CEC
中国电子
CHINA ELECTRONICS

CHINA ELECTRONICS
Corporation Holdings Company Limited
中國電子集團控股有限公司

Interim Report
2005

CORPORATE INFORMATION

Board of Directors

Non-executive Directors

Mr. Yang Xiaotang *(Chairman)*
Mr. Tong Baoan *(Vice Chairman)*

Executive Directors

Mr. Fan Qingwu *(Managing Director)*
Mr. Hua Longxing

Independent Non-executive Directors

Mr. Chan Kay Cheung
Mr. Wong Po Yan
Mr. Yin Yongli

Company Secretary

Mr. Yam Pui Hung, Robert

Principal Bankers

Bank of China (Hong Kong) Limited
The Bank of East Asia, Limited
The Hongkong and Shanghai Banking Corporation Limited

Auditors

PricewaterhouseCoopers

Legal Advisors

As to Hong Kong Law

Linklaters

As to Bermuda Law

Conyers Dill & Pearman

Investor Relations

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Sun Hung Kai Centre
30 Harbour Road
Wanchai
Hong Kong

Principal Share Registrar and Transfer Office

Butterfield Fund Services (Bermuda) Limited
Rosebank Centre
65 Front Street
Hamilton
Bermuda

Hong Kong Branch Share Registrar and Transfer Office

Abacus Share Registrars Limited
Ground Floor
Bank of East Asia Harbour View Centre
56 Gloucester Road
Wanchai
Hong Kong

Stock Code

0085

The board of directors (the "Board") of China Electronics Corporation Holdings Company Limited (the "Company") is pleased to present the interim results of the Company and its subsidiaries (collectively the "Group") for the six months ended 30th June 2005.

BUSINESS REVIEW

For the six months ended 30th June 2005, the Group recorded a consolidated sales of HK$2,129.8 million (2004: HK$2,023.7 million) and profit attributable to equity holders of HK$20.8 million (2004: HK$26.6 million) respectively. Basic earnings per share for the period was HK cents 1.92 (2004: HK cents 3.27). The Board resolved not to pay any interim dividend for the period (2004: Nil).

During the period under review, the Group sold 3.6 million units of mobile phones, representing a decrease of 7% over the same period in 2004. The decrease was due to the drop in sales of the *Philips* branded mobile phones with which sales revenue dropped by 17% to HK$1,546.9 million. The decrease was, however, offset by the terrific results in own-branded mobile phones. During the period under review, sales revenue from own-branded mobile phones was HK$569.4 million, representing a remarkable growth of more than 3 times over the same period last year. In addition to the higher average selling price of the mobile phones as more technological advanced models were being launched during the period, the overall sales revenue increased by 5.2% to HK$2,129.8 million over the same period last year. Total net profit for the period decreased by HK$6.8 million to HK$34 million. The decrease was primarily attributable to the increase in selling and marketing costs in own-branded mobile phones which was in line with the business growth, and the increase in general administrative expenses. The profit attributable to equity holders decreased by 22% to HK$20.8 million.

PROSPECTS

On 13th July 2005, the Group renewed the cooperation agreement with the Philips Group (being Koninklijke Philips Electronics N.V. and its subsidiaries). The renewal is a new milestone to the Group. The new agreement not only extends the scope of cooperation, but also broadens and strengthens the Group's business relationship with the Philips Group. Pursuant to the new arrangement, the Group will provide mobile phone Original Equipment Manufacturer ("OEM") service, and will design, develop, manufacture and supply MP3 players and other electronic products to the Philips Group as well. Despite the increasingly keen market competition, the new cooperation agreement will secure a stable source of revenue for the Group and extend the Group's products and services range, and will enable the Group to capitalize on the rapid growth of the global consumer electronics and communications products market.

At the beginning of 2005, China Electronics Corporation ("CEC"), the controlling shareholder of the Company, set up the China Cable Network ("CCN") joint venture company with China Media Group. CCN's mission is to integrate the domestic cable television network, develop and promote digital video services and network value-added services, including digital pay-TV, video-on-demand, data broadcasting and high-definition television services in China. The management of the Company will work proactively with CEC in pursuing new business cooperation in this area. Through maximizing the synergies between CEC and the Group, the management will further integrate, improve and expand its business profiles. The management will also expedite to explore other investment opportunities which have good potential. The ultimate objective is to bring profitable returns to the investors and to maximize the shareholders value as a whole.

FINANCIAL REVIEW

The Group generally finances its operation by internal resources and short term bank facilities. The Group had cash and bank balances of HK$206.2 million as at 30th June 2005 (31st December 2004: HK$217.4 million), and were primarily denominated in Hong Kong dollars, Renminbi and United States dollars.

As at 30th June 2005, the Group had unsecured short term bank borrowings of HK$187.6 million (31st December 2004: HK$392.2 million), which were all denominated in Renminbi and were borrowed at contracted fixed interest rate. The Group's available bank facilities were approximately RMB600 million. As at 30th June 2005, the Group did not have any pledged assets or guarantee.

The Group's export sales are predominantly invoiced in United States dollars and its domestic sales are invoiced in Renminbi. The Group imports some of its raw materials and production and testing equipment from overseas suppliers which are paid in United States dollars, 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 operation.

