	—	2,512	—	2,512
Net book value:				
At 31 December 2004	—	7,670	26,197	33,867
At 31 December 2003	—	3,689	—	3,689

Company

	Computer software HK$'000
Cost:	
At 26 February 2004 (date of incorporation)	—
Additions	11
At 31 December 2004	11
Accumulated amortisation:	
At 26 February 2004 (date of incorporation)	—
Provided during the period	1
At 31 December 2004	1
Net book value:	
At 31 December 2004	10

15. NEGATIVE GOODWILL

The amount of the negative goodwill recognised in the consolidated balance sheet, arising from the acquisition of subsidiaries, is as follows:

Group:

	HK$'000
Cost:	
At 1 January 2004	—
Acquisition of subsidiaries (note 30(a))	41,398
At 31 December 2004	41,398
Accumulated recognition as income:	
At 1 January 2004	—
Recognised as income	2,760
At 31 December 2004	2,760
Net book value:	
At 31 December 2004	38,638
At 31 December 2003	—

16. INTERESTS IN SUBSIDIARIES

	Company
	2004 HK$'000
Unlisted shares, at cost	1,185,912
Due from subsidiaries	841,470
	2,027,382

The amounts due from subsidiaries included in the Company's current assets are unsecured, interest-free and have no fixed terms of repayment.

Notes to Financial Statements

31 December 2004

16. INTERESTS IN SUBSIDIARIES (continued)

Particulars of the principal subsidiaries are as follows:

Name	Place and date of incorporation/place of registration and operations	Nominal value of issued and fully paid share capital	Percentage of equity interests attributable to the Company Direct	Indirect	Principal activities
TCL Communication (BVI) Limited	British Virgin Islands 27 February 2004/ British Virgin Islands	US$1	100%	—	Investment holding
TCL Mobile Communication Holdings Limited	British Virgin Islands 12 February 2003/ British Virgin Islands	US$1	100%	—	Investment holding
Alpha Alliance Enterprises Limited	British Virgin Islands 12 December 2003/ British Virgin Islands	US$1	100%	—	Investment holding
TCL Mobile Communication (HK) Company Limited	Hong Kong 21 April 1999/ Hong Kong	HK$5,000,000	—	100%	Trading of mobile phones components
Huizhou TCL Mobile Communication Co., Ltd. (note (i))	PRC 29 March 1999/ Mainland China	US$29,800,000	—	100%	Manufacture and sale of mobile phones
TCL Mobile Communication (Hohhot) Co., Ltd. (note (i))	PRC 29 April 2002/ Mainland China	RMB30,000,000	—	100%	Manufacture and sale of mobile phones
TCL & Alcatel Mobile Phones Limited ("T&A")	Hong Kong 17 May 2004/ Hong Kong	HK$10,000,000	55%	—	Investment holding
TCL & Alcatel Mobile Phones China Holding Limited	Hong Kong 17 May 2004/ Hong Kong	HK$1	—	55% (note (iii))	Investment holding
TCL & Alcatel Mobile Phones Americas Holding Limited	Hong Kong 17 May 2004/ Hong Kong	HK$1	—	55% (note (iii))	Investment holding
TCL & Alcatel Mobile Phones SAS	France 1 January 2004/ France	Euro20,040,000	—	55% (note (iii))	Development and distribution of mobile phones
TCL & Alcatel Mobile Phones SA de CV (note (ii))	Mexico 24 May 2004/ Mexico	US$4,300	—	55% (note (iii))	Distribution of mobile phones
Alcatel Suzhou Telecommunications Co., Ltd. (note (i))	PRC 14 December 1998/ Mainland China	US$28,000,000	—	55% (note (iii))	Development and distribution of mobile phones

16. INTERESTS IN SUBSIDIARIES (continued)

Notes:

(i) The subsidiaries are registered as wholly-foreign-owned enterprises under the PRC law.

(ii) Not audited by Ernst & Young Hong Kong or other Ernst & Young International member firms.

(iii) These subsidiaries are held through T&A.

During the year, the Group disposed to the management of TCL Mobile Information International Company Limited its 100% equity interest in TCL Mobile Information International Company Limited, which was incorporated in Hong Kong. The disposal of TCL Mobile Information International Company Limited which, in the opinion of the directors, had no material impact on the Group's consolidated turnover or net loss attributable to shareholders for the year.

