Notes to the Consolidated Accounts

1. GENERAL INFORMATION

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 sale of portable electronics products.

The address of the Company's registered office is Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda.

These consolidated accounts are presented in thousands of units of Hong Kong dollar (HK$), unless otherwise stated. These consolidated accounts have been approved for issue by the board of directors on 10 April 2006.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated accounts are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

(a) Preparation of accounts

The consolidated accounts of the Company and its subsidiaries (have in after collectively referred to as the "Group") have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS"). The consolidated accounts have been prepared under the historical cost convention.

The preparation of accounts in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the accounts, are disclosed in note 4.

(b) The acquisition

On 10 December 2003, China Electronics Corporation ("CEC"), the Company and the Company's then holding company, Winsan International Holdings Limited entered into a sale and purchase agreement to acquire CEC's 65% equity interest in Shenzhen Sang Fei Consumer Communications Company Limited ("Sang Fei") (the "Acquisition"), at a consideration of HK$260,000,000. The consideration was satisfied by the issuance of 6,500,000,000 shares of the Company (the "Consideration Shares") to CEC. The Acquisition was completed on 24 September 2004.

Under HKFRS and as stated in the circular to the shareholders dated 21 June 2004, the Acquisition has been accounted for as a reverse acquisition since the issuance of the Consideration Shares in exchange for the 65% equity interest in Sang Fei resulted in CEC becoming the controlling shareholder of the Company. For accounting purpose, Sang Fei is regarded as the acquirer while the Company and its then subsidiaries (the "Winsan Group") are deemed to have been acquired by Sang Fei.

Notes to the Consolidated Accounts

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.1 Basis of preparation *(continued)*

(b) The acquisition (continued)

These consolidated accounts have been prepared as a continuation of the consolidated accounts of Sang Fei and accordingly:

(i) the assets and liabilities of Sang Fei are recognised and measured at their historical carrying values prior to the completion of the Acquisition;

(ii) the retained earnings and other equity balances recognised in these consolidated accounts are those of Sang Fei; and

(iii) the amount recognised as issued equity, which consists of share capital and share premium, has been determined by adding to the issued equity of Sang Fei immediately before the completion of the Acquisition the cost of the acquisition of the Winsan Group. The equity structure (i.e. the number and type of shares issued) reflects the equity structure of the Company including the Consideration Shares.

(c) The adoption of new/revised HKFRS

In 2005, the Group adopted the new/revised standards and interpretations of HKFRS 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 17	Leases
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
HKAS-Int 15	Operating Leases – Incentives
HKFRS 2	Share-based Payments
HKFRS 3	Business Combinations

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.1 Basis of preparation *(continued)*

(c) The adoption of new/revised HKFRS (continued)

The adoption of new/revised HKASs 1, 2, 7, 8, 10, 16, 17, 21, 23, 24, 27, 32, 33, 39 and HKAS-Int 15 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, 17, 23, 27, 32, 33, 39 and HKAS-Int 15 had no material effect on the Group's policies.

– HKAS 21 had no material effect on the Group's policy. The functional currency of each of the consolidated entities has been re-evaluated based on the guidance to the revised standard. The Company adopted Hong Kong dollars as its presentation currency while its functional currency is Renminbi. All other Group entities have the same functional currency as the presentation currency of respective entity financial statements.

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

The adoption of HKFRS 2 has resulted in a change in the accounting policy for share-based payments. Until 31 December 2004, the provision of share options to employees did not result in an expense in the income statement. Effective on 1 January 2005, the Group expenses the cost of share options in the income statement. As there was no share option outstanding as at 31 December 2004, there is no effect of adopting this new accounting policy.

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

Notes to the Consolidated Accounts

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.1 Basis of preparation *(continued)*

(c) The adoption of new/revised HKFRS (continued)

In accordance with the provisions of HKFRS 3 (note 2.6):

– the Group ceased amortisation of goodwill from 1 January 2005;

– accumulated amortisation as at 31 December 2004 has been eliminated with a corresponding decrease in the cost of goodwill; and

– from the year ended 31 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 at 31 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/revised HKFRS to the consolidated accounts.

The following new standards, amendments and interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2006 or later periods but which the Group has not early adopted.

HKAS 1 (Amendment)	Capital Disclosures
HKAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 (Amendment)	The Fair Value Option
HKAS 39 and HKFRS 4 (Amendment)	Financial Guarantee Contracts
HKFRS 1 and HKFRS 6 (Amendment)	First-time Adoption of Hong Kong Financial Reporting Standards and Exploration for and Evaluation of Mineral Resources
HKFRS 6	Exploration for and Evaluation of Mineral Resources
HKFRS 7	Financial Instruments: Disclosures
HKFRS-Int 4	Determining whether an Arrangement contains a Lease
HKFRS-Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
HK(IFRIC)-Int 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment

The directors are of the opinion that HKAS 19 (Amendment), HKFRS 1 and HKFRS 6 (Amendment), HKFRS 6 are not relevant to the Group's operations and the adoption of the remaining new standards, amendments and interpretations will not result in substantial changes to the Group's accounting policies.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.2 Consolidation

The consolidated accounts include the accounts of the Company and all its subsidiaries made up to 31 December.

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividend received and receivable.