As at 30th June 2005, the Group had net current assets of HK$401.7 million (31st December 2004: HK$371.2 million). The overall gearing ratio, which is calculated as the total liabilities over total assets of the Group, was 67.8% (31st December 2004: 70.2%).

As at 30th June 2005, the Group had contracted but not provided for capital commitments of HK$1.6 million (31st December 2004: HK$8.7 million) for the acquisition of fixed assets and intangible assets. The Group did not have any material contingent liabilities outstanding as at 30th June 2005 (31st December 2004: Nil).

EMPLOYEE AND REMUNERATION POLICIES

As at 30th June 2005, the Group had approximately 3,000 employees, the majority of whom 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.

CONTINUING CONNECTED TRANSACTIONS

On 13th July 2005, the Group's principal subsidiary, Shenzhen Sang Fei Consumer Communications Company Limited ("Sang Fei"), entered into an agreement with Philips Consumer Electronics International B.V.. Pursuant to the agreement, in addition to the prevailing mobile phone OEM business, Sang Fei will design, develop, manufacture and supply MP3 players and other portable electronics products to the Philips Group. Sang Fei will also provide product maintenance services and supply related spare parts to the Philips Group. Besides, Sang Fei may also source raw materials from the Philips Group on a non-committed basis.

The agreement is for a term of two and a half years and will expire on 31st December 2007. Upon the expiry, the agreement may be extended for further one year unless either party objects. The price of the products and spare parts to be supplied under the agreement and the raw materials to be purchased from the Philips Group will be determined after arm's length negotiations between the parties with reference to market rates. For product maintenance services, Sang Fei will charge service fee based on the actual raw materials and spare parts consumed plus a pre-agreed service charge. The management expects that for the three financial years ending 31st December 2005, 2006 and 2007, the aggregate consideration to be received by Sang Fei from the Philips Group in relation to the supply of products and spare parts and the provision of product maintenance services will not exceed RMB5,610 million, RMB7,013 million and RMB7,714 million, respectively.

As the Philips Group owns 25% interest in Sang Fei, the transactions contemplated under the agreement constitutes continuing connected transactions of the Company. The Directors are of the opinion that the entering into the agreement is in the best interest of the Company and the shareholders of the Company as a whole. CEC, as the controlling shareholder of the Company, has approved the agreement and the continuing connected transactions contemplated thereunder by way of written approval.

CAPITAL REORGANISATION AND CHANGE IN BOARD LOT SIZE

As at 31st December 2004, the Company had accumulated losses of HK$154.4 million and contributed surplus of HK$140.3 million. On 18th March 2005, the Board resolved to apply the entire contributed surplus to set off an equivalent amount against the accumulated losses.

At a special general meeting of the Company held on 17th May 2005, the shareholders of the Company approved a capital reorganisation whereby the nominal value of the shares of the Company was reduced from HK$0.01 each to HK$0.00125 each. Immediately after the reduction, every eight issued shares with nominal value of HK$0.00125 each were consolidated into one new share of HK$0.01 each. With the implementation of the capital reorganisation, the issued share capital of the Company comprises 1,083,560,000 shares of HK$0.01 each. An amount of HK$75.8 million standing to the credit of the share capital account of the Company was cancelled and credited to the contributed surplus account of the Company, and an equivalent amount in the contributed surplus account was then applied to set off against the entire remaining accumulated losses of the Company.

With effect from the completion of the capital reorganisation, the shares of the Company were traded in board lot of 2,000 shares each.

TERMINATION OF ACQUISITION OF CECW

On 4th April 2005, the Company entered into an equity transfer agreement pursuant to which the Company agreed to acquire from China Electronics Industry Corporation, a subsidiary of CEC, a 48% equity interest in CEC Wireless R&D Ltd. at a cash consideration of HK$22 million (the "Acquisition"). However, as the conditions precedent as set out in the equity transfer agreement have not been fulfilled or waived by the long stop date of 15th August 2005, the equity transfer agreement was terminated automatically according to its terms. Termination of the Acquisition had no material adverse impact on the business operation or financial position of the Company.

DISCLOSURE PURSUANT TO RULE 13.20 OF THE LISTING RULES

As at 30th June 2005, the Group had in aggregate approximately HK$546.1 million due from members of the Philips Group. The receivables were mainly trade balances which arose from the sales of products including goods, samples and materials in the ordinary course of business of the Group with a small amount representing reimbursement for taxation and administrative expenses paid during the period by the Group. Such amounts are to be settled in accordance with normal trade credit terms ranging from 30 to 60 days after invoice and are mainly covered then by bank guarantee or by documents against acceptance arrangements.

The Philips Group is a connected person of the Company by virtue of being a substantial shareholder of Sang Fei.

Save as disclosed above, there is no other disclosure required to be made by the Company pursuant to Rule 13.20 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules").

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 30th June 2005, no interests nor short positions in the shares, underlying shares or debentures of the Company or any associated corporation (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")) of the Company were recorded in the register maintained by the Company pursuant to Section 352 of the SFO, or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

At no time during the six months ended 30th June 2005 was the Company, its holding company or any of its subsidiaries or fellow subsidiaries a party to any arrangements to enable the directors of the Company or their respective associates (as defined under the Listing Rules) to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

During the six months ended 30th June 2005, no options have been granted, cancelled, lapsed nor exercised under the share option scheme of the Company. As at 30th June 2005, no share options were outstanding under the share option scheme of the Company.