The above table lists all the subsidiaries of the Company which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group.

17. INVENTORIES

	Group	
	2004	2003
	HK$'000	HK$'000
Raw materials	**664,590**	589,403
Work in progress	**62,510**	80,995
Finished goods	**525,374**	150,882
	1,252,474	821,280
Provision for inventory obsolescence and net realisable value	**(220,657)**	(60,315)
	1,031,817	760,965

The carrying amount of inventories carried at net realisable value included in the above balances was HK$249,495,000 (2003: HK$106,620,000).

18. TRADE RECEIVABLES

An aged analysis of the trade receivables as at the balance sheet date, based on invoice date, is as follows:

	Group	
	2004	2003
	HK$'000	HK$'000
Within 3 months	**1,039,339**	392,615
4 to 6 months	**170,082**	688
7 to 12 months	**7,353**	1,543
Over 1 year	**5,194**	113
	1,221,968	394,959
Provision for doubtful debts	**(11,448)**	(2,768)
	1,210,520	392,191

18. TRADE RECEIVABLES (continued)

For the majority of the Group's sales in PRC, the Group requests their customers to pay in advance through commercial notes guaranteed by banks with credit periods ranging from 90 days to 180 days.

For customers to whom the Group has granted credit terms, the credit terms are generally ranging from 31 days to 180 days.

19. CASH AND CASH EQUIVALENTS

	Group		Company
	2004	2003	**2004**
	HK$'000	HK$'000	**HK$'000**
Cash and bank balances	**2,005,683**	697,100	**2,492**
Pledged deposits	**11,373**	161,354	**—**
	2,017,056	858,454	**2,492**
Less: Pledged deposits:			
— for notes issued (note 21)	**11,373**	161,354	**—**
Cash and cash equivalents	**2,005,683**	697,100	**2,492**

At the balance sheet date, the cash and bank balances of the Group denominated in Renminbi ("RMB") amounted to approximately HK$665,992,000 (2003: HK$510,513,000). The RMB is not freely convertible into other currencies. However, under Mainland China's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for other currencies through banks authorised to conduct foreign exchange business.

20. DUE FROM/TO RELATED COMPANIES

Particulars of the amounts due from related companies, disclosed pursuant to Section 161B of the Hong Kong Companies Ordinance, are as follows:

		Group	
		2004	2003
	Notes	**HK$'000**	HK$'000
TCL 通訊設備(國際)有限公司 ("TCL Communication (Int'l) Ltd.")*	(ii)	**73**	127
TCL Integrated Marketing Inc.*	(ii)	**234**	194
TCL 通訊設備(惠州)有限公司 ("TCL Communication Equipment (Huizhou) Co., Ltd.")*	(ii)	**2,071**	87,777
TCL 集團股份有限公司 ("TCL Corporation")*	(i)	**46,381**	—
Alcatel Mexico*	(iii)	**2,071**	—
		50,830	88,098

* The amounts due are unsecured, interest-free and have no fixed terms of repayment.

20. DUE FROM/TO RELATED COMPANIES (continued)

Particulars of the maximum outstanding balance of amounts due from related companies are as follows:

	Group	
	2004	2003
	HK$'000	HK$'000
TCL Communication (Int'l) Ltd.	**127**	127
TCL Integrated Marketing Inc.	**234**	194
TCL Communication Equipment (Huizhou) Co., Ltd.	**214,390**	214,390
TCL Corporation	**46,381**	—
Alcatel Mexico	**2,071**	—

Particulars of the amounts due to related companies are as follows:

