CEC
中国电子
CHINA ELECTRONICS

2005
annual report

China Electronics

Corporation Holdings Company Limited

中國電子集團控股有限公司

(Stock Code: 0085)

Contents

Corporate Information

BOARD OF DIRECTORS

Non-executive Directors
Yang Xiaotang *(Chairman)*
Tong Baoan *(Vice Chairman)*

Executive Directors
Fan Qingwu *(Managing Director)*
Hua Longxing

Independent Non-executive Directors
Chan Kay Cheung
Wong Po Yan
Yin Yongli

AUDIT COMMITTEE

Chan Kay Cheung *(Chairman)*
Wong Po Yan
Yin Yongli

REMUNERATION COMMITTEE

Wong Po Yan *(Chairman)*
Chan Kay Cheung
Yin Yongli
Fan Qingwu

COMPANY SECRETARY AND QUALIFIED ACCOUNTANT

Yam Pui Hung, Robert

REGISTERED OFFICE

Clarendon House
2 Church Street
Hamilton HM 11
Bermuda

PRINCIPAL OFFICE IN HONG KONG

Room 908, 9th Floor
Sun Hung Kai Centre
30 Harbour Road
Wanchai
Hong Kong

PRINCIPAL BANKERS

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

PRINCIPAL SHARE REGISTRAR

Butterfield Fund Services (Bermuda) Limited
Rosebank Centre
11 Bermudiana Road
Pembroke HM 08
Bermuda

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Abacus Share Registrars Limited
26/F Tesbury Centre
28 Queen's Road East
Hong Kong

AUDITORS

PricewaterhouseCoopers

LEGAL ADVISORS

As to Hong Kong Law
Linklaters
As to Bermuda Law
Conyers Dill & Pearman

INVESTOR RELATIONS

Telephone : (852) 2598 9088
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STOCK CODE

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Chairman's Statement

"We endeavour to materialise quantum growth in our business and bring better returns to our investors."

Yang Xiaotang | *Chairman*

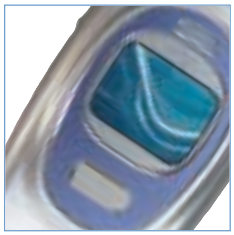
Dear Shareholders,

I am pleased to report that the Group recorded encouraging results in 2005. Despite the keen competition in the mobile handset industry, the Group achieved a turnover of HK$4,768.5 million during the year under review, representing an increase of 3.9% as compared to HK$4,590.1 million last year. The profit attributable to equity holders reached HK$49.9 million as compared to last year's loss of HK$19.3 million.

In July 2005, the Group renewed the cooperation agreement with the Philips Group. The renewal sets a new milestone to the Group. The new cooperation not only extends the scope of cooperation, but also broadens and strengthens the Group's business relationship with the Philips Group. Pursuant to the new arrangement, the Group will provide mobile handset Original Equipment Manufacturer ("OEM") service, and will design, develop, manufacture and supply MP3 players and other portable electronics products to the Philips Group as well. The Group further entered into a service agreement with the Philips Group in January 2006 in which the Group will provide mobile handset maintenance service to the Philips Group. The new business profile enables the Group to establish a comprehensive industry value chain in mobile communication products which extend the Group's products and services range and secure a stable source of revenue for the Group, and enable the Group to capitalise on the rapid growth of the global consumer electronics and communications products market. Looking forward, the Group will continue to explore proactively new business opportunities in consumer electronics and communication products and services, and endeavour to maintain itself as one of the major product supplier in the industry.

Chairman's Statement





In parallel to the strengthening of the existing core business, the Group has also been actively pursuing new investment opportunities. In particular, the Group set up a wholly-owned digital media entity in Suzhou during the year which worked closely with China Electronics Corporation ("CEC"), the controlling shareholder of the Company, in the development of cable television operation. The management believes that cable television broadcasting and related services are business sectors with promising potential in the coming future. Feasibility studies are currently in progress to structure the best operational profile in the involvement in the development and integration of domestic cable television broadcasting in China. With the technological advantage of CEC and through maximising the synergies between CEC and the Group, the management is confident with the success and materialising the quantum growth in return in this business area.

On behalf of the Group, I would like to extend my sincere thanks to our staff for their contribution and devoted effort, and to our shareholders and business partners for their continuous cooperation and support. To my fellow board members, I thank you for your dedication to the development of the Group. We will endeavour to improve the results of the Group and bring better returns to our investors in the future.