2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

Notes to the Consolidated Accounts

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.4 Foreign currency translation

(a) *Functional and presentation currency*

Items included in the accounts 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 consolidated accounts are presented in Hong Kong dollars, which is the Company's presentation currency, while the Company's functional currency is Renminbi.

(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.

(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 presentation currency are translated into the presentation currency as follows:

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

– 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

– all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities and of borrowings are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

2.5 Property, plant and equipment

Property, plant and equipment are stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Cost may also include transfers from equity of any gains/losses on qualifying cash flow hedges of foreign currency purchases of property, plant and equipment.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.5 Property, plant and equipment *(continued)*

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the income statement during the financial period in which they are incurred.

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate cost to their residual values over their estimated useful lives, as follows:

– Leasehold improvements	5 years or over the lease term, which is shorter
– Plant and machinery	3-4 years
– Motor vehicles	5 years
– Furniture and fixtures	3-5 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

During the year, the directors re-visited the residual value of property, plant and equipment and adjusted it to zero. The effect of this change in accounting estimate is to decrease the operating profit for the year by HK$8,091,000.

2.6 Intangible assets

(a) 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 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.

If the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition exceeds the cost of acquisition, the excess should be recognised immediately in the income statement.

Notes to the Consolidated Accounts

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.6 Intangible assets *(continued)*

(b) Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives.

Costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include the software development employee costs and an appropriate portion of relevant overheads.

Computer software development costs recognised as assets are amortised over their estimated useful lives.

(c) Research and development costs

Research costs are expensed as incurred. Costs incurred on development projects relating to the design and testing of new or improved products are recognised as an intangible asset where the technical feasibility and intention of completing the product under development has been demonstrated and the resources are available to do so, costs are identifiable and there is an ability to sell or use the asset that will generate probable future economic benefits. Such development costs are recognised as an asset and amortised on a straight-line basis over a period of not more than 5 years to reflect the pattern in which the related economic benefits are recognised. Development costs that do not meet the above criteria are expensed as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

2.7 Impairment of assets

Assets that have an indefinite useful life are not subject to amortisation, which are at least tested annually for impairment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. 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).

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.8 Investments

The Group classifies its investments in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

(a) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realised within 12 months of the balance sheet date. During the year, the Group did not hold any investments in this category.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are included in trade and other receivables in the balance sheet (note 2.10).

(c) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. During the year, the Group did not hold any investments in this category.

(d) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date. During the year, the Group did not hold any investments in this category.

Notes to the Consolidated Accounts

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.8 Investments *(continued)*

(d) Available-for-sale financial assets (continued)

Purchases and sales of investments are recognised on trade-date – the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Realised and unrealised gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise. Unrealised gains and losses arising from changes in the fair value of non-monetary securities classified as available-for-sale are recognised in equity. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments are included in the income statement as gains or losses from investment securities.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired.

2.9 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out method. The cost of finished goods and work in progress comprises design costs, raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

2.10 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.

2.11 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.12 Share capital

Ordinary shares are classified as equity. 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.

2.13 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. 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.

2.14 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated accounts. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2.15 Provision

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

The Group recognises a provision for repair or replacement of products still under warranty at the balance sheet date. This provision is calendared based on past history of the level of repairs and replacements.

Notes to the Consolidated Accounts

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.16 Contingent liabilities

A contingent liability is a possible obligation that arises from past events and whose existent will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, they will then be recognised as a provision.

2.17 Revenue recognition

Revenue comprises the fair value for the sale of goods, net of value-added tax. Revenue is recognised when the goods are delivered to customers, the customers has accepted the goods and collectibility of the related receivables is reasonably assured.

Interest income is recognised on a time proportion basis using the effective interest method.

Dividend income is recognised when the right to receive payment is established.

2.18 Employee benefits

(a) Pension obligations

The Group operates a mandatory provident fund scheme ("MPF") for the eligible employees in Hong Kong. The Group's contributions to MPF are set at 5% of employees' salaries, including basic salaries and other cash allowances and are expensed as incurred.

The principal operating subsidiary, Sang Fei, that operating in the People's Republic of China ("PRC") has to make contribution to staff retirement scheme managed by local government authorities in accordance with the relevant rules and regulations. Contributions to these schemes are charged to the profit and loss account as and when incurred.

(b) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are not recognised until the time of leave.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

2.18 Employee benefits *(continued)*

(c) Bonus plans

The expected cost of bonus payments are recognised as a liability when the Group has a present legal or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

Liabilities for profit sharing and bonus plans are expected to be settled within 12 months and are measured at the amounts expected to be paid when they are settled.

(d) Share-based compensation

The Group operates an equity-settled, share-based compensation plan. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity reviews its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

2.19 Operating leases (as the lessee)

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are expensed in the income statement on a straight-line basis over the period of the lease.

2.20 Dividend distribution

Dividend distribution to the Company’s shareholders is recognised as a liability in the Group’s accounts in the period in which the dividends are approved by the Company’s shareholders.

Notes to the Consolidated Accounts

3. FINANCIAL RISK MANAGEMENT

3.1 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 US 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 PRC government.

(b) Credit risk

The Group has no significant concentrations of credit risk. It has policies in place to ensure that sales are made to customers with an appropriate credit history. The Group performs ongoing credit evaluations for 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.