		Group	
		2004	2003
	Notes	**HK$'000**	HK$'000
TCL 集團物流有限公司 ("TCL Corporation Logistic Co., Ltd.")*	(ii)	**41,380**	—
TCL Corporation**	(i)	**—**	134,947
惠州 TCL 金能電池有限公司 ("TCL Hyper Power Batteries Co., Ltd.")*	(ii)	**24,369**	17,121
華通紙製品(惠州)有限公司 ("Chinaway Paper Production (Huizhou) Co., Ltd.")*	(ii)	**958**	587
TCL Communication Equipment (Huizhou) Co., Ltd.*	(ii)	**609**	—
TCL 空調器(中山)有限公司 ("TCL Air-conditioner (Zhongshan) Co., Ltd.")*	(ii)	**143**	—
TCL 王牌電器(惠州)有限公司 ("Huizhou TCL King Electronics Co., Ltd.")*	(ii)	**719**	—
惠州 TCL 文化發展有限公司 ("TCL Culture Development (Huizhou) Co., Ltd.")*	(ii)	**132**	—
TCL 通訊技術貿易有限公司 ("Huizhou TCL Communication Technology & Trade Co., Ltd.")*	(ii)	**—**	3,419
Alcatel Business Systems*	(iii)	**34,031**	—
Alcatel Espana SA*	(iii)	**11,019**	—
Alcatel China Investment Co., Ltd.*	(iii)	**495**	—
Alcatel China Ltd.*	(iii)	**102**	—
Alcanet International Asia Pacific Pte. Ltd.*	(iii)	**232**	—
Alcatel Shanghai Bell Co., Ltd.*	(iii)	**20**	—
		114,209	156,074

* The amounts due are unsecured, interest-free and have no fixed terms of repayment.

** Except for the balance of HK$4,068,383,000 in 2004, which was unsecured, bore interest at a rate of 3.2% per annum and had no fixed terms of repayment, the amounts due are mainly trading balances and are unsecured, interest-free and have no fixed terms of repayment.

Notes:

(i) TCL Corporation is the ultimate controlling shareholder of the Company.

(ii) These companies are subsidiaries of TCL Corporation.

(iii) These companies are subsidiaries of the Group's minority shareholder.

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21. TRADE AND NOTES PAYABLES

An aged analysis of the Group's trade and bills payables as at the balance sheet date, based on invoice date, is as follows:

	Group		Company
	2004	2003	**2004**
	HK$'000	HK$'000	**HK$'000**
Within 3 months	**1,756,319**	1,142,514	**31,542**
4 to 6 months	**110,097**	35,506	**6,676**
7 to 12 months	**1,124**	57,329	—
More than 1 year	**10,173**	2,353	—
	1,877,713	1,237,702	**38,218**

Notes payables of HK$107,568,000 (2003: HK$353,268,000) were secured by the pledge of deposits amounting to HK$11,373,000 (2003: 161,354,000) (note 19).

22. OTHER PAYABLES AND ACCRUALS

	Group		Company
	2004	2003	**2004**
	HK$'000	HK$'000	**HK$'000**
Value-added tax payable	—	72,004	—
Advances from customers	**109,661**	430,142	—
Salaries and welfares payable	**107,171**	15,143	—
Accrued operating expenses	**847,701**	24,175	**10,042**
Other payables#	**153,661**	211,800	—
Provision for warranties*	**143,248**	12,755	—
	1,361,442	766,019	**10,042**

\# Other payables mainly comprised deposits received from customers and distributors in respect of additional handsets obtained for replacement of problematic handsets returned from ultimate users.

* The movements of provision for warranties during the year are as follows:

	Group	
	2004	2003
	HK$'000	HK$'000
At beginning of year	**12,755**	11,691
Acquisition of subsidiaries	**143,416**	—
Provision	**88,472**	53,998
Utilised	**(112,574)**	(52,934)
Exchange realignment	**11,179**	—
At end of year	**143,248**	12,755

22. OTHER PAYABLES AND ACCRUALS (continued)

The Group generally provides one-year warranty to its customers on all products, under which faulty products are repaired or replaced. The amount of the provision for warranty is estimated based on sales volumes and past experience of the level of repairs and returns. The estimation basis is reviewed on an ongoing basis and revised where appropriate. During the year, the provision of warranty was not discounted, as the effect of discounting was not material.

23. FINANCE LEASE PAYABLES

The Group acquired certain of its machinery through finance leases. All the leases were repaid during the year.