Sincerely yours,
Yang Xiaotang
Chairman

10 April 2006

Management Discussion and Analysis

Business Review

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

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

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

Management Discussion and Analysis



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

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

Capital Resources and Liquidity

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

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

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

The Group's exports sales are predominantly invoiced in United States dollars and its domestic sales are invoiced in Renminbi. The Group imports some of its raw materials and production and testing equipments from overseas suppliers which are paid in United States dollars, Japanese Yen and Euro. The Group will make use of hedging contracts, when appropriate, to leverage the risk of foreign exchange fluctuation arising from its operations.

Contingent Liabilities and Capital Commitment

As at 31 December 2005, the Group had contracted but not provided for capital commitment of HK$3.2 million (2004: HK$8.7 million) for the acquisition of fixed assets and intangible assets. The Group did not have any material contingent liabilities outstanding as at 31 December 2005 (2004: Nil).

Employee and Remuneration Policies

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

The Group recognises the importance of high calibre and competent staff and has a strict recruitment policy and performance appraisal scheme. Remuneration packages are largely in line with industry practices, and are formulated on the basis of performance and experience and will be reviewed regularly. Bonus and other merit payments are linked with the performance of the Group and of the individuals as incentive to optimise performance. The Company has in place a share option scheme, pursuant to which share options may be granted to selected personnel of the Group, with a view to encouraging employees to work towards enhancing the value of the Group.

Continuing Connected Transactions

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

The Purchasing Agreement is for a term of two and a half years and will expire on 31 December 2007. Upon expiry, the Purchasing Agreement may be extended for further one year unless either party objects. The price of the products and spare parts to be supplied and the raw materials to be purchased from the Philips Group under the Purchasing Agreement is determined after arm's length negotiations between the parties with reference to market rates. For product maintenance services, Sang Fei will charge service fee based on the actual raw materials and spare parts consumed plus a pre-agreed service charge. The annual caps for the financial year ended 31 December 2005 and the two financial years ending 31 December 2006 and 2007 in relation to the aggregate consideration to be received by Sang Fei from the Philips Group for the supply of products and spare parts and the provision of product maintenance services are RMB5,610 million, RMB7,013 million and RMB7,714 million, respectively, and the annual caps for the aggregate consideration to be paid by Sang Fei to the Philips Group for the purchase of raw materials are RMB1,500 million, RMB1,875 million and RMB2,063 million respectively.

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

Management Discussion and Analysis



As the Philips Group owns 25% interest in Sang Fei, the transactions contemplated under the Purchasing Agreement and the Maintenance Service Agreement constitute the continuing connected transactions of the Company. The directors are of the opinion that the entering into of the Purchasing Agreement and Maintenance Service Agreement is in the best interest of the Company and the shareholders of the Company as a whole. CEC, as the controlling shareholder of the Company, has approved the Purchasing Agreement and the Maintenance Service Agreement and the continuing connected transactions contemplated thereunder by way of written approvals.

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

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

Capital Reorganisation and Change in Board Lot Size

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

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

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

Termination of Acquisition of CECW

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

Corporate Governance Report

The Company is committed to achieving the best corporate governance practices by emphasising its accountability, transparency, independence, responsibility and fairness. The Company is dedicated to exercise corporate governance through regular reviews of its adopted practices with reference to the Code on Corporate Governance Practices ("CG Code") as set out in Appendix 14 of the Rules Governing the Listing of Securities ("Listing Rules") on The Stock Exchange of Hong Kong Limited ("Stock Exchange").

The Company has fully complied with the CG Code throughout 2005. The following summarises the corporate governance practices adopted by the Company.

Board of Directors

The board of directors of the Company ("Board") consists of two executive directors, two non-executive directors and three independent non-executive directors. The Chairman of the Board is a non-executive director, who is responsible for the leadership and overseeing the functioning of the Board and the strategic development of the Group. The Managing Director is delegated with the authority and responsible for managing the Group's business, and implementation of the Group's strategy in achieving the overall commercial objectives. There are no relations among the directors (including the Chairman and the Managing Director).

All the directors, including the non-executive directors, will be subject to retirement by rotation for every three years and in accordance with the bye-laws of the Company. The remuneration of the directors are determined with reference to their duties, responsibilities and experience, and to the prevailing market conditions.

