

The directors submit their report together with the audited financial statements for the year ended 31 December 2006.

Principal activities and geographical analysis of operations

The Company is an investment holding company. The principal activities of the Company and its subsidiaries (collectively the "Group") comprise the manufacturing and sales of portable electronics products. The principal activities of the principal subsidiaries are set out in Note 8 to the financial statements.

An analysis of the Group's performance for the year by business and geographical segments is set out in Note 5 to the financial statements.

Results and appropriations

The results of the Group for the year are set out in the consolidated income statement on page 23 of the annual report.

The directors recommended the payment of a final dividend of HK\$0.016 per share to shareholders whose name appear on the register of member on 27 April 2007.

Property, plant and equipment

Details of the movements in property, plant and equipment of the Group and of the Company are set out in Note 6 to the financial statements.

Share capital

Details of the share capital of the Company are set out in Note 12 to the financial statements.

Reserves

Movements in the reserves of the Group and of the Company during the year are set out in Note 13 to the financial statements.

Distributable reserves

Distributable reserves of the Company as at 31 December 2006 as calculated under the laws in Bermuda and the Company's bye-laws amounted to HK\$130,590,000 (2005: HK\$96,374,000).

Five year financial summary

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 60 of the annual report.

Short-term loans

Particular of the short-term loans of the Group are set out in Note 15 to the financial statements.

Borrowing costs

No interest was capitalised by the Group during the year (2005: nil).

Directors

The directors during the year were:

Non-executive Directors

Chen Zhaoxiong (*Chairman*)
(appointed on 11 April 2006)
Yang Xiaotang
(resigned on 11 April 2006)
Tong Baoan (*Vice Chairman*)

Executive Directors

Fan Qingwu (*Managing Director*)
Hua Longxing

Independent Non-executive Directors

Chan Kay Cheung
Wong Po Yan
Yin Yongli

In accordance with Bye-law 87(1) of the Company's bye-laws, Messrs. Tong Baoan and Fan Qingwu will retire by rotation at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

The Company has received confirmation from each of the independent non-executive directors as regards their independence to the Company, and considers them to be independent.

None of the directors proposed for re-election at the forthcoming annual general meeting has a service contract which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

Biographical details of directors

Brief biographies of the directors of the Company are set out on pages 10 to 11 of the annual report.

Directors' and chief executive's interests and short positions in shares, underlying shares and debentures

As at 31 December 2006, the interests and short positions of the directors and chief executive of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")) as recorded in the register maintained by the Company pursuant to Section 352 of the SFO, or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies, were as follows:

Long position in shares of the Company

Name of director	Capacity	Interest in underlying shares pursuant to share options	Total interest	Approximate percentage of the issued share capital of the Company
Tong Baoan	Beneficial owner	3,800,000	3,800,000	0.35%
Fan Qingwu	Beneficial owner	3,600,000	3,600,000	0.33%
Hua Longxing	Beneficial owner	3,600,000	3,600,000	0.33%

Saved as disclosed above, as at 31 December 2006, none of the directors nor the chief executive of the Company and their respective associates had any interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO), which were recorded in the register maintained by the Company pursuant to Section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

Share option scheme

Pursuant to an ordinary resolution passed on 20 June 2002, the Company adopted a new share option scheme (the "Share Option Scheme") to replace the old share option scheme. According to the Share Option Scheme, the board of directors of the Company may grant options to any executive and non-executive directors of the Company, full time employees and part-time employees of the Group, advisors, consultants, distributors,

suppliers, agents, customers, partners, joint venture partners, promoters, service providers to the Group. The purpose is to provide the participants with the opportunity to acquire proprietary interests in the Company and to encourage participants to work towards enhancing the value of the Company.

The total number of shares which may be issued upon exercise of all options granted and to be granted under the Share Option Scheme must not exceed 108,356,000 ordinary shares, representing 10% of the issued share capital as at the date of the annual report. The number of shares which might be issued upon exercise of all outstanding options granted and yet to be exercised under the Share Option Scheme and any other share option schemes adopted by the Company must not, in aggregate, exceed 30% of the issued share capital of the Company from time to time. The maximum entitlement of each participant in any 12 month period must not exceed 1% of the shares in issue from time to time. No share options were outstanding under the old option scheme.