As at 31 December 2004, the total future minimum lease payments under finance leases and their present values for Group were as follows:

Group

	Minimum lease payments		Present value of minimum lease payments	
	2004 HK$'000	2003 HK$'000	**2004 HK$'000**	2003 HK$'000
Amounts repayable:				
Within one year	—	2,603	—	2,332
Total minimum finance lease payments	—	2,603	—	2,332
Future finance charges	—	(271)		
Total net finance lease payables	—	2,332		
Portion classified as current liabilities	—	2,332		
Long term portion	—	—		

24. RETIREMENT INDEMNITIES

Retirement indemnities in respect of the defined benefits scheme for the year ended 31 December 2004 amounted to HK$45,030,000.

	Group	
	2004 HK$'000	2003 HK$'000
Present value of fund obligation	**45,030**	—
Unrealised actuarial losses	—	—
Net liabilities in the balance sheet	**45,030**	—

24. RETIREMENT INDEMNITIES (continued)

Movement in the net liabilities recognised in the balance sheet during the year are as follow:

	Group	
	2004 HK$'000	2003 HK$'000
Net liabilities at beginning of year	—	—
Acquisition of subsidiaries	37,418	—
Benefit expenses recognised in the consolidated results (note 6)	3,098	—
Exchange realignment	4,514	—
Net liabilities at end of year	45,030	—

TCL & Alcatel Mobile Phones SAS does not have any unfunded obligations.

The main assumptions used in the retirement indemnity computation for the defined benefits scheme are as follows:

- Discount rate: 4.3%
- Future salary increase: 1% per annum

25. LONG SERVICE MEDALS

TCL & Alcatel Mobile Phones SAS provides for the probable future long service medals expected to be made to employees, as further explained under the heading "Long service medals" in note 3. The provision is based on the best estimate of the probable future payments which have been earned by the employees from their service to TCL & Alcatel Mobile Phones SAS to the balance sheet date.

26. DEFERRED TAX

Deferred tax assets

Group

	2004				
	Product warranty provision HK$'000	Provision against obsolete stock HK$'000	Impairment for fixed assets HK$'000	Tax losses HK$'000	Total HK$'000
At 1 January 2004	957	4,524	242	442	6,165
Acquisition of subsidiaries	7,143	—	—	—	7,143
Exchange realignment	1	—	—	—	1
Deferred tax credited/(charged) to the profit and loss account during the year (note 9)	1,344	—	—	(23)	1,321
Gross deferred tax assets at 31 December 2004	9,445	4,524	242	419	14,630
Net deferred tax assets at 31 December 2004	9,445	4,524	242	419	14,630

At 31 December 2004, there was no significant unrecognised deferred tax liability (2003: Nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries as the Group has no liability to additional tax should such amounts be remitted due to the availability of double tax relief.

	2003				
	Product warranty provision HK$'000	Provision against obsolete stock HK$'000	Impairment for fixed assets HK$'000	Tax losses HK$'000	Total HK$'000
At 1 January 2003	876	4,454	355	737	6,422
Deferred tax credited/(charged) to the profit and loss account during the year (note 9)	81	70	(113)	(295)	(257)
Gross deferred tax assets at 31 December 2003	957	4,524	242	442	6,165
Net deferred tax assets at 31 December 2003	957	4,524	242	442	6,165

27. SHARE CAPITAL

Shares

	2004 HK$'000
Authorised:	
5,000,000,000 (2003: Nil) ordinary shares of HK$0.10 each	**500,000**
Issued and fully paid or credited as fully paid:	
2,827,500,000 (2003: Nil) ordinary shares of HK$0.10 each	**282,750**

The following changes in the Company's authorised and issued share capital took place during the period from 26 February 2004 (date of incorporation) to 31 December 2004:

(a) As at the date of incorporation of the Company, its authorised share capital was HK$380,000, divided into 3,800,000 shares of par value HK$0.10 each. Following incorporation, one share was allotted and issued nil paid.

(b) On 5 March 2004, the sole and nil paid subscriber share was transferred to TCL Industries.

(c) On 10 August 2004, as consideration for the acquisition of the entire issued share capital of Communication Holdings, the Company issued and allotted 408 shares of HK$0.10 each credited as fully paid at par.

(d) On 10 August 2004, as consideration for the acquisition of the entire issued share capital of Communication BVI, the Company (i) issued and allotted 359 shares of HK$0.10 each credited as fully paid at par, and (ii) credited as fully paid at par the existing one nil paid share as set out in (b) above.