The Board is responsible for the formulation of long term business objectives, strategies and plans, and to monitor and control the operating and financial performance of the Group. The day-to-day operations and implementation of business objectives are delegated to the Managing Director. The management is delegated with power and authority to carry out daily operations and duties.

All directors actively participate in the review and monitor of the Company's business. The list of directors and their attendance record of the board meetings in 2005 are set out below:

Number of full board meetings held in 2005: 7

Member of the Board	**Number of meetings attended**
Non-executive directors	
Yang Xiaotang *(Chairman)*	5
Tong Baoan *(Vice Chairman)*	4
Executive directors	
Fan Qingwu *(Managing Director)*	6
Hua Longxing	7
Independent non-executive directors	
Chan Kay Cheung	7
Wong Po Yan	7
Yin Yongli	7

There has been no change to the board composition throughout 2005 and hence the board has not deal with or consider nomination of directors. The biographies of the directors are set out on page 13 of the annual report.

Compliance with the Model Code for Securities Transactions by Directors of Listed Issuers

The Company has adopted the Model Code as set out in Appendix 10 to the Listing Rules. All Directors have confirmed, following specific enquiry by the Company, that they fully complied with the Model Code throughout the year 2005.

Remuneration Committee

The Board has established a remuneration committee, comprising the three independent non-executive directors and an executive director of the Company. List of members of the remuneration committee is set out below. The terms of reference of the remuneration committee are available for inspection upon request at the principal office of the Company in Hong Kong.

The principal responsibilities of the remuneration committee include reviewing and recommending to the Board the remuneration policy and the remuneration of the directors and the senior management.

The remuneration committee has held one meeting in 2005 to review the remuneration package of the directors and the policy over grant of share options to employees. The attendance of individual members at the remuneration committee meeting is set out below:

Member of the remuneration committee	Number of meetings attended
Wong Po Yan *(Chairman)*	1
Chan Kay Cheung	1
Yin Yongli	1
Fan Qingwu	–

Details of the remuneration of the directors and the share options granted to the directors for the year ended 31 December 2005 are set out on page 59 and 18 of the annual report respectively.

Audit Committee

The Company has established an audit committee comprising the three independent non-executive directors of the Company. The members have extensive experience in financial matters and one of them is a certified public accountant. List of members of the audit committee is set out below. The terms of reference of the audit committee are available for inspection upon request at the principal office of the Company in Hong Kong.

Corporate Governance Report

The audit committee provides independent review and supervision of financial reporting, and examines the effectiveness of the internal controls of the Group and the adequacy of the external audits. The audit committee examines all matters relating to the accounting principles and practices adopted by the Group, including consideration of the auditing functions, internal controls, information systems, and financial reporting matters. External auditors and the directors are invited to attend the meetings as and when necessary. The audit committee also serve as a channel of communication between the Board and the external auditors.

The audit committee has held two meetings in 2005 to review the annual and interim accounts and the effectiveness of the internal control practices of the Group. The audit committee has also reviewed the audit plan and approach of the external auditors and monitors regularly the progress and results of the audit. The attendance of individual members at the audit committee meeting is set out below:

Member of the audit committee	Number of meetings attended
Chan Kay Cheung *(Chairman)*	2
Wong Po Yan	2
Yin Yongli*	2

* *certified public accountant*

During 2005, the Group paid to the auditors HK$1,140,000 for audit services. The Group also paid the auditors HK$100,000 for due diligence review services.

Accountability and audit

The Board is responsible for overseeing the preparation of accounts which give a true and fair view of the state of affairs of the Group and of the results and cash flow during the reporting period. A statement from the auditors about their reporting responsibilities is set out on page 25 of the annual report. In preparing the accounts for the year ended 31 December 2005, the directors have selected suitable accounting policies and applied them consistently and have made prudent and reasonable judgements and estimates and have prepared the accounts on a going concern basis. The Board has also reviewed the effectiveness of the internal control system of the Group through the assistance of the external auditors to ensure a sound system is maintained and operated by the management in compliance with agreed processes and standards.

On behalf of the Board
Yam Pui Hung Robert
Company Secretary

Hong Kong, 10 April 2006

Biographies of Directors and Senior Management

Non-executive Directors

Mr. Yang Xiaotang, aged 63, is the Chairman of the Company. Mr. Yang graduated from Yangzhou University, the PRC, and was the vice president and subsequently the president of Jin Ling Petrochemical Corporation. During 1988 to 1992, Mr. Yang was the deputy city mayor and thereafter the mayor of Changzhou City, Jiangsu Province, and he was the deputy provincial governor of Jiangsu Province and the general secretary of Suzhou City during 1992 to 1998. Mr. Yang was the vice governor of the China Development Bank during 1998 to 2001. He then joined China Electronics Corporation ("CEC") and was the president of CEC until 2005. Mr. Yang joined the Company in September 2004.