There was no requirement for a grantee to hold the option for a certain period before exercising the option unless otherwise determined by the directors. The exercise period should be any period determined by the board of directors but in any event the exercise period should not later than 10 years from the date of grant. The grantee must accept an option within 21 days from the date of offer by making a non-refundable payment of HK\$1 to the Company.

The subscription price shall be at the discretion of the board of directors provided that it shall be not less than the highest of (i) the closing price of the shares on the date of grant; (ii) the average of the closing prices of the shares for the five business days immediately preceding the date of grant; and (iii) the nominal value of a share on the date of grant. The Share Option Scheme will remain in force until 19 June 2012.

During the year, no share options were granted under the Share Option Scheme.

As at 31 December 2006, the directors and the chief executive of the Company and employees of the Group had the following personal interests in options to subscribe for shares of the Company granted under the Share Option Scheme:

Name	Options outstanding as at 1/1/2006	Options lapsed	Options outstanding as at 31/12/2006
<i>Directors</i>			
Yang Xiaotang*	4,000,000	(4,000,000)	–
Tong Baoan	3,800,000	–	3,800,000
Fan Qingwu	3,600,000	–	3,600,000
Hua Longxing	3,600,000	–	3,600,000
Sub-total	15,000,000	(4,000,000)	11,000,000
Aggregate of employees and other participants	13,450,000	(3,300,000)	10,150,000
	28,450,000	(7,300,000)	21,150,000

* Mr. Yang resigned as non-executive director and chairman of the Company on 11 April 2006. The option granted to Mr. Yang has lapsed in accordance with the terms of the Share Option Scheme as a result of his resignation.

The outstanding options were all granted on 25 October 2005 under the Share Option Scheme. The options represent personal interest held by the grantees as beneficial owners. Grantees of such options are entitled to exercise the options at a price of HK\$1.488 per share in the following periods:

- (i) in respect of 40% of the options granted, from 1 November 2005 to 31 October 2008;
- (ii) in respect of a further 30% of the options granted, from 1 November 2006 to 31 October 2009; and

- (iii) in respect of the remaining 30% of the options granted, from 1 November 2007 to 31 October 2010.

No options granted under the Share Option Scheme were exercised or cancelled during the year.

Directors' rights to acquire shares or debentures

Save as disclosed above, at no time during the year was the Company, its holding company or any of its subsidiaries or fellow subsidiaries a party to any arrangements to enable the directors of the Company or their respective

associates (as defined under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules")) to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

Directors' interests in contracts

No contracts of significance to which the Company, its holding company or any of its subsidiaries or fellow subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Connected transactions

Details of the connected transactions entered into by the Group during the year are set out below:

Continuing connected transactions

Type of transaction	Note	Amount HK\$'000
Sales of products, samples and materials and provision of after sales service to the Philips Group	i	2,894,515
Provision of maintenance services to the Philips Group	ii	25,338
Purchases of goods from the Philips Group	iii	219,418
Sales of products, samples and materials to the CEC Group	iv	4,428
Purchases of goods from the CEC Group	v	21,533
After sales repair and maintenance services by the CEC Group	vi	2,772
Provision of canteen services by the CEC Group	vii	10,918
Fitment and decoration services from the CEC Group	viii	1,820
Rental arrangements with the CEC Group	ix	8,621
Processing arrangements with the CEC Group	x	11,543

Notes:

(i) Koninklijke Philips Electronics N.V., together with its group companies (the "Philips Group"), is a connected person of the Company by virtue of being a substantial shareholder of Shenzhen Sang Fei Consumer Communications Company Limited ("Sang Fei"), the principal operating subsidiary of the Company.

Members of the Philips Group are the major customers of the Group. Sales to the Philips Group were based on the general purchasing agreement dated 13 July 2005 ("General Purchasing Agreement"), pursuant to which the Philips Group was entitled to purchase goods from the Group at a price determined using a "cost plus" basis and with reference to market rates. Sales to the Philips Group were approved by the written approval from China Electronics Corporation ("CEC"), details of which were included in the circular dated 11 August 2005.

