

NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL INFORMATION

FOR THE SIX MONTHS ENDED 30 JUNE 2006

(all amounts expressed in HK dollar thousands unless otherwise stated)

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.

The condensed consolidated interim financial information was approved for issue by the board of directors on 22 September 2006.

2 Basis of preparation

This condensed consolidated interim financial information for the period ended 30 June 2006 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 condensed interim financial report should be read in conjunction with the annual financial statements for the year ended 31 December 2005.

3 Accounting policies

The accounting policies adopted in this interim report are consistent with those of the annual financial statements for the year ended 31 December 2005 as described in the 2005 annual report of the Company.

The following new standards, amendments to standards and interpretations are mandatory for financial year ending 31 December 2006. Management do not expect such amendments and interpretation to be relevant for the Group:

- Amendment to HKAS 19, 'Actuarial gains and losses, group plans and disclosures'
- Amendment to HKAS 39, Amendment to 'The fair value option'
- Amendment to HKAS 21, Amendment 'Net investment in a foreign operation'
- Amendment to HKAS 39, Amendment 'Cash flow hedge accounting of forecast intragroup transactions'
- Amendment to HKAS 39 and HKFRS 4, Amendment 'Financial guarantee contracts'
- HKFRS 6, 'Exploration for and evaluation of mineral resources'
- 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'

3 Accounting policies (continued)

The following new standards, amendments to standards and interpretations have been issued but are not effective for 2006 and have not been early adopted:

- HK(IFRIC)-Int 7, 'Applying the Restatement Approach under HKFRS 29', effective for annual periods beginning on or after 1 March 2006. Management do not expect the interpretation to be relevant for the Group;
- HK(IFRIC)-Int 8, 'Scope of HKFRS 2', effective for annual periods beginning on or after 1 May 2006. HKFRS 7, 'Financial instruments: Disclosures', effective for annual periods beginning on or after 1 January 2007. HKAS 1, 'Amendments to capital disclosures', effective for annual periods beginning on or after 1 January 2007. Management is currently assessing the impact of HK(IFRIC)-Int 8, HKFRS 7 and HKAS 1 on the Group's operations;
- HK(IFRIC)-Int 9, 'Reassessment of Embedded Derivatives', effective for annual periods beginning on or after 1 June 2006. Management do not expect the interpretation to be relevant for the Group.

4 Segment information

(a) Primary reporting format – business segment

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

	<i>Philips branded</i> Original Equipment Manufacturer ("OEM") products		Own branded and other Original Design Manufacturer ("ODM") products		OEM of other products and other operations		Total	
	Six months ended		Six months ended		Six months ended		Six months ended	
	30 June	2005	30 June	2005	30 June	2005	30 June	2005
Sales	1,135,349	1,546,890	741,477	569,398	18,843	13,502	1,895,669	2,129,790
Segment results	50,494	84,018	79,785	31,806	401	280	130,680	116,104
Unallocated revenues							5,843	5,224
Unallocated costs							(89,270)	(78,444)
Operating profit							47,253	42,884
Finance costs							(4,288)	(5,720)
Profit before income tax							42,965	37,164
Income tax expense							(2,509)	(3,141)
Profit for the period							40,456	34,023

4 Segment information (continued)

(b) Secondary reporting format – geographical segment

	Six months ended 30 June	
	2006	2005
Sales		
Mainland China	997,458	1,116,938
Europe	7,414	343,552
Asia excluding mainland China and Hong Kong	427,630	257,179
Hong Kong	463,167	412,121
	1,895,669	2,129,790

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

5 Capital expenditures

	Intangible assets	Property, plant and equipment	Total
Opening net book amount as at 1 January 2005	3,498	119,402	122,900
Additions	4,368	5,260	9,628
Disposals	–	(69)	(69)
Depreciation/amortisation charge	(734)	(28,588)	(29,322)
Closing net book amount as at 30 June 2005	<u>7,132</u>	<u>96,005</u>	<u>103,137</u>
Opening net book amount as at 1 January 2006	14,113	79,051	93,164
Additions	1,854	19,121	20,975
Disposals	–	(25)	(25)
Depreciation/amortisation charge	(1,935)	(22,632)	(24,567)
Closing net book amount as at 30 June 2006	<u>14,032</u>	<u>75,515</u>	<u>89,547</u>

6 Inventories

	As at	
	30 June 2006	31 December 2005
Raw materials	247,253	284,703
Work in progress	83,849	100,139
Finished goods	49,172	62,192
	<u>380,274</u>	<u>447,034</u>

The cost of inventories recognised as expenses and included in cost of goods sold amounted to HK\$1,764,989,000 (30 June 2005: HK\$2,013,686,000).