(e) On 10 August 2004, as consideration for the acquisition of the entire issued share capital of Alpha Alliance, the Company issued and allotted 232 shares of HK$0.10 each credited as fully paid at par.

(f) On 25 August 2004, the authorised share capital of the Company was increased from HK$380,000 to HK$500,000,000.

(g) On 25 August 2004, the Company issued and allotted 1,153,619,592 shares, 282,749,900 shares, 254,474,910 shares and 118,754,958 shares of HK$0.10 each credited as fully paid at par to TCL Multimedia, Cheerful Asset, Jasper Ace and Mate Fair, respectively, the former shareholders of TCL Mobile in consideration of the transfer to the Company of their respective entitlement to receive the dividends declared by TCL Mobile.

(h) On 25 August 2004, the Company issued and allotted 1,017,899,640 shares of HK$0.10 each credited as fully paid at par in consideration for a cash contribution of HK$495,408,000 by TCL Industries, a wholly-owned subsidiary of TCL Corporation, the former shareholder of TCL Mobile.

27. SHARE CAPITAL (continued)

Shares (continued)

Save as described herein, there has been no change in the share capital of the Company since its date of incorporation.

A summary of the transactions with reference to the above movements in the Company's issued ordinary share capital is as follows:

		Number of shares in issue	Issued share capital HK$'000	Share premium account HK$'000	Total HK$'000
Shares allotted and issued nil paid following incorporation	(a), (b)	1	—	—	—
Shares issued as consideration for the acquisition of the entire issued share capital of Communication Holdings	(c)	408	—	—	—
Shares issued as consideration for the acquisition of the entire issued share capital of Communication BVI	(d)	359	—	—	—
Shares issued as consideration for the acquisition of the entire issued share capital of Alpha Alliance	(e)	232	—	—	—
Shares issued as consideration for the acquisition of the entitlement of dividends declared by TCL Mobile	(g)	1,809,599,360	180,960	699,857	880,817
Shares issued as consideration for the cash contribution by TCL Industries	(h)	1,017,899,640	101,790	393,618	495,408
At 31 December 2004		2,827,500,000	282,750	1,093,475	1,376,225

Share options

Details of the Company's share option scheme are included in note 28 to the financial statements.

28. SHARE OPTION

(i) Share Option Scheme

The Company operates a share option scheme (the "Scheme") for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Eligible participants of the Scheme include directors, including independent non-executive directors, or employees, contractors, agents, persons or entities that provide advisory, consultancy, professional services for the business of the Group; vendors; suppliers; customers of any member of the Group or any other person whom the directors in their sole discretion considers may contribute or have contributed to the Group. The Scheme became effective on 13 September 2004 and, unless otherwise cancelled or amended, will remain in force for 10 years from that date.

28. SHARE OPTION (continued)

(i) Share Option Scheme (continued)

The maximum number of unexercised share options currently permitted to be granted under the Scheme is an amount equivalent, upon their exercise, to 10% of the shares of the Company in issue at any time. The maximum number of shares issuable under share options to each eligible participant in the Scheme within any 12-month period is limited to 1% of the shares of the Company in issue at any time. Any further grant of share options in excess of this limit is subject to shareholders' approval in a general meeting.

The exercise period of the share options granted is determinable by the directors, and commences after a certain vesting period and ends on a date which is not later than 10 years from the date of the offer of the share options or the expiry date of the Scheme, whichever is earlier.

The exercise price of the share options is determinable by the directors, but may not be less than the higher of: (i) the average Stock Exchange closing price of the Company's shares for the trading days which have elapsed from the Listing Date; and (ii) the offer price, if the option is granted before five business days have elapsed from (and including) the Listing Date or (i) the Stock Exchange closing price of the Company's shares on the date of the offer of the share options; and (ii) the average Stock Exchange closing price of the Company's shares for the five trading days immediately preceding the date of the offer, if the option is granted after five business days have lapsed from (and including) the Listing Date.

Share options do not confer rights on the holders to dividends or to vote at shareholders' meetings.

Further details of the Scheme are set out in the Listing Document.