SUBSTANTIAL SHAREHOLDERS

As at 30th June 2005, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO showed that the following shareholders had notified the Company their relevant interests in the issued capital of the Company.

Name of shareholder	Number of shares held	Percentage of shareholding
China Electronics Corporation (BVI) Holdings Company Limited ("CEC BVI")	812,500,000	74.98%
CEC *(note 1)*	812,500,000	74.98%
Devon Fortune Limited	91,421,608	8.43%
Mr. Chan Chak Shing	95,546,608 *(note 2)*	8.81%

Notes:

(1) CEC holds 100% interest in CEC BVI and is deemed to be interested in the shares held by CEC BVI.

(2) This number of shares represents the aggregate of (i) the family interest of Mr. Chan Chak Shing of 4,125,000 shares and (ii) corporate interest of 91,421,608 shares held by Devon Fortune Limited. As Mr. Chan Chak Shing holds 100% interest in Devon Fortune Limited, the shares held by Devon Fortune Limited are deemed to be interests of Mr. Chan Chak Shing.

All the interests disclosed above represent long position in the shares of the Company. Save as disclosed above, as at 30th June 2005, no person or corporation had any interest or short position in the shares or underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

During the six months ended 30th June 2005, the Company has not redeemed any of its shares. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the period.

CODE ON CORPORATE GOVERNANCE PRACTICES

In the opinion of the directors, the Company has complied with all the code provisions of the Code on Corporate Governance Practices, as set out in Appendix 14 to the Listing Rules, throughout the period.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS OF LISTED ISSUERS

The Company has adopted the Model Code for Securities Transactions by Directors as set out in Appendix 10 to the Listing Rules as its own code of conduct regarding securities transactions by the directors of the Company (the "Code"). Having made specific enquiry with the directors of the Company, all the directors confirmed that they had complied with the required standards as set out in the Code throughout the period.

AUDIT COMMITTEE

The audit committee of the Company comprises Messrs. Chan Kay Cheung, Wong Po Yan and Yin Yongli, being all independent non-executive directors of the Company. The Group's unaudited interim report for the period has been reviewed by the audit committee, which is of the opinion that such report complies with the applicable accounting standards, the Listing Rules and legal requirements and that adequate disclosures have been made.

CONDENSED CONSOLIDATED BALANCE SHEET

As at 30th June 2005
(All amounts expressed in HK dollar thousands unless otherwise stated)

	Note	30th June 2005 (Unaudited)	31st December 2004 (Audited and restated)
ASSETS			
Non-current assets			
Property, plant and equipment	6	**96,005**	119,402
Intangible assets	6	**7,132**	3,498
		103,137	122,900
Current assets			
Inventories	7	**479,212**	388,620
Trade and other receivables	8	**780,667**	931,391
Cash and cash equivalents		**206,186**	217,433
		1,466,065	1,537,444
Total assets		**1,569,202**	1,660,344

CONDENSED CONSOLIDATED BALANCE SHEET *(continued)*

As at 30th June 2005
(All amounts expressed in HK dollar thousands unless otherwise stated)

	Note	**30th June 2005 (Unaudited)**	31st December 2004 (Audited and restated)
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Issued equity	*9*	**370,074**	373,750
Other reserves	*10*	**19,204**	19,204
Retained earnings/ (accumulated losses)			
– Proposed final dividend		**–**	–
– Others		**714**	(23,713)
		389,992	369,241
Minority interests		**114,874**	124,884
Total equity		**504,866**	494,125
CURRENT LIABILITIES			
Trade and other payables	*11*	**870,666**	768,237
Current income tax liabilities		**1,282**	3,537
Short term bank loans	*12*	**187,629**	392,231
Provision for warranty	*13*	**4,759**	2,214
		1,064,336	1,166,219
Total equity and liabilities		**1,569,202**	1,660,344
Net current assets		**401,729**	371,225
Total assets less current liabilities		**504,866**	494,125

CONDENSED CONSOLIDATED INCOME STATEMENT

For the six months ended 30th June 2005
(All amounts expressed in HK dollar thousands unless otherwise stated)

	Note	Unaudited Six months ended 30th June 2005	2004 (Restated)
Sales	5	**2,129,790**	2,023,669
Cost of goods sold	15	**(2,013,686)**	(1,928,205)
Gross profit		**116,104**	95,464
Other gain, net	14	**5,224**	5,535
Selling and marketing costs	15	**(22,672)**	(16,097)
Administrative expenses	15	**(55,530)**	(37,645)
Other operating expenses, net	15	**(69)**	–
Operating profit		**43,057**	47,257
Finance costs	16	**(5,893)**	(2,891)
Profit before income tax		**37,164**	44,366
Income tax expense	17	**(3,141)**	(3,508)
Profit for the period		**34,023**	40,858
Attributable to:			
Equity holders of the Company		**20,751**	26,558
Minority interests		**13,272**	14,300
		34,023	40,858
Earnings per share for profit attributable to the equity holders of the Company during the six months ended 30th June			
– Basic	18	**HK cents 1.92**	HK cents 3.27
– Diluted	18	**N/A**	N/A

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 30th June 2005
(All amounts expressed in HK dollar thousands unless otherwise stated)