(ii) Members of the Philips Group engaged the Group for the provision of maintenance services during the product warranty period. The maintenance services were provided under the maintenance services agreement dated 21 January 2006 ("Maintenance

Services Agreement") and were carried out on normal commercial terms and conditions with reference to market rates. The provision of maintenance services to the Philips Group were approved by the written approval from CEC, details of which were included in the circular dated 16 February 2006.

(iii) Members of the Philips Group are the major suppliers of raw materials. Purchases of raw materials from the Philips Group were based on the General Purchasing Agreement and on normal commercial terms and conditions and with reference to market rates. Purchases of raw materials from the Philips Group were approved by the written approval from CEC, details of which were included in the circular dated 11 August 2005.

(iv) CEC together with its subsidiaries (the "CEC Group"), is a connected person of the Company by virtue of being the controlling shareholder of the Company. The connected transactions with the CEC Group disclosed in this section were approved by the shareholders at a special general meeting on 14 July 2004, details of which were included in the circular dated 21 June 2004.

Members of the CEC Group are major customers of the Group. Sales to the CEC Group were based on the business services agreement dated 17 June 2004 ("Business Services Agreement") and were carried out on normal commercial terms and conditions and with reference to market rates.

(v) The Group from time to time purchases raw materials from members of the CEC Group. Purchases of raw materials from the CEC Group were based on the Business Services Agreement and the Plastic Supply Agreement (detailed of which were included in the circular dated 31 March 2006) and were carried out on normal commercial terms and conditions and with reference to market rates.

(vi) The Group engaged Shenzhen SED ARC Co., Ltd. and Shanghai SED ARC Co., Ltd. (members of the CEC Group) to provide after sales product repair and maintenance services in respect of its products. The repair and maintenance services were based on the Business Services Agreement and were carried out on normal commercial terms and conditions with reference to market rates.

(vii) Shenzhen Sang Da Baili Electronics Co., Ltd. (a member of the CEC Group) provides canteen services to the production staff of the Group. The canteen services were based on the Business

- Services Agreement and the service fees were calculated by reference to actual consumption and an agreed fixed premium. Such service fees were on normal commercial terms and conditions and were determined with reference to market rates. The Company has subsequently revised the cap in relation to the provision of canteen services. Details of which were included in the announcement of the Company dated 6 January 2006.
- (viii) The Group engaged members of the CEC Group to undertake renovation works in connection with the expansion and improvement of the Group's production premises. The fitment and decoration services were based on the Business Services Agreement and were on normal commercial terms and conditions with reference to market rates.
- (ix) 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. These rentals arrangements were based on lease agreements entered into between the relevant members of the CEC Group and the Group and were calculated on normal commercial terms and conditions with reference to market rates. The Company further leased a warehouse from members of the CEC Group, details of which were included in the announcement of the Company dated 15 September 2006.
- (x) The Group secured dedicated processing services of surface mount assembly production lines from members of the CEC Group. The processing services were based on the Processing Agreements entered into between the relevant members of the CEC Group and the Group and were carried out on normal commercial terms and conditions with reference to market rates.
- In the opinion of the independent non-executive directors of the Company, the above transactions were carried out in the ordinary and usual course of business of the Group, on normal commercial terms and were in accordance with the relevant agreements governing them and on terms that were fair and reasonable and in the interests of the Group and the shareholders of the Company as a whole.
- The auditors have confirmed that the above transactions:
- had been approved by the board of directors of the Company;
 - were in accordance with the pricing policies of the Group;
 - were entered into in accordance with the terms of the relevant agreements governing such transactions; and
 - had not exceeded their respective caps as describe in previous announcements and approved by the Stock Exchange.

