



SMS

PDA

AV PRODUCTS

WIRELESS PRODUCTS

TFT TV

LCD

Interim Report **2002-2003**

Characteristics of The Growth Enterprise Market (the “GEM”) of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”)

GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

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The principal means of information dissemination on GEM is publication on the internet website operated by the Stock Exchange. Listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website at www.hkgem.com in order to obtain up-to-date information on GEM-listed issuers.

The Stock Exchange takes no responsibility for the contents of this report, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this report.

This report, for which the directors of Arcontech Corporation collectively and individually accept responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange for the purpose of giving information with regard to Arcontech Corporation. The directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief:- (1) the information contained in this report is accurate and complete in all material respects and not misleading; (2) there are no other matters the omission of which would make any statement in this report misleading; and (3) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

CHAIRMAN'S STATEMENT

I am pleased to announce the results of Arcontech Corporation ("Arcontech" or the "Company") and its subsidiaries (collectively referred to as the "Arcontech Group" or the "Group") for the second quarter and the six months ended 30 September 2002.

Financial Review

An adverse 3C products and semiconductor market resulting from the economic downturn in Asia and in North America has posed a tremendous challenge to our business. However, in spite of the severe operating conditions, the Group achieved satisfactory growth in turnover. During the second quarter ended 30 September 2002, the Group's turnover increased by 130% from HK\$117 million to HK\$269 million compared to the same period in 2001.

Profit attributable to shareholders for the first quarter or the three months ended 30 June 2002 declined to HK\$10 million due to the thinning of the gross profit margin. Profit attributable to shareholders for the second quarter or the three months ended 30 September 2002 bounced back to HK\$15 million with strong sales turnover recorded in the period. The strong growth in the sales turnover of the Group in the second quarter was attributable to increased sales of the Group's solutions in audio/visual ("A/V") products and helped offset the negative impact on the group profitability resulting from the declines in the gross profit margin.

Market Development

The Group is positive about the long-term growth and prospects of the 3C products and semiconductor industry, especially in the area of consumer electronics. In addition to the existing Shenzhen R&D center, the Group has set up an office in Shanghai in October 2001 to promote the Group's 3C products and solutions to potential customers in that area. The Group has also set up another business unit in South Korea in July 2002 to enhance cooperation with 3C products and solutions developers and potential customers. At the moment, the development team in Korea is testing various flat-panel display devices such as plasma panel television and a TFT-LCD television embedded with the Group's proprietary solutions.

Business Outlook

The lackluster economic environment and impaired consumer confidence in Asia and in North America continue to pose serious challenges to the Group. This is further compounded by the threat of war, rising oil prices, high unemployment rate and volatile global stock markets. Despite these challenges, the Group considers that China will continue to remain a vast consumer market with significant potentials, providing numerous opportunities for the Group and its 3C products and solutions. I am confident that the Group will become one of the leading consumer-focused technology solution providers in Asia; and turnover and margin will further improve once the economic uncertainties are overcome.

On the staff side, Mr. Francis Leung was appointed deputy chief executive officer of the Group in August 2002. In addition we welcomed Mr. Edwin Yip as the Group's executive director and chief financial officer in August 2002.

It is with a deep sense of grief that I inform you of the passing of our dear Chairman of the Technology Advisory Board and Chief Consultant of the Company, NEC Distinguished Professor Tien on 29 October 2002. Professor Tien Chang Lin had contributed much in respect of strategic planning, technology developments and deployments to the success of the Group and is best remembered as the SAR Chief Executive's principal advisor who led the SAR in mapping out strategies and laying foundation for Hong Kong's public programmes for strengthening the use of innovation and technology when he served as the head of the Commission on Innovation and Technology. He is much missed by his fellow board members and colleagues. We offer our sincere and heartfelt condolences to his family in the United States and would like to thank Professor Tien for his immeasurable contribution to the Company.

I would like to take this opportunity to thank our development engineers who continue to develop new and innovative 3C products and solutions, and the management and support staff who helped steer the company through such difficult times.