	(Unaudited)				
	Attributable to equity holders of the Company				
	Issued equity	Other reserves *(Note 10)*	Retained earnings/ (accumulated losses)	Minority interests	Total
Balance at 1st January 2004, as previously reported as equity	169,437	13,100	1,654	–	184,191
Balance at 1st January 2004, as previously reported as minority interests	–	–	–	99,180	99,180
Balance at 1st January 2004, as restated	169,437	13,100	1,654	99,180	283,371
Profit for the period	–	–	26,558	14,300	40,858
Balance at 30th June 2004	169,437	13,100	28,212	113,480	324,229
Balance at 1st January 2005, as previously reported as equity	373,750	19,204	(23,713)	–	369,241
Balance at 1st January 2005, as previously reported as minority interests	–	–	–	124,884	124,884
Balance at 1st January 2005, as restated	373,750	19,204	(23,713)	124,884	494,125
Utilisation of issued equity against accumulated losses	(3,676)	–	3,676	–	–
Dividends paid by a subsidiary	–	–	–	(23,282)	(23,282)
Profit for the period	–	–	20,751	13,272	34,023
Balance at 30th June 2005	**370,074**	**19,204**	**714**	**114,874**	**504,866**

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 30th June 2005
(All amounts expressed in HK dollar thousands unless otherwise stated)

	Unaudited Six months ended 30th June	
	2005	2004
Net cash generated from/(used in) operating activities	**224,334**	(134,669)
Net cash used in investing activities	**(7,698)**	(24,239)
Net cash (used in)/generated from financing activities	**(227,883)**	209,316
Net (decrease)/increase in cash and cash equivalents	**(11,247)**	50,408
Cash and cash equivalents at 1st January	**217,433**	23,444
Cash and cash equivalents at 30th June	**206,186**	73,852
Analysis of balances of cash and cash equivalents:		
Cash at bank and in hand	**206,186**	73,852

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL INFORMATION

For the six months ended 30th June 2005
(All amounts expressed in HK dollar thousands unless otherwise stated)

1 Organisation and principal activities

China Electronics Corporation Holdings Company Limited (the "Company") was incorporated in the Cayman Islands and continued in Bermuda with limited liability. The Company has its shares listing on The Stock Exchange of Hong Kong Limited.

The principal activities of the Company and its subsidiaries (collectively the "Group") comprise the manufacturing and selling of mobile telephones.

2 Basis of preparation and accounting policies

This unaudited condensed consolidated financial information of the Group has been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Report" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA").

This condensed consolidated financial information was not audited and the Board has engaged PricewaterhouseCoopers to review this condensed consolidated financial information in accordance with Statement of Auditing Standard 700 "Engagement to Review Interim Financial Reports" issued by the HKICPA and an unmodified review report has been issued.

This condensed consolidated financial information should be read in conjunction with the 2004 annual financial statements.

The accounting policies, the reverse acquisition accounting treatment adopted for the acquisition of Shenzhen Sang Fei Consumer Communications Company Limited ("Sang Fei") and methods of computation used in the preparation of this condensed consolidated financial information are consistent with those used in the annual financial statements for the year ended 31st December 2004 except that the Group has changed certain of its accounting policies following its adoption of the new/revised Hong Kong Financial Reporting Standards ("HKFRSs") and HKASs (collectively referred to a "new HKFRSs") issued by HKICPA which are effective for accounting periods commencing on or after 1st January 2005.

The changes to the Group's accounting policies and the effects of adopting these new policies are set out in note 3 below.

3 Changes in accounting policies

(a) Effect of adopting new HKFRSs

In 2005, the Group adopted the new HKFRSs below, which are relevant to its operations. The 2004 comparatives have been amended as required, in accordance with the relevant requirements.

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 16	Property, Plant and Equipment
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 32	Financial Instruments: Disclosures and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKFRS 3	Business Combinations

The adoption of new/revised HKASs 1, 2, 7, 8, 10, 16, 21, 23, 24, 27, 32, 33 and 39 did not result in substantial changes to the Group's accounting policies. In summary:

– HKAS 1 has affected the presentation of minority interest and other disclosures.

– HKASs 2, 7, 8, 10, 16, 21, 23, 27, 32, 33 and 39 had no material effect on the Group's policies.

– HKAS 24 has affected the identification of related parties and some other related-party disclosures.

The adoption of HKFRS 3, HKAS 36 and HKAS 38 results in a change in the accounting policy for goodwill. Until 31st December 2004, goodwill was:

– Amortised on a straight line basis over a period of 10 years; and

– Assessed for an indication of impairment at each balance sheet date.

3 Changes in accounting policies *(continued)*

(a) Effect of adopting new HKFRSs *(continued)*

In accordance with the provisions of HKFRS 3 (Note 3.3):

- The Group ceased amortisation of goodwill from 1st January 2005;
- Accumulated amortisation as at 31st December 2004 has been eliminated with a corresponding decrease in the cost of goodwill;
- From the year ending 31st December 2005 onwards, goodwill is tested annually for impairment, as well as when there is indication of impairment.

As provision for impairment on the full amount of the goodwill has been made as at 31st December 2004, there is no effect of adopting this new accounting policy.

The Group has reassessed the useful lives of its intangible assets in accordance with the provisions of HKAS 38. No adjustment resulted from this reassessment.

There is no material effect of adopting new HKFRSs to the condensed consolidated financial information.