3.2 Fair value estimation

The nominal value less estimated credit adjustments or trade receivables and payables are assumed to approximate their values. The fair values of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest that is available to the Group for similar financial instruments.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) Estimated impairment of non-financial assets

The Group tests annually whether non-financial assets, mainly including property, plant and equipment and intangible assets has suffered any impairment in accordance with the accounting policy stated in note 2.7. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require the use of estimates.

(b) Income taxes

The Group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

(c) Share option

The Group operates a share option scheme. The fair value of the options granted during the year (note 12(c)) is determined by using valuation techniques. The Group uses its judgement to select the valuation method and make assumptions for the significant inputs into the valuation model. At each balance sheet date, the Group reviews its estimates and recognises the impact of the revision of original estimates, if any, in the income statement, with a corresponding adjustment to equity.

Notes to the Consolidated Accounts

5. SEGMENT INFORMATION

Primary reporting format – business segments

The Group is principally engaged in manufacturing and sale of portable electronics products.

	***Philips* branded mobile handset products**		**Own branded mobile handset products**		**OEM other products and other operations**		**Total**	
	2005	2004	**2005**	2004	**2005**	2004	**2005**	2004
Sales	**3,349,265**	4,149,406	**1,063,387**	368,665	**355,874**	72,052	**4,768,526**	4,590,123
Segment results	**118,412**	182,718	**89,487**	39,833	**44,160**	14,933	**252,059**	237,484
Unallocated revenues							**18,519**	916
Unallocated costs							**(169,131)**	(140,763)
Operating profits							**101,447**	97,637
Finance costs							**(11,501)**	(21,180)
Profit after finance costs							**89,946**	76,457
Provision for impairment on goodwill							**–**	(61,498)
Profit before income tax							**89,946**	14,959
Income tax expenses							**(5,598)**	(8,518)
Profit for the year							**84,348**	6,441
Segment assets	**997,513**	728,981	**43,428**	65,876	**9,618**	6,951	**1,050,559**	801,808
Unallocated assets							**885,478**	858,536
Total assets							**1,936,037**	1,660,344
Segment liabilities	**63,090**	30,476	**3,718**	5,409	**–**	–	**66,808**	35,885
Unallocated liabilities							**1,300,834**	1,130,334
Total liabilities							**1,367,642**	1,166,219
Capital expenditures							**26,935**	82,651
Depreciation/amortisation charge							**57,863**	45,837
Impairment charge							**21,024**	86,081

5. SEGMENT INFORMATION *(CONTINUED)*

Secondary reporting format – geographical segments

The Group's three business segments operate in four main geographical areas – Mainland China, Europe, Asia and Hong Kong. The segment sales based on the geographical location of its customers are presented below:

	Sales	
	2005	2004
Mainland China	**2,256,707**	2,116,578
Europe	**690,062**	1,528,452
Asia excluding Mainland China and Hong Kong	**606,578**	199,375
Hong Kong	**1,215,179**	745,718
	4,768,526	4,590,123

No segment assets and liabilities are presented as over 90% of the Group's assets are located in Mainland China.

Notes to the Consolidated Accounts

6. PROPERTY, PLANT AND EQUIPMENT

Group

	Leasehold improvements	Plant and machinery	Motor vehicles	Furniture and fixtures	Total
At 1 January 2004					
Cost	25,695	209,414	2,146	23,701	260,956
Accumulated depreciation	(20,882)	(141,592)	(1,114)	(9,346)	(172,934)
Net book amount	4,813	67,822	1,032	14,355	88,022
Year ended 31 December 2004					
Opening net book amount	4,813	67,822	1,032	14,355	88,022
Acquisition of subsidiary	77	–	–	40	117
Additions	7,673	67,807	749	5,586	81,815
Depreciation charge	(1,042)	(38,464)	(402)	(3,173)	(43,081)
Impairment charge	–	(3,830)	(58)	(3,471)	(7,359)
Disposals	(3)	(53)	–	(56)	(112)
Closing net book amount	11,518	93,282	1,321	13,281	119,402
At 31 December 2004					
Cost	33,466	276,074	2,887	25,354	337,781
Accumulated depreciation and impairment	(21,948)	(182,792)	(1,566)	(12,073)	(218,379)
Net book amount	11,518	93,282	1,321	13,281	119,402
Year ended 31 December 2005					
Opening net book amount	11,518	93,282	1,321	13,281	119,402
Additions	3,809	6,300	335	3,393	13,837
Depreciation charge	(3,481)	(42,864)	(456)	(8,533)	(55,334)
Exchange differences	195	1,430	10	179	1,814
Disposals	(58)	(568)	–	(42)	(668)
Closing net book amount	11,983	57,580	1,210	8,278	79,051
At 31 December 2005					
Cost	37,834	286,627	3,265	29,068	356,794
Accumulated depreciation and impairment	(25,851)	(229,047)	(2,055)	(20,790)	(277,743)
Net book amount	11,983	57,580	1,210	8,278	79,051

Depreciation expense of HK$43,944,000 (2004: HK$42,549,000) has been expensed in cost of goods sold, HK$225,000 (2004: HK$97,000) in selling and marketing costs and HK$11,165,000 (2004: HK$7,794,000) in administrative expenses.