Mr. Tong Baoan, aged 58, is the Vice Chairman of the Company and a director of CEC. Mr. Tong graduated from Tianjin University, the PRC, and was the deputy director of the Department of International Cooperation of the Ministry of Electronics Industry under the State Council. During 1996 to 2001, Mr. Tong was the general manager of Shenzhen Sang Da Electronics Corporation, and was the vice president of CEC from 2001 to 2005. Mr. Tong joined the Company in September 2004.

Executive Directors

Mr. Fan Qingwu, aged 42, is the Managing Director of the Company. He is also a director of Shenzhen Sang Fei Consumer Communications Company Limited ("Sang Fei"). Mr. Fan graduated from the Faculty of Economics of the Graduate School, Renmin University of China in the PRC. From 1996 to 1999, Mr. Fan was the executive vice president of China Securities Industry Institute. From 1999 to 2003, he was the general manager of the Investment Banking Department and the Asset Management Department of CEC. Mr. Fan is the vice president of China Electronics Industry Corporation since 2003 and the Chief Economist of CEC in 2005. Mr. Fan joined the Company in September 2004.

Mr. Hua Longxing, aged 64, is an executive director of the Company and is also the chairman of the board of directors of Sang Fei. Mr. Hua graduated from the Faculty of Wireless Engineering of Southeast University in the PRC. From 1993 to 2000, Mr. Hua was the vice-chairman of the board of directors and the general manager of Shenzhen SED Industry Company Limited. Before that, he was the deputy general manager of Shenzhen Sang Da Electronics Corporation. From 1983 to 1987, he was the director of the Liaison Division of the office of Ministry of Electronics Industry in Shenzhen Economic Zone. Mr. Hua joined the Company in September 2004.

Biographies of Directors and Senior Management

Independent Non-executive Directors

Mr. Chan Kay Cheung, aged 59, is an executive director and deputy chief executive of The Bank of East Asia, Limited. He joined the bank in 1965 and possesses extensive knowledge and experience in the banking industry. Mr. Chan is a fellow member of the Hong Kong Institute of Bankers, a member of the MPF Industry Schemes Committee, advisory committee member on the Admission Scheme for Mainland Talents and Professionals of the Hong Kong Immigration Department, China trade advisory committee member of Hong Kong Trade Development Council and international senior economic consultant of The People's Government of Shaanxi Province. He is also an independent non-executive director of Chu Kong Shipping Development Company Limited and Four Seas Food Investment Holdings Limited. Mr. Chan was appointed as director of the Company in May 1997.

Mr. Wong Po Yan, aged 82, is the chairman and managing director of United Overseas Enterprises Limited and the chairman of the board of Asia Television Limited. Mr. Wong was the vice-chairman of the Basic Law Committee of Hong Kong Special Administrative Region, the chairman of the Airport Authority, and a member of the Drafting Committee of Basic Law and a member of the Preparatory Committee of Hong Kong Special Administrative Region. He had been a member of the Legislative Council for 9 years. Mr. Wong was appointed as director of the Company in May 1997.

Mr. Yin Yongli, aged 66, graduated from Shandong Finance Institute, the PRC. Mr. Yin is the chairman of China Rightson Certified Public Accountants/Tianhua Certified Public Accountants since September 2001. He was the chairman of another firm of auditors in the PRC during the period from 1998 to 2001. Before that, Mr. Yin spent over 35 years in the petrochemical industry in the PRC as an accountant of Sinopec Corporation. From 1985 to 1988, he became the chief accountant of the financial planning department. From 1988 to 1998 he was the deputy department head of the finance department. Mr. Yin was appointed as director of the Company in September 2004.

Senior Management

Mr. Yam Pui Hung, Robert, aged 38, is the qualified accountant and company secretary of the Company. Mr. Yam is a certified public accountant of the Hong Kong Institute of Certified Public Accountants and a fellow member of the Association of Chartered Certified Accountants. Mr. Yam holds a bachelor's degree in accountancy and has extensive experience in accounting, financial management and corporate finance. Mr. Yam joined the Company in September 2004.