(ii) The Option Agreement

On 31 August 2004, the Company and Alcatel, a company incorporated in France with its shares listed on *Premier Marche of Euronext Paris S.A.* and the New York Stock Exchange (the "Alcatel"), entered into a put and call option agreement (the "Option Agreement"). Under the Option Agreement, the Company granted to Alcatel a put option (the "Alcatel Put Option") and Alcatel granted to the Company a call option (the "Company Call Option") to exchange all of the shares held by Alcatel in the T&A. The Alcatel Put Option shall be exercisable on or after the fourth anniversary of 31 August 2004, the closing date of subscription by the Company and Alcatel of their respective shareholdings in the T&A (the "Joint Venture Closing Date") and the Company Call Option on or after the fifth anniversary of T&A Closing Date. There is no expiry date for the exercise of the options. The number of shares to be issued to Alcatel on exercise of the Alcatel Put Option or the Company Call Option is calculated by a formula specified in the Option Agreement with reference to the fair market value of Alcatel's interest in the T&A at the time of exercise of the relevant option. The fair market value of the T&A of this purpose shall be determined using internationally recognised valuation methodologies and adopting reasoning therefor. In the event that the Company and Alcatel cannot reach agreement on the valuation, they shall engage an expert to assist in such valuation. Further details of the Option Agreement are set out in the Listing Document.

29. RESERVES

(a) Group

The amounts of the Group's reserves and the movements therein for the current and prior years are presented in the consolidated statement of changes in equity on page 47 of the financial statements.

The Group's contributed surplus represents the difference between the nominal value of the shares and the share premium account of the subsidiaries acquired pursuant to the Group Reorganisation prior to the listing of the Company's shares, over the nominal value of the Company's shares issued in exchange therefor.

Pursuant to the relevant laws and regulations in the PRC, a portion of the profits of the Group's subsidiaries established in the PRC should be transferred to the statutory reserves which are restricted as to use.

(b) Company

	Contributed surplus HK$'000	Share premium account HK$'000	Accumulated losses HK$'000	Total HK$'000
Balance at 26 February 2004 (date of incorporation)	—	—	—	—
Arising on Group Reorganisation	669,907	—	—	669,907
Issue of new shares	—	1,093,475	—	1,093,475
Net loss attributable to shareholders	—	—	(62,934)	(62,934)
At 31 December 2004	669,907	1,093,475	(62,934)	1,700,448

The Company's contributed surplus represents the excess of the fair value of the shares of the subsidiaries acquired pursuant to the Group Reorganisation referred to in notes 1 and 16, over the nominal value of the Company's shares issued in exchange therefor. Under the Company Law of the Cayman Islands, a company may make distribution to its members out of the contributed surplus in certain circumstances.

30. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Acquisition of subsidiaries

	Notes	2004 HK$'000	2003 HK$'000
Net assets acquired:			
Fixed assets	13	60,752	—
Intangible assets		24,784	—
Other long term assets		288	—
Deferred tax assets		7,143	—
Inventories		75,329	—
Trade receivables		848,300	—
Notes receivables		1,248	
Other receivables		214,830	—
Cash and bank balances		1,771,039	—
Trade and notes payables		(940,702)	—
Tax payable		(7,132)	
Other payables and accruals		(974,440)	—
Due to shareholder		(24,392)	
Other long term liabilities		(43,587)	—
Minority interests		(456,057)	—
		557,403	
Negative goodwill on acquisition	15	(41,398)	—
		516,005	—
Satisfied by Cash		516,005	—

An analysis of the net inflow of cash and cash equivalents in respect of the acquisition of subsidiaries is as follows:

	2004 HK$'000	2003 HK$'000
Cash consideration	(516,005)	—
Cash and bank balances acquired	1,771,039	—
Net inflow of cash and cash equivalents in respect of the acquisition of subsidiaries	1,255,034	—

On 31 August 2004, the Company had established a joint-venture with Alcatel, the T&A, of which the Company has an equity interest of 55%. The mobile phone division of Alcatel was injected into the T&A. The purchase consideration for the acquisition was in the form of cash and being paid at the acquisition date.

Since its acquisition, the T&A contributed HK$1,729,989,000 to the Group's turnover and HK$258,466,000 to the consolidated loss after tax and before minority interests for the year ended 31 December 2004.

30. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

(b) Disposal of a subsidiary

	Note	2004 HK$'000	2003 HK$'000
Net assets disposed of:			
Fixed assets		21	—
Cash and bank balances		11,488	—
Other receivables		134	—
Other payables and accruals		(4,930)	—
Amounts due to related companies		(7,681)	—
		(968)	—
Gain on disposal of a subsidiary	5	1,268	—
		300	—
Satisfied by:			
Cash		300	—

An analysis of the net outflow of cash and cash equivalents in respect of the disposal of a subsidiary is as follows:

	2004 HK$'000	2003 HK$'000
Cash consideration	300	—
Cash and bank balances disposed of	(11,488)	—
Net outflow of cash and cash equivalents in respect of the disposal of a subsidiary	(11,188)	—

On 26 March 2004, the Group disposed to the managements of TCL Mobile Information International Company Limited its 100% equity interest in TCL Mobile Information International Company Limited, which was incorporated in Hong Kong.

The disposal of TCL Mobile Information International Company Limited had no material impact on the Group's consolidated turnover or net loss attributable to shareholders for the year ended 31 December 2004.

31. CONTINGENT LIABILITIES

(i) As at 31 December 2004, contingent liabilities in respect of discounted notes and endorsed notes with recourse not provided for in the financial statements were as follows:

	Group	
	2004	2003
	HK$'000	HK$'000
Notes discounted or endorsed with recourse	**48,657**	599,155

(ii) One of the Group's subsidiary, Alcatel Suzhou Telecommunications Co., Ltd. ("ASTEC") was involved in a patent infringement litigation brought by Hubin, Huxuanhua and Dalian Hanpu Applied Technology Co., Ltd. (the "plaintiff") in March 2001. In May 2002, the PRC trial court rendered civil judgement in favour of ASTEC with no damages or expenses to be borne by ASTEC. In the same month, the plaintiff appealed to the High Court and up to date, the appellate proceeding is still in progress.

According to the legal letter and the opinion from the engaged lawyer, it is very likely for the appellate court to render judgement in favor of ASTEC again. Accordingly, no provision was made for such Litigation in the financial statements.

32. OPERATING LEASE ARRANGEMENTS

The Group leases certain of its office premises, warehouses and staff dormitories under operating lease arrangements. Leases for these properties are negotiated for terms ranging from one to six years.

At 31 December 2004, the Group had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	Group		Company
	2004	2003	**2004**
	HK$'000	HK$'000	**HK$'000**
Within one year	**41,455**	1,328	**1,003**
In the second to fifth years, inclusive	**59,364**	380	**523**
Over five years	**45,572**	—	—
	146,391	1,708	**1,526**

33. COMMITMENTS

In addition to the operating lease commitments detailed above, the Group had the following capital commitments for the procurement of production facilities at the balance sheet date:

	Group	
	2004	2003
	HK$'000	HK$'000
Contracted, but not provided for	**23,845**	19,044

34. RELATED PARTY TRANSACTIONS

During the year ended 31 December 2004, the Group had the following material transactions with the following related parties:

Company name	Nature of transaction	Notes	2004 HK$'000	2003 HK$'000
Jasper Ace (HK) Limited	Consultancy Fee	(i), (v)	—	180
Markden Limited	Consultancy Fee	(ii), (v)	990	1,250
TCL Corporation	Brand name management fee/ TCL Brand Common Fund	(iii), (vi)	27,816	26,906
	Interest expenses	(vii)	12,636	—
	Short-term loan obtained	(viii)	4,068,383	—
	Sale of finished goods	(ix)	—	1,593
	Purchase of raw materials	(x)	2,400,354	3,549,876
TCL Corporation Logistic Co., Ltd.	Purchase of raw materials	(iv), (x)	456,515	—
TCL Hyper Power Batteries Co., Ltd.	Purchase of raw materials	(iv), (xi)	133,451	143,523
Chinaway Paper Production (Huizhou) Co., Ltd.	Purchase of raw materials	(iv), (xi)	1,730	1,877
TCL 通訊設備股份有限公司 ("TCL Communication Equipment Co., Ltd.")	Purchase of raw materials	(iv), (xi)	—	44,175
	Fund advanced	(xii)	—	13,190,419
	Interest income	(xiii)	—	1,790
TCL Communication Equipment (Huizhou) Co., Ltd.	Purchase of raw materials	(iv), (xi)	8,245	—
	Fund advanced	(xii)	7,880,342	—
	Interest income	(xiii)	871	—
	Sale of finished goods	(ix)	4,117	—
Huizhou TCL King Electronics Co., Ltd.	Rental charges	(iv), (xiv)	2,625	1,181
Huizhou TCL Communication Technology & Trade Co., Ltd.	Sale of finished goods	(iv), (ix)	15,705	26,480
TCL Air-conditioner (Zhongshan) Co., Ltd.	Purchase of finished goods	(iv), (xv)	—	17,144