Lease rentals amounting to HK$16,168,000 (2004: HK$14,734,000) relating to the lease of property and machinery are included in the income statement.

6 PROPERTY, PLANT AND EQUIPMENT *(CONTINUED)*

Company

	Motor vehicles	**Furniture and fixtures**	**Total**
At 1 January 2004			
Cost	118	137	255
Accumulated depreciation	(47)	(91)	(138)
Net book amount	71	46	117
Year ended 31 December 2004			
Opening net book amount	71	46	117
Additions	684	40	724
Depreciation charge	(57)	(10)	(67)
Disposals	(59)	(34)	(93)
Closing net book amount	639	42	681
At 31 December 2004			
Cost	684	52	736
Accumulated depreciation	(45)	(10)	(55)
Net book amount	639	42	681
Year ended 31 December 2005			
Opening net book amount	639	42	681
Additions	–	72	72
Depreciation charge	(137)	(11)	(148)
Closing net book amount	502	103	605
At 31 December 2005			
Cost	684	124	808
Accumulated depreciation	(182)	(21)	(203)
Net book amount	502	103	605

Notes to the Consolidated Accounts

7. INTANGIBLE ASSETS – GROUP

	Goodwill	Computer Software	Total
At 1 January 2004			
Cost	–	9,773	9,773
Accumulated amortisation	–	(5,932)	(5,932)
Net book amount	–	3,841	3,841
Year ended 31 December 2004			
Opening net book amount	–	3,841	3,841
Reverse acquisition of a subsidiary	63,075	–	63,075
Additions	–	836	836
Impairment charge	(61,498)	–	(61,498)
Amortisation charge	(1,577)	(1,179)	(2,756)
Closing net book amount	–	3,498	3,498
At 31 December 2004			
Cost	63,075	10,609	73,684
Accumulated amortisation and impairment	(63,075)	(7,111)	(70,186)
Net book amount	–	3,498	3,498
Year ended 31 December 2005			
Opening net book amount	–	3,498	3,498
Additions	–	13,098	13,098
Exchange differences	–	46	46
Amortisation charge	–	(2,529)	(2,529)
Closing net book amount	–	14,113	14,113
At 31 December 2005			
Cost	63,075	23,918	86,993
Accumulated amortisation and impairment	(63,075)	(9,805)	(72,880)
Net book amount	–	14,113	14,113

Amortisation of HK$137,000 (2004: Nil) is included in the cost of goods sold; HK$32,000 (2004:Nil) in selling and marketing costs; and HK$2,360,000 (2004: HK$2,756,000) in administrative expenses in the income statement.

8. INVESTMENTS IN SUBSIDIARIES – COMPANY

	2005	2004
Investments in subsidiaries – unlisted shares, at cost	**260,000**	260,000
Amounts due from subsidiaries	**3,900**	639
	263,900	260,639

The following is a list of the principal subsidiaries as at 31 December 2005.

Name	Place of Incorporation and kind of legal entity	Principal activities and place of operation	Particulars of issued share capital	Interest held
Indirectly held:				
Sang Fei	PRC, a Sino-foreign equity joint venture company	PRC, manufacture and sale of portable electronics products	Registered capital of US$33,000,000	65%
China Electronics Corporation Management Limited	Hong Kong, limited company	Hong Kong, provision of group management services	2 ordinary shares of HK$1 each	100%

9. INVENTORIES – GROUP

	2005	2004
Raw materials	**284,703**	216,064
Work in progress	**100,139**	109,726
Finished goods	**62,192**	62,830
	447,034	388,620

The cost of inventories recognised as expense and included in cost of goods sold amounted to HK$4,325,554,000 (2004:HK$4,123,676,000).

Written down of inventories to net realisable value of HK$21,024,000 (2004:HK$17,224,000) has been expensed in administrative expenses during the year.

Notes to the Consolidated Accounts

10. TRADE AND OTHER RECEIVABLES

	Group		Company	
	2005	2004	**2005**	2004
Trade receivables (note (a))	**1,010,140**	801,085	**–**	–
Notes receivables	**1,981**	3,255	**–**	–
Other receivables from related parties	**26,583**	25,240	**–**	–
Prepayments and deposits	**11,868**	27,867	**484**	791
Value-added tax refundable	**21,000**	65,690	**–**	–
Other receivables	**13,372**	8,254	**1,649**	9
	1,084,944	931,391	**2,133**	800

The Directors are of the opinion that the carrying amounts of trade and other receivables approximate their fair values.

(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 31 December 2005, the ageing analysis of the Group's trade receivables was as follows:

	2005	2004
Current to 30 days	**968,786**	798,907
31 – 60 days	**23,480**	25
Over 60 days	**17,874**	2,153
	1,010,140	801,085

Including in the balance were trade receivables from related parties of HK$920,551,000 (2004: HK$729,925,000). About 91% (2004: 91%) of the trade receivables from related parties as at 31 December 2005 was covered by bank issued guarantee documents.

11. CASH AND CASH EQUIVALENTS

	Group		Company	
	2005	2004	**2005**	2004
Cash at bank and in hand	**238,732**	217,433	**101,925**	137,342
Short-term bank deposits	**67,649**	–	**67,649**	–
	306,381	217,433	**169,574**	137,342

The effective interest rate on short-term bank deposits was 3.844%. The maturity days of these deposits ranged from 15 to 35 days.