(b) New accounting policies

The accounting policies used for the condensed consolidated financial information for the six months ended 30th June 2005 are the same as those set out in note 2 to the 2004 annual financial statements except for the following:

3.1 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The condensed consolidated financial information are presented in Hong Kong dollars, which is the Company's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

3 Changes in accounting policies *(continued)*

(b) New accounting policies *(continued)*

3.1 Foreign currency translation (continued)

(c) Group companies

The results and financial position of all the group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the Group's presentation currency are translated into the Group's presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognised as a separate component of equity.

3.2 Property, plant and equipment

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

During the period, the directors re-visited the residual value of property, plant and equipment and adjusted to zero. The effect of this change in accounting estimate is to decrease the operating profit for the period by HK$4,095,000.

3.3 Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary company at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing.

3 Changes in accounting policies *(continued)*

(b) New accounting policies *(continued)*

3.4 Impairment of assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

3.5 Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement.

3.6 Share capital

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

3.7 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

4 Financial risk management

4.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: foreign exchange risk, credit risk, liquidity risk and cash flow and fair value interest rate risk.

(a) *Foreign exchange risk*

The foreign exchange risks of the Group occur due to the fact that the Group has business activities denominated in foreign currencies, primarily with respect to the United States dollars, Renminbi, Euro and Japanese Yen. The Group has entered into foreign exchange forward contracts to manage the risk arising from its operations. Nevertheless, the conversion of Renminbi into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the People's Republic of China (the "PRC") government.

(b) *Credit risk*

The Group has no significant concentrations of credit risk. It has policies in place to ensure that the products are made to customers with an appropriate credit history. The Group performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral on trade receivables. The Group maintains a provision for doubtful debts and actual losses have been within management's expectation.

(c) *Liquidity risk*

Prudent liquidity risk management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Group aims to maintain flexibility in funding by keeping committed credit lines available.

(d) *Cash flow and fair value interest rate risk*

The Group does not have significant interest-bearing assets, the Group's income and operating cash flows are substantially independent of changes in market interest rates.

5 Segment information

(a) Primary reporting format – business segment

	Philips branded products		Own branded products		Original Equipment Manufacturer ("OEM") other products and other operations		Total	
	Six months ended 30th June		Six months ended 30th June		Six months ended 30th June		Six months ended 30th June	
	2005	2004	**2005**	2004	**2005**	2004	**2005**	2004
Sales	**1,546,890**	1,867,805	**569,398**	133,697	**13,502**	22,167	**2,129,790**	2,023,669
Segment results	**84,018**	75,511	**31,806**	15,610	**280**	4,343	**116,104**	95,464
Unallocated revenues							**5,224**	5,535
Unallocated costs							**(78,271)**	(53,742)
Operating profit							**43,057**	47,257
Finance costs							**(5,893)**	(2,891)
Profit before income tax							**37,164**	44,366
Income tax expense							**(3,141)**	(3,508)
Profit for the period							**34,023**	40,858

(b) Secondary reporting format – geographical segment

	Six months ended 30th June	
	2005	2004
Sales		
Mainland China	**1,116,938**	902,338
Europe	**343,552**	387,278
Asia excluding mainland China and Hong Kong	**257,179**	676,715
Hong Kong	**412,121**	57,338
	2,129,790	2,023,669

Sales are allocated based on the places in which customers are located.

6 Capital expenditures

	Goodwill	Computer software	Total intangible assets	Property, plant and equipment
Opening net book amount as at 1st January 2005	–	3,498	**3,498**	119,402
Additions	–	4,368	**4,368**	5,260
Disposals	–	–	**–**	(69)
Depreciation/amortisation charge	–	(734)	**(734)**	(28,588)
Closing net book amount as at 30th June 2005	–	7,132	**7,132**	96,005
Opening net book amount as at 1st January 2004	–	3,841	**3,841**	88,022
Additions	–	440	**440**	24,313
Disposals	–	–	**–**	(67)
Depreciation/amortisation charge	–	(311)	**(311)**	(20,688)
Closing net book amount as at 30th June 2004	–	3,970	**3,970**	91,580
Acquisition of subsidiaries	63,075	–	**63,075**	117
Additions	–	396	**396**	57,500
Disposals	–	–	**–**	(43)
Depreciation/amortisation charge	(1,577)	(868)	**(2,445)**	(22,393)
Impairment charge	(61,498)	–	**(61,498)**	(7,359)
Closing net book amount as at 31st December 2004	–	3,498	**3,498**	119,402

7 Inventories

	30th June 2005	31st December 2004
Raw materials	**311,899**	234,231
Work in progress	**139,684**	109,726
Finished goods	**50,699**	62,830
	502,282	406,787
Less: Written down of inventories to net realisable value	**(23,070)**	(18,167)
Inventories, net	**479,212**	388,620

As at 30th June 2005, the carrying amount of inventories that are carried at net realisable value amounted to zero (31st December 2004: Nil).