Written down of inventories to net realisable value of HK\$2,404,000 (30 June 2005: HK\$4,903,000) has been expensed in administrative expenses during the period.

7 Trade and other receivables

	As at	
	30 June 2006	31 December 2005
Trade receivables (note (a))	712,330	1,010,140
Notes receivable	–	1,981
Other receivables due from related parties (note 21(d))	26,286	26,583
Prepayments and deposits	14,975	11,868
Value-added tax refundable	6,943	21,000
Other receivables	10,293	13,372
	<u>770,827</u>	<u>1,084,944</u>

- (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 30 June 2006 and 31 December 2005, the ageing analysis of the Group's trade receivables was as follows:

	As at	
	30 June 2006	31 December 2005
Current to 30 days	620,996	968,786
31– 60 days	33,057	23,480
Over 60 days	58,277	17,874
	<u>712,330</u>	<u>1,010,140</u>

Included in the balance were trade receivables due from related parties of HK\$695,619,000 (31 December 2005: HK\$920,551,000) (note 21(d)). About 80% (31 December 2005: 91%) of the trade receivables from related parties as at 30 June 2006 was covered by bank issued guarantee documents.

8 Issued equity

	Number of shares	Issued equity
As at 1 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)
	<u>1,083,560,000</u>	<u>370,074</u>
As at 30 June 2005	1,083,560,000	370,074
	<u>1,083,560,000</u>	<u>370,074</u>
As at 1 January and 30 June 2006	1,083,560,000	370,074

- (a) Pursuant to the resolutions passed at 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.
- (b) 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.

9 Other reserves

	Capital reserve (note (a))	Surplus reserves (note (b))	Share option reserve (note (c))	Translation reserve	Total
At 1 January and 30 June 2005	(1,806)	21,010	–	–	19,204
At 1 January 2006	(1,806)	25,992	6,572	4,304	35,062
Share option granted	–	–	2,625	–	2,625
Currency translation differences	–	–	–	(609)	(609)
	<u>(1,806)</u>	<u>25,992</u>	<u>9,197</u>	<u>3,695</u>	<u>37,078</u>
At 30 June 2006	(1,806)	25,992	9,197	3,695	37,078

(a) Capital reserve

Capital reserve represents the exchange differences arising from paid-in capital paid by foreign currencies in the principal subsidiary, Shenzhen Sang Fei Consumer Communications Company Limited (“Sang Fei”).

9 Other reserves (continued)**(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.

(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 option was exercised during the period.

Expense arising from the share option scheme recognised in administrative expenses during the period amounted to HK\$2,625,000.

10 Trade and other payables

	As at	
	30 June 2006	31 December 2005
Trade payables (note (a))	559,382	966,990
Other payables due to related parties (note 21(d))	8,816	10,774
Accrued expenses	35,068	30,583
Advance from customers	31,730	24,880
Other payables	109,354	95,967
	<u>744,350</u>	<u>1,129,194</u>

(a) The ageing analysis of trade payables was as follows:

	As at	
	30 June 2006	31 December 2005
Current to 30 days	526,900	943,177
31– 60 days	7,111	2,561
Over 60 days	25,371	21,252
	<u>559,382</u>	<u>966,990</u>

Included in the balance were trade payables due to related parties amounted to HK\$39,982,000 (31 December 2005: HK\$56,034,000) (note 21(d)).

11 Short term bank loans

	As at	
	30 June 2006	31 December 2005
Short term bank loans	187,500	230,769

The bank loans were unsecured, repayable within one year and bore interest at the average borrowing rate of 4.715% (31 December 2005: 4.674%) per annum.

The carrying amounts of bank loans were denominated in Renminbi and approximated their fair values.

12 Provision for warranty

	Six months ended 30 June	
	2006	2005
At 1 January	2,106	2,214
Additional provisions charged to income statement	14,344	7,180
Less: utilised during the period	(6,079)	(4,635)
At 30 June	10,371	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.

