Management Discussion and Analysis

Business Review

For the year ended 31 December 2005, the Group recorded a consolidated sales of HK$4,768.5 million (2004: HK$4,590.1 million) and profit attributable to equity holders of HK$49.9 million (2004: loss of HK$19.3 million) respectively. Basic earnings per share for the year was HK cents 4.61 (2004: loss of HK cents 2.17 per share). The Board proposed a final dividend of HK$0.02 per share (2004: Nil) amounting to a total dividend of HK$21.7 million in cash, representing a dividend payout ratio of 43.4%, which is subject to the approval by the shareholders of the Company at the forthcoming annual general meeting.

During the year under review, the Group sold 7.9 million units of mobile handsets, representing a decrease of 6.6% as compared to 2004. The decrease was primarily due to the drop in sales of *Philips* branded mobile handsets with which sales revenue dropped by 19.3% to HK$3,349.3 million. The decrease was, however, offset by the terrific results in own-branded mobile handsets. During the year, sales revenue from own-branded mobile handsets was HK$1,063.4 million, achieving a remarkable growth of 1.9 times over last year.

In the second half of the year, the Group launched new product lines in which new products including MP3 players and other portable electronics products were offered to the Philips Group and other OEM customers. The new product line contributed HK$319.6 million to the sales revenue of the Group. In addition to other sales-related services provided to the customers, the total revenue for the year was HK$4,768.5 million, representing a mild increase of 3.9% over 2004.

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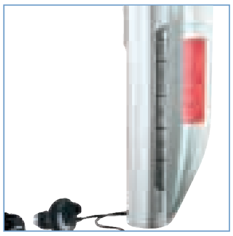

Cost of goods sold for the year increased by 3.8% to HK$4,516.5 million. The primary component of product cost was cost of raw material, which represented 95.8% of the total cost. The increase in cost of goods sold was in line with the growth in sales. Despite the general increase in the cost of material supply, the Group's global material sourcing channels together with the well-implemented inventory control policies effectively minimised the overall impact on the production costs of the Group.

Operating profit for the year was HK$101.4 million, representing an increase of 3.9% over last year. The operating profit margin was 2.1% which was in line with that of previous year. In addition to savings in finance costs and as the Group did not have impairment of goodwill this year, the Group recorded a profit for the year of HK$84.3 million, a growth of 12.1 times as compared to HK$6.4 million last year. The profit attributable to equity holders for the year was HK$49.9 million.

Capital Resources and Liquidity

The Group finances its operations primarily by internal resources and short term bank borrowings. As at 31 December 2005, the Group had cash and cash equivalents amounted to HK$306.4 million (2004: HK$217.4 million) which were primarily denominated in Hong Kong dollars, Renminbi and United States dollars.

As at 31 December 2005, the Group had unsecured short term bank borrowings of HK$230.8 million (2004: HK$392.2 million). The bank borrowings were all denominated in Renminbi, and were borrowed at contracted fixed interest rate. The total bank facilities available to the Group were RMB600 million. As at 31 December 2005, the Group did not have any pledged assets or guarantee.

As at 31 December 2005, the Group had net current assets of HK$470.7 million (2004: HK$371.2 million). The overall gearing ratio, which is calculated as the total liabilities over total assets of the Group, was 70.6% (2004: 70.2%).

The Group's exports 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 equipments 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 operations.

Contingent Liabilities and Capital Commitment

As at 31 December 2005, the Group had contracted but not provided for capital commitment of HK$3.2 million (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 31 December 2005 (2004: Nil).

Employee and Remuneration Policies

As at 31 December 2005, the Group had 3,500 employees, the majority of whom were based in China.

The Group recognises 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 optimise 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 13 July 2005, the Group's principal operating subsidiary, Shenzhen Sang Fei Consumer Communications Company Limited ("Sang Fei"), entered into a purchasing agreement (the "Purchasing Agreement") with Philips Consumer Electronics International B.V. Pursuant to the Purchasing Agreement, in addition to the mobile handset 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 Purchasing Agreement is for a term of two and a half years and will expire on 31 December 2007. Upon expiry, the Purchasing Agreement may be extended for further one year unless either party objects. The price of the products and spare parts to be supplied and the raw materials to be purchased from the Philips Group under the Purchasing Agreement is 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 annual caps for the financial year ended 31 December 2005 and the two financial years ending 31 December 2006 and 2007 in relation to the aggregate consideration to be received by Sang Fei from the Philips Group for the supply of products and spare parts and the provision of product maintenance services are RMB5,610 million, RMB7,013 million and RMB7,714 million, respectively, and the annual caps for the aggregate consideration to be paid by Sang Fei to the Philips Group for the purchase of raw materials are RMB1,500 million, RMB1,875 million and RMB2,063 million respectively.

On 21 January 2006, Sang Fei further entered into a maintenance service agreement (the "Maintenance Service Agreement") with Philips (China) Investment Company Limited ("Philips China"), whereby Sang Fei will provide mobile handsets maintenance service to Philips China. The term of the Maintenance Service Agreement is for one year commencing from 1 January 2006. Upon expiry of the one-year term, the agreement may be extended for one year unless either party objects. The price of the maintenance service will be determined after arm's length negotiations between the parties with reference to the estimated costs to be incurred by Sang Fei for the provision of the maintenance services plus a service charge which is determined in accordance with market rates. The annual cap as set for the aggregate consideration to be received by Sang Fei from Philips China in relation to the provision of maintenance service was RMB60 million.

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As the Philips Group owns 25% interest in Sang Fei, the transactions contemplated under the Purchasing Agreement and the Maintenance Service Agreement constitute the continuing connected transactions of the Company. The directors are of the opinion that the entering into of the Purchasing Agreement and Maintenance Service 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 Purchasing Agreement and the Maintenance Service Agreement and the continuing connected transactions contemplated thereunder by way of written approvals.

On 3 March 2006, Sang Fei entered into a plastic supply agreement with Shenzhen Sang Da Baili Electronics Co., Ltd. ("Baili"), whereby Sang Fei will purchase from Baili the plastic parts used for the manufacture of mobile handsets. The agreement will be for a term of 3 years commencing from 1 April 2006. The price of the plastic parts to be supplied by Baili to Sang Fei under the agreement will be determined after arm's length negotiation with reference to market rates. The pricing terms will be no less favourable than those offered to Sang Fei by other third party suppliers. The Company estimated that the aggregate amount of consideration to be paid by Sang Fei to Baili for the purchase of plastic parts for the nine months ending 31 December 2006, for the two financial years ending 31 December 2007 and 2008 and for the three months ending 31 March 2009 will be RMB43.5 million, RMB104.5 million, RMB120 million and RMB30 million respectively.

As Baili is an indirect non-wholly owned subsidiary of CEC, the transactions contemplated under the agreement constitute continuing connected transactions of the Company. The transactions are subject to the approval by the shareholders in the special general meeting to be held on 21 April 2006.

Capital Reorganisation and Change in Board Lot Size

As at 31 December 2004, the Company had accumulated losses of HK$154.4 million and contributed surplus of HK$140.3 million. On 18 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 17 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 4 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 15 August 2005, the equity transfer agreement was terminated automatically according to the terms of the agreement. Termination of the Acquisition had no material adverse impact on the business operation or financial position of the Company.