Report of the Directors

The directors would like to present their report together with the audited accounts for the year ended 31 December 2005.

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 sale of portable electronics products. The principal activities of the major subsidiaries are set out in note 8 to the accounts.

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

RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated income statement on page 28 of the annual report.

The directors recommended the payment of a final dividend of HK$0.02 per share to shareholders whose names appear on the register of members on 19 May 2006.

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 accounts.

SHARE CAPITAL

Details of the movements in share capital of the Company are set out in note 12 to the accounts.

RESERVES

Movements in the reserves of the Group and of the Company during the year are set out in note 13 to the accounts.

DISTRIBUTABLE RESERVES

Distributable reserves of the Company at 31 December 2005 as calculated under the laws in Bermuda and the Company's bye-laws amounted to HK$96,374,000 (2004: Nil).

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 68.

Report of the Directors

SHORT-TERM LOANS

Particular of the short-term loans of the Group are set out in note 15 to the accounts.

BORROWING COSTS

No interest was capitalised by the Group during the year (2004: Nil).

DIRECTORS

The directors during the year were:

Non-executive directors
Yang Xiaotang *(Chairman)*
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. Chan Kay Cheung and Wong Po Yan 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 page 13 of the annual report.

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

As at 31 December 2005, 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 directors	Capacity	Interest in underlying shares pursuant to share options	Total interest	Approximate percentage of the issued share capital of the Company
Yang Xiaotang	Beneficial owner	4,000,000	4,000,000	0.37%
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 2005, 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 ("Share Option Scheme") to replace an old 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.

Report of the Directors

SHARE OPTION SCHEME *(CONTINUED)*

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 remains in force until 19 June 2012.

Details of the options outstanding during the year were as follows:

Name	Options outstanding as at 1/1/2005	Options granted	Options outstanding as at 31/12/2005
Directors			
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
Total	–	15,000,000	15,000,000
Aggregate of employees and other participants	–	13,450,000	13,450,000
	–	28,450,000	28,450,000

The options were all granted on 25 October 2005 under the Share Option Scheme. The closing share price immediately before the date of grant was HK$1.46. The options represent personal interest held by the directors 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, lapsed or cancelled during 2005.

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.

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 transactions	*Note*	*Amount HK$'000*
Sales of products, samples and materials and provision of after sales service to the Philips Group	i	3,694,588
Purchases of raw materials from the Philips Group	ii	438,378
Sales of products, samples and materials to the CEC Group	iii	4,804
Purchases of raw materials from the CEC Group	iv	8,317
After sales repair and maintenance services by the CEC Group	v	1,493
Provision of canteen services by the CEC Group	vi	11,273
Fitment and decoration services from the CEC Group	vii	2,459
Rental arrangement with the CEC Group	viii	7,283
Processing arrangements with the CEC Group	ix	8,974

Note:

(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 a long-term agreement in which the Philips Group was entitled to purchase goods from the Group at a price determined using a "cost plus" basis and with reference to market rates.

(ii) Members of the Philips Group are the major suppliers of raw materials. Purchases of raw materials from the Philips Group were based on a long term agreement and were carried out in the ordinary course of business and on commercial terms and conditions and with reference to market rates.

Report of the Directors

CONNECTED TRANSACTIONS *(CONTINUED)*

(iii) China Electronics Corporation together with its subsidiaries (the "CEC Group") is a connected person of the Company by virtue of being the controlling shareholder of the Company.

Members of the CEC Group are the major customers of the Group. Sales to the CEC Group were based on a business service agreement and were carried out on commercial terms and conditions and with reference to market rates.

(iv) 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 a business service agreement and were carried out in the ordinary course of business and on commercial terms and conditions and with reference to market rates.

(v) The Group engaged Shenzhen SED ARC Co., Ltd. for after sales product repair and maintenance services in respect of its own-branded products. The repair and maintenance services were based on a business service agreement and carried out on commercial terms and conditions and with reference to market rates.

(vi) Shenzhen Sang Da Baili Electronics Co., Ltd. provides canteen services to the staff of the Group. The canteen services were based on a business service agreement and the fee were calculated by reference to actual consumption and an agreed fixed premium and were on commercial terms and conditions and with reference to market rates.

(vii) 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 based on a business service agreement and were on commercial terms and conditions and with reference to market rates.

(viii) 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 and with reference to market rates.