Tsoi Siu Ching, Leo
Chairman

Hong Kong, 1 November 2002

INTERIM RESULTS (UNAUDITED)

The Board of Directors (“Board”) of Arcontech Corporation (the “Company”) is pleased to announce the unaudited condensed consolidated results of the Company and its subsidiaries (collectively the “Group”) for the six months and three months ended 30 September 2002, together with the comparative unaudited figures for the corresponding periods in 2001 (the “Relevant Periods”) as follows:

	Note	Six months ended 30 September		Three months ended 30 September	
		2002 HK\$'000 (Unaudited)	2001 HK\$'000 (Unaudited)	2002 HK\$'000 (Unaudited)	2001 HK\$'000 (Unaudited)
Turnover	2	388,473	234,968	269,328	116,773
Cost of sales		<u>(311,862)</u>	<u>(155,733)</u>	<u>(225,757)</u>	<u>(79,503)</u>
Gross profit		76,611	79,235	43,571	37,270
Other revenues	2	440	390	211	183
Selling and distribution expenses		(5,924)	(5,488)	(3,934)	(3,112)
General and administrative expenses		<u>(36,770)</u>	<u>(24,111)</u>	<u>(20,024)</u>	<u>(12,789)</u>
Operating profit	3	34,357	50,026	19,824	21,552
Finance costs	5	<u>(2,812)</u>	<u>(1,234)</u>	<u>(1,351)</u>	<u>(744)</u>
Profit before taxation		31,545	48,792	18,473	20,808
Taxation	6	<u>(5,810)</u>	<u>(8,121)</u>	<u>(3,590)</u>	<u>(3,478)</u>
Profit after taxation		25,735	40,671	14,883	17,330
Minority interests		<u>(863)</u>	<u>—</u>	<u>(16)</u>	<u>—</u>
Profit attributable to shareholders		<u>24,872</u>	<u>40,671</u>	<u>14,867</u>	<u>17,330</u>
Interim dividend per share		<u>0.85 cent</u>	<u>1.50 cents</u>	<u>0.50 cent</u>	<u>0.50 cent</u>
Earnings per share - basic	7	<u>3.09 cents</u>	<u>5.65 cents</u>	<u>1.81 cents</u>	<u>2.41 cents</u>

Consolidated Balance Sheet

		As at 30 September 2002	As at 31 March 2002
	<i>Note</i>	<i>HK\$'000 (Unaudited)</i>	<i>HK\$'000 (Audited)</i>
Fixed assets	8	<u>100,770</u>	<u>110,107</u>
Investment in associated companies		<u>4</u>	<u>4</u>
Current assets			
Inventories		17,780	13,311
Trade receivables	9	481,814	325,925
Deposits and prepayments		63,575	18,596
Tax recoverable		443	—
Cash and bank balances		59,941	76,036
		<u>623,553</u>	<u>433,868</u>
Current liabilities			
Trade payables	10	44,017	6,707
Other payables and accruals		2,798	6,920
Amount due to a director		—	2,182
Current portion of long-term liabilities	11	14,533	7,607
Trust receipt and factoring loans		120,706	91,219
Taxation		—	16,680
Bank overdrafts		16,961	14,009
		<u>199,015</u>	<u>145,324</u>
Net current assets		<u>424,538</u>	<u>288,544</u>
		<u>525,312</u>	<u>398,655</u>
Financed by:			
Share capital	12	82,000	72,000
Reserves		203,759	95,063
Retained earnings		180,115	162,213
2002 proposed final dividend		—	8,200
Proposed interim dividend		4,100	—
Shareholders' funds		469,974	337,476
Minority interests		32,311	31,448
Long-term liabilities	11	13,774	20,988
Deferred taxation		9,253	8,743
		<u>525,312</u>	<u>398,655</u>