12. ISSUED EQUITY/SHARE CAPITAL

(a) Issued equity – Group

	Number of shares	Issued equity
At 1 January 2005	8,668,480,000	373,750
Capital reorganisation (i)	(7,584,920,000)	–
Utilisation of contributed surplus against accumulated losses (ii)	–	(3,676)
At 31 December 2005	1,083,560,000	370,074

(i) Pursuant to the resolutions passed on a special general meeting on 17 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.

(ii) On 18 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.

Notes to the Consolidated Accounts

12. ISSUED EQUITY/SHARE CAPITAL *(CONTINUED)*

(b) Share capital – Company

	Number of shares – ordinary share of HK$0.01 each				
	Authorised	Issued and fully paid	Share capital	Share premium	Total
At 1 January 2004	30,000,000,000	1,558,480,000	15,585	–	15,585
Issue of consideration shares	–	6,500,000,000	65,000	(5,975)	59,025
Issue of shares	–	610,000,000	6,100	331,030	337,130
At 31 December 2004	30,000,000,000	8,668,480,000	86,685	325,055	411,740
At 1 January 2005	30,000,000,000	8,668,480,000	86,685	325,055	411,740
Capital reorganisation (note 12 (a)(i))	–	(7,584,920,000)	(75,849)	–	(75,849)
At 31 December 2005	30,000,000,000	1,083,560,000	10,836	325,055	335,891

(c) Share option

On 25 October 2005, 28,450,000 options were granted to certain directors, employees and other participants at an exercise price of HK$1.488 under the Share Option Scheme. 40% of the options granted are exercisable from 1 November 2005 to 31 October 2008, another 30% will become exercisable from 1 November 2006 to 31 October 2009 and the remaining 30% will become exercisable from 1 November 2007 to 31 October 2010. No options were exercised, lapsed or cancelled during the year.

The average fair value of the options granted during the year, determined using the Black-Scholes valuation model, was HK$0.571 per share. The significant inputs into the model were share price of HK$1.45 at the grant date, exercise price shown above, standard deviation of expected share price returns of 63.6%, average expected life of options of 2.4 years, and annual risk-free interest rate of approximately 4%. The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices over one years immediately preceding the grant date. Changes in these subjective input assumptions could materially affect the estimation of the fair value of the options.

Expense arising from the share option scheme recognised in administrative expenses during the year amounted to HK$6,572,000.

13. OTHER RESERVES

Group

	Capital reserve (note (a))	Surplus reserves (note (b))	Share option (note 12(c))	Translation reserve	Total
At 1 January 2004	(1,806)	14,906	–	–	13,100
Appropriation from retained earnings	–	6,104	–	–	6,104
At 31 December 2004	(1,806)	21,010	–	–	19,204
At 1 January 2005	(1,806)	21,010	–	–	19,204
Share option granted	–	–	6,572	–	6,572
Appropriation from retained earnings	–	4,982	–	–	4,982
Currency translation differences	–	–	–	4,304	4,304
At 31 December 2005	(1,806)	25,992	6,572	4,304	35,062

(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 loses or to increase capital while the enterprise expansion fund can be used to expand production and to increase capital.

Notes to the Consolidated Accounts

13. OTHER RESERVES *(CONTINUED)*

Company

	Contributed surplus	**Share option**	**Total**
At 1 January 2004 and 31 December 2004	140,263	–	140,263
At 1 January 2005	140,263	–	140,263
Capital reorganisation (note 12(a)(i))	75,849	–	75,849
Utilisation of contributed surplus against accumulated losses (note 12(a)(ii))	(154,440)	–	(154,440)
Share option granted (note 12(c))	–	6,572	6,572
At 31 December 2005	61,672	6,572	68,244

Under the companies Act 1981 of Bermuda, the contributed surplus of the Company is distributable to shareholders in certain circumstances as specified in section 54 thereof.

14. TRADE AND OTHER PAYABLES

	Group		**Company**	
	2005	2004	**2005**	2004
Trade payables (note (a))	**966,990**	640,669	**–**	–
Other payables from related parties	**10,774**	9,079	**–**	–
Accrued expenses	**30,583**	17,792	**3,947**	1,899
Advance from customers	**24,880**	44,037	**–**	–
Other payables	**95,967**	56,660	**–**	–
	1,129,194	768,237	**3,947**	1,899

14. TRADE AND OTHER PAYABLES *(CONTINUED)*

(a) At 31 December 2005, the ageing analysis of the Group's trade payables was as follows:

	2005	2004
Current to 30 days	**943,177**	578,606
31 – 60 days	**2,561**	27,257
Over 60 days	**21,252**	34,806
	966,990	640,669

Included in the balance were trade payables to related parties amounted to HK$56,034,000 (2004: HK$46,358,000).

15. SHORT-TERM BANK LOANS – GROUP

The bank loans are unsecured, repayable within one year and bear interest at the average borrowing rate of 4.674% (2004: 4.438%) per annum. The carrying amounts of bank loans are denominated in Renminbi and approximate their fair values.

The Group has undrawn borrowing facilities of approximately HK$346,154,000 as at 31 December 2005 (2004: HK$362,059,000). The facilities are at fixed rate and expiring within one year which are subject to review at various dates during 2006.