(ix) The Group secured dedicated processing services of surface mount assembly production lines from members of the CEC Group. The processing services were based on service contracts entered into by the relevant parties and the Group and were carried out on commercial terms and conditions and with reference to market rates.

Pursuant to the resolutions passed in the Company's special general meeting on 14 July 2004 and the written approval obtained from CEC, details of which were included in the circular dated 11 August 2005, the above connected transactions were approved by the independent shareholders of the Company. The Company has subsequently revised the cap in relation to the provision of canteen services from Shenzhen Sang Da Baili Electronics Co., Ltd. Details of which were included in the announcement of the Company dated 6 January 2006.

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 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 the cap approved by the board of directors of the Company as described in the circulars of the Company dated 21 June 2004 and 11 August 2005 and the announcement dated 6 January 2006.

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
Yang Xiaotang (note c)	China Electronics Corporation (note a)	Investment holdings	President and legal representative
Tong Baoan	China Electronics Corporation (note a)	Investment holdings	Director
	China Electronics Industry Corporation (note b)	Investment holdings	President and legal representative
	Shenzhen SED Industry Co., Ltd. (note b)	Investment holdings	Chairman
Fan Qingwu	China Electronics Industry Corporation (note b)	Investment holdings	Vice president
	CEC Wireless R&D Co. Ltd. (note d)	Research and development of mobile handsets	Director

Note:

(a) China Electronics Corporation ("CEC") is the controlling shareholder of the Company. CEC is a state-owned nationwide electronics and information technology conglomerate established under the laws of the People's Republic of China, and has other subsidiaries and associates engaged in mobile handset related businesses which compete or are likely to compete with the business of the Group.

(b) China Electronics Industry Corporation and Shenzhen SED Industry Co., Ltd. have subsidiaries or associates engaged in the mobile handset related businesses which compete or are likely to compete with the business of the Group. China Electronics Industry Corporation is wholly owned by CEC. 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 55.34% by CEC as at the date of this report.

(c) Mr. Yang has ceased to be the president of CEC as at the date of this report.

(d) CEC Wireless R&D Co. Ltd. has ceased to be a subsidiary of 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.

Report of the Directors

SUBSTANTIAL SHAREHOLDERS

As at 31 December 2005, the register of substantial shareholders maintained by the Company pursuant to Section 336 of the SFO showed that the following shareholders had notified the Company of 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%

Note:

(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 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 2005, no person or corporation had any interest or short position in the shares or underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO.

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 CUSTOMERS AND SUPPLIERS

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

Sales	
– the largest customer	38%
– five largest customers combined	83%

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	36%

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

None of the directors, their 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.

DISCLOSURE PURSUANT TO RULE 13.20 OF THE LISTING RULES

As at 31 December 2005, the Group had in aggregate approximately HK$947 million (RMB985 million) due from members of the Philips Group. The receivables were mainly trade balances which arose from sales of products including goods, samples and materials in the ordinary course of business of the Group with a small amount which represented reimbursement for taxation and administrative expenses paid during the year by the Group. Such amounts are to be settled in accordance with normal trade credit terms ranging from 45 to 60 days after invoice and are interest-free within credit period. The receivables are mainly covered then by bank guarantee or by documents against acceptance arrangements.

The Philips Group is a connected person of the Company by virtue of being a substantial shareholder of the Sang Fei, the principal operating subsidiary of the Company. Details of the transactions are set out in the section headed "Connected Transactions" above.

Save as disclosed above, there is no other disclosure required to be made by the Company pursuant to Rule 13.20 of the Listing Rules.

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.

Report of the Directors

AUDIT COMMITTEE

The audit committee comprises Messrs. Chan Kay Cheung, Wong Po Yan and Yin Yongli, who are independent non-executive directors of the Company. The audit committee examined the accounting principles and practices adopted by the Group and discussed with management its internal controls and accounts. During the year, the audit committee has reviewed the unaudited interim accounts for the six months ended 30 June 2005 and the audited accounts for the year ended 31 December 2005.