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34. RELATED PARTY TRANSACTIONS (continued)

Company name	Nature of transaction	Notes	2004 HK$'000	2003 HK$'000
TCL 家用電器(惠州)有限公司 ("TCL Householding Appliance (Huizhou) Co., Ltd.")	Purchase of finished goods	(iv), (xv)	—	5,379
TCL Culture Development (Huizhou) Co., Ltd.	Purchase of raw materials	(iv), (xi)	166	—
惠州 TCL 電器銷售有限公司 ("TCL Household Appliance Marketing Co., Ltd.")	Purchase of raw materials	(iv), (xi)	1,081	—
Alcatel Mexico	Agency services obtained	(xvi), (xvii)	1,960	—
	Administrative and management services obtained	(xviii)	12,334	—
	Sale support services obtained	(xix)	4,084	—
Alcatel Espana SA	Sale support services obtained	(xvi), (xix)	12,619	—
Alcatel Business Systems	Administrative and management services obtained	(xvi), (xviii)	71,468	—

Notes:

In the opinion of the directors of the Company, the above related party transactions were carried out in the ordinary course of business.

(i) A director of the Company is also a shareholder of Jasper Ace (HK) Limited.

(ii) A director of the Company is also a shareholder of Markden Limited.

(iii) TCL Corporation is considered by the Company's directors as the Company's ultimate controlling shareholder.

(iv) Those companies are subsidiaries of TCL Corporation.

(v) The consultancy fee was calculated on terms mutually agreed by the contracting parties.

(vi) The brand name management fee/TCL Brand Common Fund was calculated on terms mutually agreed by the contracting parties.

(vii) The interest was charged with reference to the interest rate published by the Peoples' Bank of China on the amount due to TCL Corporation during the year.

(viii) The short-term loans from TCL Corporation were secured by the same amount of the Group's notes receivable, which bore interest at a rate of 3.2% per annum and are repayable within three months.

(ix) The directors considered that the sale of finished goods were made according to the published prices and conditions similar to those offered to the major customers of the Company.

(x) The raw materials were sold by TCL Corporation and TCL Corporation Logistic Co., Ltd. with a 0.2% margin.

34. RELATED PARTY TRANSACTIONS (continued)

Notes: (continued)

(xi) The directors considered that the purchase of raw materials were made according to the published prices and conditions similar to those offered to the major customers of the suppliers.

(xii) The fund advanced to TCL Communication Equipment Co., Ltd. and TCL Communication Equipment (Huizhou) Co., Ltd. were unsecured, bore interest at a rate of 1.4% per annum and had no fixed terms of repayment.

(xiii) The interest is charged at a rate of 1.4% per annum on the amount advanced to TCL Communication Equipment Co., Ltd. and TCL Communication Equipment (Huizhou) Co., Ltd.

(xiv) The rental charges were calculated on terms mutually agreed by the contracting parties.

(xv) The directors considered that the purchase of finished goods was made according to the published prices and conditions similar to those offered by major suppliers.

(xvi) This company is a subsidiary of the Group's minority shareholder.

(xvii) The directors considered that the agency services obtained were calculated on terms mutually agreed by the contracting parties.

(xviii) The directors considered that the administrative and management services obtained were calculated on terms mutually agreed by the contracting parties.

(xix) The directors considered that the sales support services obtained were calculated on terms mutually agreed by the contracting parties.

35. COMPARATIVE AMOUNTS

During current year, certain comparative amounts have been reclassified to conform to the current year's presentation.

36. POST BALANCE SHEET EVENTS

There were no significant events after 31 December 2004.

37. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 16 April 2005.