16. PROVISION FOR WARRANTY – GROUP

	2005	2004
At 1 January	**2,214**	1,172
Additional provision	**11,516**	5,949
Less: utilised during the year	**(11,624)**	(4,907)
At 31 December	**2,106**	2,214

The Group provides warranties on products distributed by Sang Fei for end users in the PRC market and undertakes to repair or replace items that fail to operate satisfactorily. Provisions have been recognised for expected warranty claims based on past experience of the level of repairs and returns.

17. OTHER GAINS – NET

	2005	2004
Sales of samples and materials	**11,828**	8,708
Interest income	**4,697**	916
Others	**1,994**	(2,816)
	18,519	6,808

Notes to the Consolidated Accounts

18. EXPENSES BY NATURE

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

	2005	2004
Depreciation, amortisation and impairment expenses (notes 6 and 7)	**57,863**	53,196
Employee benefit expenses (note 19)	**139,525**	108,218
Changes in inventories of finished goods and work in progress	**4,588**	(95,184)
Raw materials and consumables used	**4,320,966**	4,218,860
Bad debt expense	**570**	–
Written down of inventories to net realisable value (note 9)	**21,024**	17,224
Provision on warranty (note 16)	**11,516**	5,949
Operating lease expenses on buildings	**16,168**	14,734
Research and development costs	**15,830**	10,497
Auditors' remuneration	**1,140**	889

19. EMPLOYEE BENEFIT EXPENSE

	2005	2004
Basic salaries, allowances and benefits in kind	**118,743**	91,891
Contributions to retirement schemes (note a and b)	**6,300**	6,423
Share based compensation (note 12(c))	**6,572**	–
Others	**7,910**	9,904
	139,525	108,218

(a) The Group operates a MPF for the eligible employees in Hong Kong. The Group's contributions to MPF are set at 5% (2004: 5%) of employees' salaries, including basic salaries and other cash allowances and are expensed as incurred.

(b) The principal operating subsidiary, Sang Fei, participates in a defined contribution retirement scheme based on laws and regulations in the PRC. Each employee covered by the scheme is entitled, after their retirement from Sang Fei, to a pension equal to the basis salary of the employees as at their retirement dates in the PRC. The local government authority of the PRC is responsible for the pension liabilities to these retired employees in the PRC. Sang Fei made monthly contributions to the retirement scheme at a minimum rate of 8% (2004: 8%) of the basis salaries of employees in the PRC.

20. DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

(a) Directors' and senior management's emoluments

The remuneration of each of the directors for the year ended 31 December 2005 is set out below:

Name of Director	Fees	Salaries, allowance and benefits in kind	Discretionary bonuses	Employer's contribution to pension scheme	Share-based compensation (note 12(c))	Total
Yang Xiaotang	–	600	–	30	924	1,554
Tong Baoan	–	500	–	25	878	1,403
Fan Qingwu	–	400	–	20	832	1,252
Hua Longxing	–	404	–	–	832	1,236
Chan Kay Cheung	180	–	–	–	–	180
Wong Po Yan	180	–	–	–	–	180
Yin Yongli	180	–	–	–	–	180
	540	1,904	–	75	3,466	5,985

During the year, no director has waived emolument or has agreed to waived the directors' emolument.

The remuneration of each of the directors for the year ended 31 December 2004 is set out below:

Name of Director	Fees	Salaries, allowance and benefits in kind	Discretionary bonuses	Employer's contribution to pension scheme	Share-based compensation (note 12(c))	Total
Yang Xiaotang (note b)	–	150	–	8	–	158
Tong Baoan (note b)	–	125	–	6	–	131
Fan Qingwu (note b)	–	100	19	5	–	124
Hua Longxing (note b)	–	396	19	–	–	415
Chan Chak Shing (note a)	–	1,326	–	9	–	1,335
Chan Hon Ching (note a)	–	113	–	6	–	119
Lo Mei Chun (note a)	–	113	–	9	–	122
Chiu King Cheung (note a)	–	113	–	5	–	118
Chan Kay Cheung	180	–	–	–	–	180
Wong Po Yan	180	–	–	–	–	180
Yin Yongli (note b)	49	–	–	–	–	49
	409	2,436	38	48	–	2,931

Notes:

(a) Resigned on 24 September 2004.

(b) Appointed on 24 September 2004.

Notes to the Consolidated Accounts

20. DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS *(CONTINUED)*

(b) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include two directors (2004: 1) whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining three (2004: 4) individual during the year are as follows:

	2005	2004
Basic salaries, allowances and benefits in kind	**3,397**	5,329
Bonuses	**1,066**	1,667
Contributions to retirement schemes	**180**	522
Share-based compensation (note 12(c))	**289**	–
	4,932	7,518

The emoluments fell within the following band:

	Number of individuals	
	2005	2004
HK$1,000,001 – HK$1,500,000	**1**	1
HK$1,500,001 – HK$2,000,000	**2**	1
HK$2,000,001 – HK$2,500,000	**–**	1
HK$2,500,001 – HK$3,000,000	**–**	1
	3	4

21. FINANCE COSTS

	2005	2004
Interest on bank loans	**11,501**	21,180

22. TAXATION

(a) Income tax expense

The amount of taxation charged to the consolidated income statement represents:

	2005	2004
Current taxation – PRC enterprise income tax	**10,112**	8,518
Deferred taxation	**(4,514)**	–
	5,598	8,518

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

(ii) The principal subsidiary, Sang Fei, is a foreign investment production enterprise established in Shenzhen Special Economic Zone in the PRC, the prevailing PRC enterprise income tax rate is 15%. As approved by the tax authorities in 1998, Sang Fei is entitled to exemption from income tax for two years followed by a 50% tax reduction for three years, commencing from the year ended 31 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 enterprise income tax for further three years starting from 2005. Consequently, enterprise income tax has been provided at the rate of 7.5% (2004: 7.5%) for the year.