Condensed Consolidated Cash Flow Statement

	For the six months ended 30 September 2002 <i>HK\$'000</i> <i>(Unaudited)</i>	For the six months ended 30 September 2001 <i>HK\$'000</i> <i>(Unaudited)</i>
Net cash outflow from operating activities	(165,920)	(16,062)
Net cash outflow from investing activities	(1,021)	(24,574)
Net cash outflow before financing	(166,941)	(40,636)
Net cash inflow/(outflow) from financing	118,856	(452)
Decrease in cash and cash equivalents	(48,085)	(41,088)
Effect of foreign exchange rate changes	(449)	(91)
Cash and cash equivalents at beginning of the period	(29,192)	47,859
Cash and cash equivalents at the end of the period	<u>(77,726)</u>	<u>6,680</u>
Analysis of balances of cash and cash equivalents:		
Cash and bank balances	59,941	54,416
Bank overdrafts	(16,961)	(186)
Trust receipt loans and factoring loans	(120,706)	(47,550)
	<u>(77,726)</u>	<u>6,680</u>

Condensed Consolidated Statement of Changes in Equity for the six months ended 30 September 2002

	Share capital	Share premium	Merger reserve	Exchange reserve	Retained earnings	Proposed interim dividend	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
(Unaudited)							
At 1 April 2002	72,000	74,242	20,943	(122)	170,413	—	337,476
Issue of shares							
pursuant to placing	10,000	113,000	—	—	—	—	123,000
Share issuing expenses	—	(3,855)	—	—	—	—	(3,855)
Profit attributable							
to shareholders	—	—	—	—	24,872	—	24,872
2002 Final dividend	—	—	—	—	(8,200)	—	(8,200)
2003 Interim dividend	—	—	—	—	(2,870)	—	(2,870)
2003 Proposed interim dividend	—	—	—	—	(4,100)	4,100	—
Exchange differences	—	—	—	(449)	—	—	(449)
	<u>82,000</u>	<u>183,387</u>	<u>20,943</u>	<u>(571)</u>	<u>180,115</u>	<u>4,100</u>	<u>469,974</u>
(Unaudited)							
At 1 April 2001	72,000	84,737	20,943	(99)	128,001	—	305,582
Profit attributable							
to shareholders	—	—	—	—	40,671	—	40,671
2001 Final dividend	—	—	—	—	(10,800)	—	(10,800)
2002 Interim dividend	—	—	—	—	(7,200)	—	(7,200)
2002 Proposed							
interim dividend	—	—	—	—	(3,600)	3,600	—
Exchange differences	—	—	—	(91)	—	—	(91)
	<u>72,000</u>	<u>84,737</u>	<u>20,943</u>	<u>(190)</u>	<u>147,072</u>	<u>3,600</u>	<u>328,162</u>

Notes to condensed accounts:

1. Basis of presentation and accounting policies

These unaudited consolidated condensed accounts are prepared in accordance with Hong Kong Statement of Standard Accounting Practice ("SSAP") 25, Interim Financial Reporting, issued by the Hong Kong Society of Accountants ("HKSA").

These condensed accounts should be read in conjunction with the 2002 annual accounts.

The accounting policies and methods of computation used in the preparation of these condensed accounts are consistent with those used in the annual accounts for the year ended 31 March 2002 except that the Group has changed certain of its accounting policies following its adoption of the following SSAPs issued by HKSA which are effective for accounting periods commencing on or after 1 January 2002:

SSAP 1 (revised):	Presentation of financial statements
SSAP 15 (revised):	Cash flow statements
SSAP 25 (revised):	Interim financial reporting
SSAP 34:	Employee benefits

2. Turnover and revenue

The Group is principally engaged in the design, development of software and engineering solutions including sales of semiconductors, and the location-based technology devices and applications ("GPS") in Hong Kong. Revenues recognised during the Relevant Periods are as follows:

	Six months ended 30 September		Three months ended 30 September	
	2002	2001	2002	2001
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Turnover				
Sale of goods at invoiced value, net of returns and discounts	379,437	224,380	267,297	115,723
Royalty income	9,036	10,588	2,031	1,050
	<u>388,473</u>	<u>234,968</u>	<u>269,328</u>	<u>116,773</u>
Other revenues				
Interest income	367	226	190	19
Software and internet service income	73	164	21	164
	<u>440</u>	<u>390</u>	<u>211</u>	<u>183</u>
Total revenues	<u><u>388,913</u></u>	<u><u>235,358</u></u>	<u><u>269,539</u></u>	<u><u>116,956</u></u>

Segment information

As the Group's operations are principally located in Hong Kong, no geographical segmental analysis is presented. An analysis of the Group's revenue and segment results by principal business segment is as follows:

	Sales of software and engineering solutions excluding GPS	Sales of software and engineering solutions excluding GPS	Sales of GPS	Sales of GPS	Group	Group
	For the six months ended	For the six months ended	For the six months ended	For the six months ended	For the six months ended	For the six months ended
	30 September 2002	30 September 2001	30 September 2002	30 September 2001	30 September 2002	30 September 2001
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Turnover	<u>334,447</u>	<u>212,679</u>	<u>54,026</u>	<u>22,289</u>	<u>388,473</u>	<u>234,968</u>
Segment results	<u>31,226</u>	<u>48,158</u>	<u>3,131</u>	<u>1,868</u>	34,357	50,026
Finance costs					<u>(2,812)</u>	<u>(1,234)</u>
Profit before taxation					31,545	48,792
Taxation					<u>(5,810)</u>	<u>(8,121)</u>
Profit after taxation					25,735	40,671
Minority interests					<u>(863)</u>	<u>—</u>
Profit attributable to shareholders					<u>24,872</u>	<u>40,671</u>

3. Operating profit

Operating profit is stated after charging the following:

	For the six months ended 30 September 2002 HK\$'000	For the six months ended 30 September 2001 HK\$'000
Depreciation:		
Owned fixed assets	10,168	6,206
Leased fixed assets	190	175
	<u>10,358</u>	<u>6,381</u>

4. Staff costs

	For the six months ended 30 September 2002 HK\$'000	For the six months ended 30 September 2001 HK\$'000
Basic salaries, allowances and other benefits in kind	15,458	11,608
Retirement scheme contributions	342	311
	<u>15,800</u>	<u>11,919</u>

5. Finance costs

	Six months ended 30 September		Three months ended 30 September	
	2002	2001	2002	2001
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Interest on bank loans and overdrafts	2,774	1,197	1,332	729
Interest element of finance leases	38	37	19	15
	<u>2,812</u>	<u>1,234</u>	<u>1,351</u>	<u>744</u>

6. Taxation

Hong Kong profits tax has been calculated at 16% (2001: 16%) on the estimated assessable profits of the Group for the Relevant Periods.

Taxation on profits of subsidiaries in the Mainland China has been calculated on the estimated assessable profits for the periods at the rates of taxation prevailing in the Mainland China.

7. Earnings per share

The calculation of basic earnings per share for the six months ended 30 September 2002 is based on the Group's profit attributable to shareholders of approximately HK\$24,872,000 (2001: HK\$40,671,000) and the weighted average number of 804,699,454 shares (2001: 720,000,000 shares) in issue during the period.

The calculation of basic earnings per share for the three months ended 30 September 2002 is based on the Group's profit attributable to shareholders of approximately HK\$14,867,000 (2001: HK\$17,330,000) and 820,000,000 shares (2001: 720,000,000 shares) in issue during the period.

Diluted earnings per share is not presented because there were no dilutive potential ordinary shares outstanding during the period.