AUDITORS

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

On behalf of the Board
Yang Xiaotang
Chairman

Hong Kong, 10 April 2006

Auditors' Report

PRICEWATERHOUSECOOPERS

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TO THE SHAREHOLDERS OF
CHINA ELECTRONICS CORPORATION HOLDINGS COMPANY LIMITED
(incorporated in the Cayman Islands and continued in Bermuda with limited liability)

We have audited the accounts on page 26 to 67 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of accounts which give a true and fair view. In preparing accounts which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion solely to you, as a body, in accordance with section 90 of Companies Act 1981 of Bermuda, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion the accounts give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2005 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirement of the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 10 April 2006

Consolidated Balance Sheet

As at 31 December 2005

(All amounts in HK dollar thousands unless otherwise stated)

	Note	As at 31 December 2005	2004
ASSETS			
Non-current assets			
Property, plant and equipment	6	**79,051**	119,402
Intangible assets	7	**14,113**	3,498
Deferred income tax assets	22(b)	**4,514**	–
		97,678	122,900
Current assets			
Inventories	9	**447,034**	388,620
Trade and other receivables	10	**1,084,944**	931,391
Cash and cash equivalents	11	**306,381**	217,433
		1,838,359	1,537,444
Total assets		**1,936,037**	1,660,344
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Issued equity	12	**370,074**	373,750
Other reserves	13	**35,062**	19,204
Retained earnings/(accumulated losses)			
– Proposed final dividend		**21,671**	–
– Others		**3,209**	(23,713)
		430,016	369,241
Minority interests		**138,379**	124,884
Total equity		**568,395**	494,125
Current liabilities			
Trade and other payables	14	**1,129,194**	768,237
Current income tax liabilities		**5,573**	3,537
Short-term bank loans	15	**230,769**	392,231
Provision for warranty	16	**2,106**	2,214
Total liabilities		**1,367,642**	1,166,219
Total equity and liabilities		**1,936,037**	1,660,344
Net current assets		**470,717**	371,225
Total assets less current liabilities		**568,395**	494,125

The notes on page 31 to 67 are an integral part of these consolidated accounts.

Yang Xiaotang
Director

Fan Qingwu
Director

Balance Sheet

As at 31 December 2005

(All amounts in HK dollar thousands unless otherwise stated)

		As at 31 December	
	Note	**2005**	2004
ASSETS			
Non-current assets			
Property, plant and equipment	6	**605**	681
Investments in subsidiaries	8	**263,900**	260,639
		264,505	261,320
Current assets			
Other receivables	10	**2,133**	800
Cash and cash equivalents	11	**169,574**	137,342
		171,707	138,142
Total assets		**436,212**	399,462
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	12	**335,891**	411,740
Other reserves	13	**68,244**	140,263
Retained earnings/(accumulated losses)			
– Proposed final dividend		**21,671**	–
– Others		**6,459**	(154,440)
Total equity		**432,265**	397,563
Current liabilities			
Other payables	14	**3,947**	1,899
Total equity and liabilities		**436,212**	399,462
Net current assets		**167,760**	136,243
Total assets less current liabilities		**432,265**	397,563

The notes on page 31 to 67 are an integral part of these consolidated accounts.

Yang Xiaotang
Director

Fan Qingwu
Director

Consolidated Income Statement

For the year ended 31 December 2005

(All amounts in HK dollar thousands unless otherwise stated)

		Year ended 31 December	
	Note	**2005**	2004
Sales	5	**4,768,526**	4,590,123
Cost of goods sold	18	**(4,516,467)**	(4,352,639)
Gross profit		**252,059**	237,484
Other gains – net	17	**18,519**	6,808
Selling and marketing costs	18	**(41,706)**	(43,032)
Administrative expenses	18	**(127,425)**	(103,623)
Operating profit		**101,447**	97,637
Finance costs	21	**(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 expense	22(a)	**(5,598)**	(8,518)
Profit for the year		**84,348**	6,441
Attributable to:			
Equity holders of the Company	23	**49,899**	(19,263)
Minority interests		**34,449**	25,704
		84,348	6,441
Earnings/(loss) per share for profit/(loss) attributable to the equity holders of the Company during the year (expressed in HK cents per share)			
– basic	24	**4.61**	(2.17)
– diluted	24	**N/A**	N/A
Dividend	25	**21,671**	–

The notes on page 31 to 67 are an integral part of these consolidated accounts.