(iii) The taxation on the Group's profit before taxation differs from the theoretical amount that would arise using the taxation rate in the PRC as follows:

	2005	2004
Profit before income tax	**89,946**	14,959
Calculated at a taxation rate of 15% (2004: 15%)	**13,492**	2,244
Profit earned in the tax holiday period	**(11,074)**	(6,323)
Expenses not deductible for taxation purposes	**317**	12,008
Tax losses for which no deferred income tax asset was recognised	**2,863**	589
Income tax expense	**5,598**	8,518

Notes to the Consolidated Accounts

22. TAXATION *(CONTINUED)*

(b) Deferred taxation

The movement on the deferred tax assets during the year is as follows:

	Group	
	2005	2004
At 1 January	**–**	–
Deferred taxation credited to the income statement	**4,514**	–
At 31 December	**4,514**	–
Representing deferred tax assets arising from:		
Impairment of inventories	**2,939**	–
Accelerated depreciation of property, plant and equipment	**540**	–
Others	**1,035**	–
	4,514	–

The amounts shown in the balance sheet include the following:

	Group	
	2005	2004
Deferred tax assets to be recovered after more than 12 months	**3,479**	–
Deferred tax assets to be recovered within 12 months	**1,035**	–
	4,514	–

Deferred income tax assets are recognised for tax loss carrying-forwards to the extent that the realisation of the related tax benefit through the future taxable profits is probable. The Group did not recognise deferred income tax assets of HK$2,863,000 (2004: HK$589,000) in respect of losses amounted to HK$16,363,000 (2004: HK$3,366,000) as there is no reasonable expectation that losses will be recovered in the foreseeable future.

23. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The profit attributable to equity holders of the Company is dealt with the accounts of the Company to the extent of the HK$28,130,000 (2004: HK$30,465,000).

24. EARNINGS/(LOSS) PER SHARE

The calculation of the basic earnings/(loss) per share is based on the Group's profit attributable to equity holders of the Company for the year ended 31 December 2005 of HK$49,899,000 (2004: loss of HK$19,263,000) and the 1,083,560,000 (2004: the weighted average of 885,819,508 ordinary shares) ordinary shares in issue during the year.

24. EARNINGS/(LOSS) PER SHARE *(CONTINUED)*

As detailed in note 12(a)(i), the Company carried out a capital reorganisation during the year. The capital reorganisation is deemed to have been taken place on 1 January 2004 for the purpose of computing the earnings/(loss) per share and the financial information for the year ended 31 December 2004 has been restated accordingly.

The exercise of the share options granted under the Share Option Scheme of the Company would have an anti-dilutive effect on the earnings per share for the year and therefore, no diluted earnings per share has been presented.

25. DIVIDEND

The directors proposed a final dividend of HK$0.02 per share (2004: Nil) amounting to a total dividend of HK$21,671,000 in cash which is subject to the approval by the shareholders of the Company at the forthcoming annual general meeting.

26. CASH GENERATED FROM OPERATIONS

	2005	2004
Profit for the year	**84,348**	6,441
Adjustment for:		
Income tax expense	**5,598**	8,518
Depreciation of owned property, plant and equipment	**55,334**	43,081
Impairment of goodwill	**–**	61,498
Impairment of property, plant and equipment	**–**	7,359
Amortisation of intangible assets	**2,529**	2,756
Profit on sale of property, plant and equipment	**(4)**	–
Interest income	**(4,697)**	(916)
Interest expense	**11,501**	21,180
Share-based compensation	**6,572**	–
Changes in working capital (excluding the effects of acquisition and exchange differences on consolidation)		
Inventories	**(58,415)**	(133,893)
Trade and other receivables	**(153,553)**	84,756
Trade and other payables	**365,730**	(16,246)
Provision for warranty	**(108)**	1,042
Cash generated from operations	**314,835**	85,576

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

	2005	2004
Net book amount (note 6)	**668**	112
Profit on sale of property, plant and equipment	**4**	–
Proceeds from sale of property, plant and equipment	**672**	112

Notes to the Consolidated Accounts

27. COMMITMENTS

(a) Capital commitments – Group

As at 31 December 2005, the Group's capital commitment which were contracted but not provided for were as follows:

	2005	2004
Purchase of property, plant and equipment and computer software	**3,163**	8,717

(b) Operating lease commitments

As at 31 December 2005, the Group had future aggregate minimum lease payments under non-cancellable operating leases for factories and office premises as follows:

	Group		**Company**	
	2005	2004	**2005**	2004
Not later than one year	**25,635**	24,676	**631**	175
In the second to fifth years	**27,808**	37,987	**626**	131
	53,443	62,663	**1,257**	306