13 Other gain, net

	Six months ended 30 June	
	2006	2005
Sales of samples and materials	2,314	3,155
Interest income	2,842	2,052
Others	687	17
	5,843	5,224

14 Expenses by nature

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

	Six months ended 30 June	
	2006	2005
Employee benefits expenses	74,127	60,598
Changes in inventories of finished goods and work in progress	29,310	(17,827)
Raw material and consumables used	1,625,396	1,908,953
Depreciation of property, plant and equipment (note 5)	22,632	28,588
Amortisation of intangible assets (note 5)	1,935	734
Written down of inventories to net realisable value (note 6)	2,404	4,903
Provision for warranty (note 12)	14,344	7,180
Operating leases of buildings	8,108	8,285
Research and development costs	3,355	6,831
Directors' remuneration	995	750
	<u> </u>	<u> </u>

15 Finance costs

	Six months ended 30 June	
	2006	2005
Interest on bank loans	4,288	5,720
	<u> </u>	<u> </u>

16 Income tax expense

	Six months ended 30 June	
	2006	2005
Current taxation – PRC enterprise income tax	4,680	3,141
Deferred income tax	(2,171)	–
	<u> </u>	<u> </u>
	2,509	3,141
	<u> </u>	<u> </u>

- (a) No provision for Hong Kong profits tax has been made as the Group has no assessable profit for the six months ended 30 June 2006 (30 June 2005: 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 31 December 2000, the first cumulative profit-making year net of losses carried forward.

Sang Fei was certified as a high-tech 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% for the six months ended 30 June 2006 (30 June 2005: 7.5%).

17 Earnings per share

The calculation of the basic earnings per share is based on the Group's profit attributable to equity holders of the Company for the six months ended 30 June 2006 of HK\$24,421,000 (30 June 2005: HK\$20,751,000) and 1,083,560,000 (30 June 2005: 1,083,560,000 ordinary shares deemed to have been in issue on 1 January 2005) ordinary shares in issue during the six months ended 30 June 2006.

The exercise of the share option granted under the share option schedule of the Company would have an anti-dilutive effect on the earnings per share for the period and therefore, no diluted earnings per share has been presented.

18 Dividends

A 2005 final dividend of HK\$0.02 (2004 final: Nil) per ordinary share totaling HK\$21,671,000 was paid in June 2006.

The directors do not recommend the payment of an interim dividend for the six months ended 30 June 2006 (30 June 2005: Nil).

19 Commitments**(a) Capital commitments**

The Group had no material capital commitments which were authorised but not contracted and provided for as of 30 June 2006.

The Group's capital commitments which were contracted but not provided for were as follows:

	As at	
	30 June 2006	31 December 2005
Purchase of property, plant and equipment and computer software	<u>1,502</u>	<u>3,163</u>

(b) Operating lease commitments

As at 30 June 2006 the Group had future aggregate minimum lease payments under non-cancellable operating leases of buildings as follows:

	As at	
	30 June 2006	31 December 2005
Not later than one year	20,537	25,635
In the second to fifth year	21,903	27,808
	<u>42,440</u>	<u>53,443</u>

20 Contingent liability

The Group did not have any material contingent liabilities outstanding as at 30 June 2006 (31 December 2005: Nil).

21 Related party transactions and balances

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:

- China Electronics Corporation, 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.

(a) Sales of goods, samples and materials and maintenance services

	Six months ended 30 June	
	2006	2005
Sales of products:		
Philips (China) Investment Co., Ltd#	935,559	41,867
Philips Electronics Singapore Pte. Ltd.#	419,176	245,754
Philips Electronics Hong Kong Ltd.#	178,715	137,938
Philips France S.A.S.#	1,651	339,265
Philips Electronics (Shanghai) Co., Ltd#	–	789,171
Philips Electronics Trading Service (Shanghai) Co., Ltd.#	–	5,052
CEC Wireless R&D Ltd.*	–	332
	<hr/>	<hr/>
Sales of samples and materials:		
Philips Consumer Electronics B.V.#	5,003	1,840
Philips (China) Investment Co., Ltd#	2,586	3,362
Philips Electronics Singapore Pte Ltd#	615	1,896
Philips Electronics Hong Kong Ltd.	283	–
Philips France S.A.S#	23	4,930
Philips Electronics (Shanghai) Co., Ltd#	–	8,236
CEC Wireless R&D Ltd.*	–	485
Shenzhen SED Industry Co., Ltd.*	–	281
	<hr/>	<hr/>
Sales of maintenance services:		
Philips (China) Investment Co., Ltd.#	13,188	–
	<hr/>	<hr/>