8 Trade and other receivables

	30th June 2005	31st December 2004
Trade receivables *(note (a))*	**683,786**	801,085
Notes receivable	**1,580**	3,255
Other receivables due from related parties	**30,144**	25,240
Prepayments and deposits	**9,978**	27,867
Value-added tax refundable	**42,708**	65,690
Other receivables	**12,471**	8,254
	780,667	931,391

8 Trade and other receivables *(continued)*

(a) The majority of the Group's sales are on letter of credit or documents against payment. The remaining amounts are with credit term of 30 to 60 days. At 30th June 2005 and 31st December 2004, the ageing analysis of the Group's trade receivables was as follows:

	30th June 2005	31st December 2004
Current to 30 days	**563,188**	798,907
31-60 days	**47,485**	25
Over 60 days	**73,113**	2,153
	683,786	801,085

Included in the balance were trade receivables from related parties of HK$518,744,000 (31st December 2004: HK$729,925,000). About 95% (2004: 91%) of the trade receivables from related parties as at 30th June 2005 was covered by bank issued guarantee documents.

Amount of HK$164,510,000 (31st December 2004: HK$51,918,000), of which HK$110,396,000 (31st December 2004: Nil) which the ageing over 30 days, included in the trade receivables was due from a customer which is a third party as at 30th June 2005. On the other hand, the Group recorded a trade payable balance due to the customer's affiliated company, one of the Group's vendors, amounted to HK$138,377,000 (31st December 2004: HK$55,749,000) as at 30th June 2005. According to a trade agreement among the Group, the customer and its affiliated company, the Group is only required to settle those trade payables when the corresponding trade receivables have been received from the customer. Pursuant to the arrangement, the net amount receivable from the customer, net of the trade payable due to its affiliated company, was HK$26,133,000 (31st December 2004: net payable of HK$3,831,000) as at 30th June 2005.

9 Issued equity

	Number of shares	**Issued equity**
As at 1st January 2005	8,668,480,000	373,750
Capital reorganisation *(note (a))*	(7,584,920,000)	–
Utilisation of issued equity against accumulated losses *(note (b))*	–	(3,676)
As at 30th June 2005	1,083,560,000	370,074

9 Issued equity *(continued)*

(a) Pursuant to the resolutions passed at a special general meeting on 17th May 2005, the nominal value of the shares of the Company was reduced from HK$0.01 each to HK$0.00125 each, and immediately after the reduction, every eight then issued shares with nominal value of HK$0.00125 each were consolidated into one new share of HK$0.01 each. After the capital reorganisation, the issued share capital of the Company comprises 1,083,560,000 shares HK$0.01 each. An amount of HK$75,849,000 standing to the credit of the share capital account of the Company was cancelled and credited to the contributed surplus account.

(b) On 18th March 2005, the board of directors of the Company resolved to apply the entire contributed surplus of HK$154,440,000 to set off an equivalent amount of the accumulated losses. Upon completion of the capital reorganisation, an equivalent amount in the contributed surplus account was then applied to set off against the entire remaining accumulated losses of the Company.

10 Other reserves

	Capital reserve *(note (a))*	**Surplus reserves** *(note (b))*	**Total**
At 1st January and 30th June 2005	(1,806)	21,010	19,204
At 1st January and 30th June 2004	(1,806)	14,906	13,100
Appropriation from retained earnings	–	6,104	6,104
At 31st December 2004	(1,806)	21,010	19,204

(a) Capital reserve

Capital reserve represents the exchange differences arising from paid-in capital paid by foreign currencies in the principal subsidiary, Sang Fei.

(b) Surplus reserves

In accordance with the "Laws of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment" and Sang Fei's Articles of Association, appropriations of the reserve fund and the enterprise expansion fund from profit after taxation have to be made prior to profit distribution to the equity owners. The percentage of appropriation of reserve fund and the enterprise expansion fund is approved by the board of directors.

Upon approval from the board of directors, the reserve fund can be used to offset against accumulated losses or to increase capital while the enterprise expansion fund can be used to expand production and to increase capital.

11 Trade and other payables

	30th June 2005	31st December 2004
Trade payables *(note 8(a))*	**745,131**	640,669
Other payables due to related parties	**8,205**	9,079
Accrued expenses	**27,646**	17,792
Advance from customers	**28,429**	44,037
Other payables	**61,255**	56,660
	870,666	768,237

The ageing analysis of trade payables was as follows:

	30th June 2005	31st December 2004
Current to 30 days	**717,486**	578,606
31-60 days	**2,546**	27,257
Over 60 days	**25,099**	34,806
	745,131	640,669

12 Short term bank loans

The bank loans are unsecured, repayable within one year and bear interest at the average borrowing rate of 4.650% (2004: 4.438%) per annum.

The carrying amounts of bank loans are denominated in Renminbi and approximate their fair value.

13 Provision for warranty

At 1st January 2004	1,172
Additional provisions charged to income statement	1,515
Less: utilised during the period	(485)
At 30th June 2004	2,202
Additional provisions charged to income statement	4,434
Less: utilised during the period	(4,422)
At 31st December 2004	2,214
Additional provisions charged to income statement	7,180
Less: utilised during the period	(4,635)
At 30th June 2005	4,759

The Group gives 15-month warranties on products distributed by Sang Fei for end users in the PRC market and undertakes to repair and replace items that fail to operate satisfactorily. Provision has been recognised for expected warranty claims based on past experience of the level of repairs and returns.