Directors' interests in competing business

During the year and up to the date of this report, the following directors of the Company are considered to have interests in businesses which compete or are likely to compete, either directly or indirectly, with the businesses of the Group:

Name of director	Name of entity	Principal business of the entity	Nature of director's interest in the entity
Chen Zhaoxiong	China Electronics Corporation <i>(Note a)</i>	Investment holdings	Vice chairman and president
Tong Baoan	China Electronics Corporation <i>(Note a)</i>	Investment holdings	Director
	China Electronics Industry Corporation <i>(Note b)</i>	Investment holdings	President and legal representative
Fan Qingwu	Shenzhen SED Industry Co., Ltd. <i>(Note b)</i>	Investment holdings	Chairman
	China Electronics Industry Corporation <i>(Note b)</i>	Investment holdings	Vice president

Notes:

- (a) China Electronics Corporation ("CEC") is the controlling shareholder of the Company. CEC is a state-owned nationwide electronics and information technology conglomerate, and has subsidiaries and associates engaged in mobile handset related businesses which compete or are likely to compete with the business of the Group. Mr. Chen Zhaoxiong was appointed the vice chairman and president of CEC in October 2005.
- (b) China Electronics Industry Corporation and Shenzhen SED Industry Co., Ltd. have subsidiaries or associates engaged in mobile handset related businesses which compete or are likely to compete with the business of the Group. China Electronics Industry Corporation has ceased to be a subsidiary of CEC as at the date of this report. Shenzhen SED Industry Co., Ltd. is a company whose A shares are listed on the Shenzhen Stock Exchange and is indirectly owned as to approximately 46.05% by CEC as at the date of this report.

The abovementioned competing businesses are operated and managed by independent management and administration. In addition, the directors of the Company consider that the business model of and markets served by the Group are different from those companies. The board of the Company can exercise

independent judgement and is always acting for the interests of the Company and its shareholders as a whole. Accordingly, the Group is capable of carrying on its businesses independently of, and at arm's length from, the competing businesses mentioned above.

Substantial shareholders

As at 31 December 2006, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO showed that the following shareholders had notified the Company of their relevant interests in the issued capital of the Company.

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

Notes:

- (1) CEC holds 100% interest in CEC BVI and is deemed to be interested in the shares held by CEC BVI. The directors regard CEC, a state-owned enterprise established under the laws of the People's Republic of China, as being the ultimate holding company of the Group.
- (2) This number of shares represents the aggregate of (i) Mr. Chan Chak Shing's family interest of 4,125,000 shares and (ii) corporate interest of 91,421,608 shares held by Devon Fortune. As Mr. Chan Chak Shing holds 100% interest in Devon Fortune, the interests of Devon Fortune are deemed to be the interests of Mr. Chan Chak Shing.

All the interests disclosed above represent long position in the shares of the Company.

Save as disclosed above, as at 31 December 2006, no person or corporation had any interest or short position in the shares or underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO.

Pre-emptive rights

There is no provision for pre-emptive rights under the Company's bye-laws or the laws in Bermuda.

Purchase, sale or redemption of securities

The Company has not redeemed any of its shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the year.

Major suppliers and customers

During the year, the percentages of sales for the year attributable to the Group's major customers are as follows:

Sales

- the largest customer 46%
- five largest customers combined 90%

The percentages of purchases for the year attributable to the Group's major suppliers are as follows:

Purchases

- the largest supplier 9%
- five largest suppliers combined 30%

Philips Group is the beneficial owner of three of the five largest customers of the Group. Details of the transactions are set out in the section headed "Connected Transactions" above.

Save as disclosed above, none of the directors, their respective associates or any shareholder (which to the knowledge of the directors owns more than 5% of the Company's share capital) had an interest in the major customers or suppliers noted above.

Public float

Based on the information that is publicly available to the Company and within the knowledge of the directors of the Company, as at the date of this report, the Company has maintained the prescribed public float under the Listing Rules.

Audit committee

The audit committee comprises Messrs. Chan Kay Cheung, Wong Po Yan and Yin Yongli, who are independent non-executive directors. The audit committee examined the accounting principles and practices adopted by the Group and discussed with management its internal controls and financial statements. During the year, the audit committee has reviewed the unaudited interim financial statements for the six months ended 30 June 2006 and the audited financial statements for the year ended 31 December 2006.

Auditors

The financial statements have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for reappointment.

On behalf of the Board

Chen Zhaoxiong

Chairman

Hong Kong, 23 March 2007