28. CONTINGENT LIABILITIES

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

29. RELATED-PARTY TRANSACTIONS AND BALANCES

Save as disclosed other where in this report, significant related party transactions of the Group's business are as follows:

During the year, 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), 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:

29. RELATED-PARTY TRANSACTIONS AND BALANCES *(CONTINUED)*

(a) Sales of products, samples and materials:

		2005	2004
Sales of products:			
Philips (China) Investment Co., Ltd.	#	**1,797,211**	–
Philips Electronics (Shanghai) Co., Ltd.	#	**–**	1,735,539
Philips France S.A.S.	#	**689,190**	1,525,193
Philips Electronics Singapore Pte. Ltd.	#	**606,578**	719,537
Philips Electronics Hong Kong Ltd.	#	**515,138**	169,136
Shenzhen SED Coalition Electronics Co., Ltd.	*	**–**	25,550
Philips Electronics Trading Services (Shanghai) Co., Ltd.	#	**8,428**	–
CEC Wireless R&D Ltd.	*	**–**	899
Sales of samples and materials:			
Philips Electronics (Shanghai) Co., Ltd.	#	**13,349**	12,429
Philips (China) Investment Co., Ltd.	#	**40,143**	–
Philips Electronics Hong Kong Ltd.	#	**16,962**	–
Shenzhen SED Industry Co., Ltd.	*	**4,444**	17,513
Philips Electronics Singapore Pte. Ltd.	#	**6,660**	–
CEC Group, others	*	**360**	76
Philips Group, others	#	**929**	293

Members of KPE and its affiliated companies (the “Philips Group”) and members of CEC and its group companies (the “CEC Group”) are the major customers of the Group.

Notes to the Consolidated Accounts

29. RELATED-PARTY TRANSACTIONS AND BALANCES *(CONTINUED)*

(b) Other transactions

		2005	2004
Purchase of raw materials:			
Philips Electronics Hong Kong Ltd.	#	**421,970**	1,033,030
Philips (China) Investment Co., Ltd.	#	**12,208**	–
Shenzhen Sang Da Baili Electronics Co., Ltd.	*	**7,748**	8,052
Philips Electronics (Beijing) Co., Ltd.	#	**2,216**	–
Philips France S.A.S.	#	**701**	764
Philips Electronics Trading Services (Shanghai) Co., Ltd	#	**971**	–
CEC Group, others	*	**569**	–
Philips Group, others	#	**312**	407
Corporate services:			
Philips Electronics Hong Kong Ltd.	#	**–**	15,535
Processing services:			
Shenzhen Sang Da Baili Electronics Co., Ltd.	*	**4,867**	5,572
Shenzhen SED Industry Co., Ltd.	*	**4,107**	792
Fitment and decoration services:			
Shenzhen SED Fitment & Decoration Co., Ltd.	*	**2,459**	5,065
Canteen services:			
Shenzhen Sang Da Baili Electronics Co., Ltd.	*	**11,273**	6,459
Repair and maintenance services:			
Shenzhen SED ARC Co., Ltd.	*	**1,493**	1,175
Rental:			
Shenzhen SED Industry Co., Ltd.	*	**7,283**	4,996
Shenzhen Sang Da Baili Electronics Co., Ltd.	*	**–**	1,014
Purchases of property, plant and equipment:			
Assembleon Hong Kong Ltd.	#	**–**	19,649

29. RELATED-PARTY TRANSACTIONS AND BALANCES *(CONTINUED)*

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

		2005	2004
Receivables from related parties:			
Philips (China) Investment Co., Ltd.	#	**500,921**	–
Philips Electronics (Shanghai) Co., Ltd.	#	**5,553**	329,251
Philips France S.A.S.	#	**100,739**	245,932
Philips Electronics Singapore Pte. Ltd.	#	**212,126**	139,989
Philips Electronics Hong Kong Ltd.	#	**123,494**	29,531
Philips Electronics Trading Services (Shanghai) Co., Ltd.	#	**3,928**	–
Shenzhen SED Industry Co., Ltd.	*	**–**	7,026
Shenzhen Sang Da Baili Electronics Co., Ltd.	*	**–**	1,327
Payables to related parties:			
Philips Electronics Hong Kong Ltd.	#	**45,218**	35,887
Philips (China) Investment Co., Ltd.	#	**12,325**	3
Shenzhen Sang Da Baili Electronics Co., Ltd.	*	**1,010**	5,661
Philips France S.A.S.	#	**1,523**	4,622
Philips Electronics Singapore Pte. Ltd.	#	**3,081**	2,577
Shenzhen SED Coalition Electronics Co., Ltd.	*	**1,146**	–
Langfang CEC Dacheng Electronic Co., Ltd.	*	**652**	–
Philips Electronics (Beijing) Co., Ltd.	#	**608**	–
Philips Electronics Trading Services (Shanghai) Co., Ltd	#	**292**	–
Shenzhen Fitment and Decoration Co., Ltd.	*	**29**	–

30. COMPARATIVE FIGURES

The Group has adopted new HKFRS which are effective for accounting periods commencing on or after 1 January 2005. As mentioned in note 2, 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 conform to the current year presentation.