14 Other gain, net

	Six months ended 30th June	
	2005	2004
Sales of samples and materials	**3,155**	5,129
Interest income	**2,052**	216
Others	**17**	190
	5,224	5,535

15 Expenses by nature

Expenses included in cost of goods sold, other operating expenses, selling and marketing costs and administrative expenses are analysed as follows:

	Six months ended 30th June	
	2005	2004
Employee benefits expenses	**60,598**	51,198
Costs of inventories (including direct materials, direct labor and overheads)	**2,013,686**	1,928,205
Depreciation of property, plant and equipment *(Note 6)*	**28,588**	20,688
Amortisation of intangible assets *(Note 6)*	**734**	311
Written down of inventories to net realisable value	**4,903**	3,035
Provision for warranty *(Note 13)*	**7,180**	1,515
Operating leases of buildings	**8,285**	6,594
Research and development costs	**6,831**	5,035
Directors' remuneration	**750**	141

16 Finance costs

	Six months ended 30th June	
	2005	2004
Interest on bank loans	**5,720**	7,387
Net foreign exchange transaction loss/(gain)	**173**	(4,496)
	5,893	2,891

17 Income tax expense

	Six months ended 30th June	
	2005	2004
Current taxation – PRC enterprise income tax	**3,141**	3,508

(a) No provision for Hong Kong profits tax has been made as the Group has no assessable profit for the period (2004: Nil).

(b) The principal subsidiary, Sang Fei, is a foreign investment production enterprise established in Shenzhen Special Economic Zone in the PRC, the prevailing enterprise income tax rate is 15%. As approved by the tax authorities in 1998, Sang Fei is entitled to exemption from income taxes for two years followed by a 50% tax reduction for three years, commencing from the year ended 31st December 2000, the first cumulative profit-making year net of losses carried forward.

Sang Fei was certified as a high technology enterprise from 2002 and as approved by the tax authorities in 2004, Sang Fei is entitled to 50% tax reduction from income taxes for further three years starting from 2005. Consequently, enterprise income taxes have been provided at the rate of 7.5% (2004: 7.5%) for the period.

18 Earnings per share

The calculation of the basic earnings per share is based on the Group's profit attributable to equity holders for the six months ended 30th June 2005 of HK$20,751,000 (2004: profit of HK$26,558,000) and the 1,083,560,000 (2004: 812,500,000 ordinary shares deemed to have been in issue on 1st January 2004) ordinary shares in issue during the period.

19 Dividends

The directors do not recommend the payment of an interim dividend for the six months ended 30th June 2005 (2004: Nil).

20 Commitments

(a) Capital commitments

As at 30th June 2005, the Group's capital commitments which were contracted but not provided for are as follows:

	30th June 2005	31st December 2004
Purchase of fixed assets and computer software	**1,559**	8,717

(b) Operating lease commitments

As at 30th June 2005, the Group had future aggregate minimum lease payments under non-cancellable operating leases of buildings as follows:

	30th June 2005	31st December 2004
Not later than one year	**21,134**	24,676
In the second to fifth year	**26,997**	37,987
	48,131	62,663

21 Contingent liability

The Group did not have any material contingent liabilities outstanding as at 30th June 2005 (31st December 2004: Nil).

22 Related party transactions

Parties are considered to be related if one company has the ability, directly or indirectly, to control the other company 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.

During the period, the Group entered into transactions with companies under common control of:

– CEC, the ultimate holding company. These companies are denoted by * below;

– Koninklijke Philips Electronics N.V. ("KPE") (a company incorporated in Holland) and its subsidiaries (the "Philips Group"), the ultimate holding company of the minority shareholder with significant influence on operation of the principal subsidiary, Sang Fei. These companies are denoted by # below.

(a) Sales of goods, samples and materials

	Six months ended 30th June	
	2005	2004
Sales of products		
Philips Electronics (Shanghai) Co., Ltd.#	**789,171**	748,665
Philips France S.A.S.#	**339,265**	674,524
Philips Electronics Singapore Pte. Ltd.#	**245,754**	387,278
Philips Electronics Hong Kong Ltd.#	**137,938**	57,339
Philips (China) Investment Co., Ltd#	**41,867**	–
Philips Electronics Trading Services (Shanghai) Co., Ltd.#	**5,052**	–
CEC Wireless R&D Ltd.*	**332**	79
Shenzhen SED Coalition Electronics Co., Ltd.*	**–**	22,987
Sales of samples and materials		
Philips Electronics (Shanghai) Co., Ltd.#	**8,236**	3,579
Philips France S.A.S.#	**4,930**	–
Philips (China) Investment Co., Ltd.#	**3,362**	–
Philips Electronics Singapore Pte. Ltd.#	**1,896**	10
Philips Consumer Electronics International B.V.#	**1,840**	–
CEC Wireless R&D Ltd.*	**485**	–
Shenzhen SED Industry Co., Ltd.*	**281**	6,129

Sales to companies in Philips Group were based on a long-term agreement in which the Philips Group was entitled to purchase goods from the Group at a price determined using a "cost plus" basis.

Sales to other related parties were carried out on commercial terms and conditions and at market prices.