Consolidated Statement of Changes in Equity

For the year ended 31 December 2005

(All amounts in HK dollar thousands unless otherwise stated)

	Attributable to equity holders of the Company				
	Issued equity (note 12)	**Other reserves** (note 13)	**Retained earnings/ (accumulated losses)**	**Minority interests**	**Total**
Balance at 1 January 2004, as previously reported as equity	169,437	13,100	1,654	–	184,191
Balance at 1 January 2004, as previously separately reported as minority interests	–	–	–	99,180	99,180
Balance at 1 January 2004, as restated	169,437	13,100	1,654	99,180	283,371
Issue of shares	142,130	–	–	–	142,130
Arising from reverse acquisition	62,183	–	–	–	62,183
Appropriation to other reserves	–	6,104	(6,104)	–	–
(Loss)/profit for the year	–	–	(19,263)	25,704	6,441
Balance at 31 December 2004	373,750	19,204	(23,713)	124,884	494,125
Balance at 1 January 2005, as previously reported as equity	373,750	19,204	(23,713)	–	369,241
Balance at 1 January 2005, as previously separately reported as minority interests	–	–	–	124,884	124,884
Balance at 1 January 2005, as restated	373,750	19,204	(23,713)	124,884	494,125
Utilisation of contributed surplus against accumulated losses	(3,676)	–	3,676	–	–
Dividend paid by a subsidiary related to 2004	–	–	–	(23,282)	(23,282)
Share option granted	–	6,572	–	–	6,572
Currency translation differences	–	4,304	–	2,328	6,632
Appropriation to other reserves	–	4,982	(4,982)	–	–
Profit for the year	–	–	49,899	34,449	84,348
Balance at 31 December 2005	370,074	35,062	24,880	138,379	568,395

The notes on page 31 to 67 are an integral part of these consolidated accounts.

Consolidated Cash Flow Statement

For the year ended 31 December 2005

(All amounts in HK dollar thousands unless otherwise stated)

		Year ended 31 December	
	Note	**2005**	2004
Cash flows from operating activities			
Cash generated from operations	26	**314,835**	85,576
Interest paid		**(11,501)**	(21,445)
Income tax paid		**(8,076)**	(7,646)
Net cash generated from operating activities		**295,258**	56,485
Cash flows from investing activities			
Interest received		**4,697**	916
Purchase of property, plant and equipment and intangible assets (excluding goodwill)	6,7	**(26,935)**	(82,651)
Proceed on disposal of property, plant and equipment	26	**672**	112
Net cash used in investing activities		**(21,566)**	(81,623)
Cash flows from financing activities			
Issue of ordinary shares		**–**	142,130
Transaction costs of reversed acquisition		**–**	(5,975)
Dividend paid to minority interests		**(23,282)**	–
Proceeds from bank loans		**1,363,248**	1,470,621
Repayment of bank loans borrowed		**(1,524,710)**	(1,387,649)
Net cash (used in)/inflow from financing activities		**(184,744)**	219,127
Net increase in cash and cash equivalents		**88,948**	193,989
Cash and cash equivalents at beginning of the year		**217,433**	23,444
Cash and cash equivalents at end of the year	11	**306,381**	217,433

The notes on page 31 to 67 are an integral part of these consolidated accounts.

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 authoristies 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 foreseable 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.

Financial Summary

Set out below is a summary of the financial information of the Group for the last five financial years.

RESULTS

	Year ended 31 December				
	2005	2004	2003	2002	2001
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
			(note)	(note)	(note)
Sales	**4,768,526**	4,590,123	3,369	708	240,376
Profit/(loss) before income tax	**89,946**	14,959	(85,756)	(48,255)	(471,571)
Income tax expense	**(5,598)**	(8,518)	–	–	(10,821)
Profit/(loss) for the year	**84,348**	6,441	(85,756)	(48,255)	(482,392)
Attributable to:					
Equity holders of the Company	**49,899**	(19,263)	(85,756)	(47,177)	(479,400)
Minority interests	**34,449**	25,704	–	(1,078)	(2,992)
	84,348	6,441	(85,756)	(48,255)	(482,392)

ASSETS AND LIABILITIES

	As at 31 December				
	2005	2004	2003	2002	2001
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
			(note)	(note)	(note)
Total assets	**1,936,037**	1,660,344	7,534	76,283	102,138
Total liabilities	**(1,367,642)**	(1,166,219)	(74,757)	(57,750)	(86,557)
Minority interests	**(138,379)**	(124,884)	–	–	(1,078)
	430,016	369,241	(67,223)	18,533	14,503

Note:

The financial information as at 31 December 2001, 2002 and 2003 and for the three financial years then ended as set out above are that of the Winsan Group, and are not comparable to the basis of preparation of accounts as at 31 December 2004 and 2005 and for the two financial years then ended.