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

21 Related party transactions and balances (continued)**(b) Other transactions**

	Note	Six months ended 30 June	
		2006	2005
Purchases of goods:	(i)		
Philips Electronics Hong Kong Ltd.#		93,787	194,306
Shenzhen Sang Da Baili Electronics Co., Ltd.*		5,563	5,494
Philips France S.A.S.#		2,526	535
Shenzhen SED Fitment & Decoration Co., Ltd.*		1,544	–
Shanghai SED ARC Co., Ltd.*		699	–
Philips Electronics Trading Services (Shanghai) Co., Ltd.#		620	–
Langfang CEC Dacheng Electronics Co., Ltd.*		608	–
Philips Electronics Beijing Co., Ltd.#		285	388
CEC Wireless R&D Ltd.*		–	3,014
Assembleon Hong Kong Ltd.#		–	4,133
		<hr/>	<hr/>
Processing services:	(ii)		
Shenzhen Sang Da Baili Electronics Co., Ltd.*		2,538	2,659
Shenzhen SED Industry Co., Ltd.*		2,077	2,031
		<hr/>	<hr/>
Fitment and decoration services:	(iii)		
Shenzhen SED Fitment & Decoration Co., Ltd.*		767	1,648
		<hr/>	<hr/>
Canteen services:	(iv)		
Shenzhen Sang Da Baili Electronics Co., Ltd.*		6,247	3,467
		<hr/>	<hr/>
Repair and maintenance services:	(v)		
Shanghai SED ARC Co., Ltd.*		353	–
Shenzhen SED ARC Co., Ltd.*		50	–
		<hr/>	<hr/>
Rental:	(vi)		
Shenzhen SED Industry Co., Ltd.*		4,277	3,968
		<hr/>	<hr/>

- (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.

21 Related party transactions and balances (continued)**(b) Other transactions** (continued)

- (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. and Shanghai 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.

(c) Key management compensation

	Six months ended 30 June	
	2006	2005
Salaries and other short-term benefits	1,355	1,348
Employer's contribution to pension scheme	49	56
Share-based compensations	2,036	–
	<hr/> 3,440 <hr/>	<hr/> 1,404 <hr/>

21 Related party transactions and balances (continued)

(d) Period-end balances arising from sales and other transactions

	As at	
	30 June 2006	31 December 2005
Trade receivables due from related parties:		
Philips (China) Investment Co., Ltd.#	422,017	495,947
Philips Electronics Singapore Pte. Ltd.#	221,238	212,073
Philips Electronics Hong Kong Ltd.#	52,364	112,833
Philips France S.A.S.#	–	95,770
Philips Electronics Trading Service (Shanghai) Co., Ltd.#	–	3,928
	695,619	920,551
Other receivables due from related parties:		
Philips (China) Investment Co., Ltd.#	3,779	4,974
Philips Electronics Singapore Pte. Ltd.#	585	53
Philips Electronics Hong Kong Ltd.#	974	10,661
Philips Consumer Electronics B.V.#	6,403	–
Philips Electronics (Shanghai) Co., Ltd.#	5,553	5,553
Philips France S.A.S.#	4,969	4,969
Shenzhen Sang Da Baili Electronics Co., Ltd.*	3,654	–
Shenzhen SED Coalition Electronics Co., Ltd.*	–	4
PCC Hong Kong Ltd.#	369	369
	26,286	26,583
Trade payables due to related parties:		
Philips Electronics Hong Kong Ltd.#	22,443	39,010
Philips France S.A.S.#	9,106	1,523
Philips (China) Investment Co., Ltd.#	6,273	12,325
Philips Electronics Singapore Pte. Ltd.#	276	778
Shenzhen SED Fitment and Decoration Co., Ltd.*	86	–
Shenzhen SED Coalition Electronics Co., Ltd.*	816	1,138
Shenzhen Sang Da Baili Electronics Co., Ltd.*	425	–
Langfang CEC Dacheng Electronic Co., Ltd.*	363	652
Philips Electronics (Beijing) Co., Ltd.#	172	608
Philips Electronics Trading Services (Shanghai) Co., Ltd.#	22	–
	39,982	56,034
Other payables due to related parties:		
Philips Electronics Hong Kong Ltd.#	4,681	6,208
Philips Electronics Singapore Pte. Ltd.#	2,303	2,303
Shenzhen SED Fitment and Decoration Co., Ltd.*	767	29
Shenzhen Sang Da Baili Electronics Co., Ltd.*	366	1,942
Philips Electronics Trading Services (Shanghai) Co., Ltd.#	699	292
	8,816	10,774