22 Related party transactions *(continued)*

(b) Other transactions

	Note	Six months ended 30th June 2005	2004
Purchases of goods	*(i)*		
Philips Electronics Hong Kong Ltd.#		**194,306**	575,404
Assembleon Hong Kong Ltd.#		**4,133**	–
Philips France S.A.S.#		**535**	524
Philips Electronics Beijing Co., Ltd.#		**388**	40
Shenzhen Sang Da Baili Electronics Co., Ltd.*		**5,494**	1,177
CEC Wireless R&D Ltd.*		**3,014**	–
Processing services	*(ii)*		
Shenzhen Sang Da Baili Electronics Co., Ltd.*		**2,659**	2,659
Shenzhen SED Industry Co., Ltd.*		**2,031**	–
Fitment and decoration services	*(iii)*		
Shenzhen SED Fitment & Decoration Co., Ltd.*		**1,648**	3,234
Canteen services	*(iv)*		
Shenzhen Sang Da Baili Electronics Co., Ltd.*		**3,467**	3,181
Repair and maintenance services	*(v)*		
Shenzhen SED ARC Co., Ltd.*		**–**	653
Rental	*(vi)*		
Shenzhen SED Industry Co., Ltd.*		**3,968**	3,399

22 Related party transactions *(continued)*

(b) Other transactions *(continued)*

(i) Members of the Philips Group are the major suppliers of raw materials. Purchases of raw materials from the Philips Group were carried out in the ordinary course of business and on commercial terms and conditions.

The Group from time to time purchases raw materials from members of the CEC Group. Purchases of goods from the CEC Group were carried out in the ordinary course of business and on commercial terms and conditions.

(ii) The Group secured dedicated processing services of SMA production lines from members of the CEC Group. The processing services were carried out on commercial terms and conditions.

(iii) The Group engaged members of the CEC Group to undertake renovation works in connection with the expansion of the Group's production premises. The fitment and decoration services were carried out in the ordinary course of business and were on commercial terms and conditions.

(iv) Shenzhen Sang Da Baili Electronics Co., Ltd. provides canteen services to the production staff of the Group. The fee of the canteen services were calculated by reference to actual consumption and an agreed fixed premium and were carried out on commercial terms and conditions.

(v) The Group engaged Shenzhen SED ARC Co., Ltd. for after sales product repair services in respect of its own-branded products. The repair and maintenance services were carried out on commercial terms and conditions.

(vi) The production facilities and some of the staff quarters of the Group were located within an industrial complex owned by members of the CEC Group. The rentals were based on lease agreements entered into by the relevant parties and the Group and were calculated on commercial terms and conditions.

22 Related party transactions *(continued)*

(c) Period-end balance arising from sales and other transactions

	30th June 2005	31st December 2004
Receivables from related parties		
Philips Electronics (Shanghai) Co., Ltd.#	**268,659**	329,251
Philips Electronics Singapore Pte. Ltd.#	**128,125**	139,989
Philips France S.A.S.#	**86,115**	245,932
Philips Electronics Hong Kong Ltd.#	**52,078**	29,531
Philips Electronics Trading Service (Shanghai) Co., Ltd.#	**5,911**	–
Philips (China) Investment Co., Ltd#	**3,362**	–
Philips Consumer Electronics International B.V.#	**1,840**	–
Shenzhen Sang Da Baili Electronics Co., Ltd.*	**1,056**	1,327
Shenzhen SED Industry Co., Ltd.*	**–**	7,026
Payables to related parties		
Philips Electronics Hong Kong Ltd.#	**41,614**	35,887
Philips Electronics Singapore Pte. Ltd.#	**2,712**	2,577
Philips France S.A.S.#	**1,333**	4,622
CEC Wireless R&D Ltd.*	**2,717**	–
Shenzhen Sang Da Baili Electronics Co., Ltd.*	**2,343**	5,661

The receivables/payables from/to related parties were interest-free, unsecured and settled in accordance with terms of the agreement and generally within one year. Sales of goods made to the Philips Group in 2004 and 2005 were covered by guarantee documentation issued by banks.

23 Events after the balance sheet date

(a) On 13th July 2005, Sang Fei entered into a general purchase agreement with Philips Consumer Electronics International B.V. ("Philips CEI"). Philips CEI is a member of the Philips Group. Pursuant to the agreement, Sang Fei will design, develop, manufacture and supply mobile phones, MP3 players and other portable electronics products to the Philips Group. Sang Fei will also provide product maintenance services and supply related spare parts to the Philips Group. Under the agreement, Sang Fei may also source from the Philips Group the raw materials used to manufacture the electronics products on a non-committed basis.

The agreement is for a term of two and a half years and will expire on 31st December 2007. During the term of the agreement, either party may give six months' notice to terminate the agreement. Upon the expiry of the term of the agreement, the agreement may be extended for further one year unless either party objects.

(b) On 4th April 2005, the Company entered into an equity transfer agreement in which the Company agreed to acquire from China Electronics Industry Corporation, a subsidiary of CEC, a 48% equity interest in CEC Wireless R&D Ltd. at a consideration of HK$22,000,000 (the "Acquisition"). However, as the conditions precedent as set out in the equity transfer agreement have not been fulfilled, the Company determined to terminate the acquisition on 15th August 2005. Termination of the Acquisition had no material adverse impact on the business operation or financial position of the Company.

24 Comparative figures

The Group has adopted new HKFRSs which are effective for accounting periods commencing on or after 1st January 2005. As mentioned in Note 3, this has resulted in changes to the presentation of certain items and comparative financial information has been restated, accordingly. In addition, certain comparative figures have been reclassified to confirm with the current period's presentation.