8. Capital expenditure

Fixed assets *HK\$'000*

6 months ended 30 September 2002

Opening net book amount	110,107
Additions	1,021
Depreciation charge	(10,358)
	<hr/>
Closing net book amount	100,770
	<hr/> <hr/>

9. Trade receivables

The Group normally grants credit period ranging from 30 days to 120 days to its trade debtors. Details of ageing analysis of trade receivables were as follows:

	As at 30 September 2002	As at 31 March 2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
0-30 days	181,752	62,904
31-60 days	34,910	20,166
61-90 days	45,517	30,256
Over 90 days	219,635	212,599
	<hr/>	<hr/>
	481,814	325,925
	<hr/> <hr/>	<hr/> <hr/>

10. Trade payables

Details of ageing analysis of the trade payables were as follows:

	As at 30 September 2002	As at 31 March 2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
0-30 days	36,552	4,216
31-60 days	5,601	700
61-90 days	149	134
Over 90 days	1,715	1,657
	<hr/>	<hr/>
	44,017	6,707
	<hr/> <hr/>	<hr/> <hr/>

11. Long-term liabilities

	As at 30 September 2002	As at 31 March 2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
Bank loans	27,835	27,932
Obligations under finance leases	472	663
	<hr/>	<hr/>
	28,307	28,595
Current portion of long-term liabilities	(14,533)	(7,607)
	<hr/>	<hr/>
	13,774	20,988
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The bank loans and the obligations under finance leases are wholly repayable within five years.

At 30 September 2002, the Company's bank loans were repayable as follows:

	As at 30 September 2002	As at 31 March 2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
Within one year	14,152	7,226
In the second year	13,683	13,881
In the third to fifth year	—	6,825
	<hr/>	<hr/>
	27,835	27,932
	<hr/> <hr/>	<hr/> <hr/>

At 30 September 2002, the Company's finance lease liabilities were repayable as follows:

	As at 30 September 2002	As at 31 March 2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
Within one year	456	457
In the second year	64	277
In the third to fifth year	33	52
	<hr/>	<hr/>
	553	786
Future finance charges on finance leases	(81)	(123)
	<hr/>	<hr/>
Present value of finance lease liabilities	472	663
	<hr/> <hr/>	<hr/> <hr/>

The present value of finance lease liabilities is as follows:

Within one year	381	381
In the second year	58	233
In the third to fifth year	33	49
	<hr/>	<hr/>
	472	663
	<hr/> <hr/>	<hr/> <hr/>

12. Share capital

	As at 30 September 2002	As at 31 March 2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
Authorised:		
3,000,000,000 ordinary shares of HK\$0.10 each	300,000	300,000
Issued and fully paid:		
820,000,000 ordinary shares (31 March 2002: 720,000,000 shares) of HK\$0.10 each	82,000	72,000

On 17 April 2002, the Company entered into a placement agreement and a subscription agreement (the "Agreements") with SBI E2-Capital Securities Limited ("SBI E2") and Upgrade Technology Limited ("Upgrade") pursuant to which SBI E2 will procure purchasers to purchase from Upgrade and Upgrade, in return, will subscribe from the Company for 100,000,000 shares of HK\$0.10 each in the share capital of the Company at the price of HK\$1.23 per share.

On 29 April 2002, the Agreements were completed and the Company raised approximately HK\$119 million by way of issuing 100,000,000 new shares through this top-up placement.

13. Commitments

(a) Capital commitments for property, plant and equipment:

	As at 30 September 2002	As at 31 March 2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
Contracted but not provided for	2,661	877
Authorised but not contracted for	11,855	28,106
	<u>14,516</u>	<u>28,983</u>

(b) **Commitments under operating leases**

The Group had total future aggregate minimum lease payments under non-cancelable operating leases in respect of land and buildings as follows:

	As at 30 September 2002	As at 31 March 2002
	<i>HK\$'000</i>	<i>HK\$'000</i>
Within one year	4,109	1,884
In the second to fifth year inclusive	3,448	1,043
	<u>7,557</u>	<u>2,927</u>

INTERIM DIVIDENDS

The Board recommends the payment of an interim dividend of HK0.50 cent per share for the three months ended 30 September 2002 (2001: HK0.50 cent). The dividend will be payable on Wednesday, 27 November 2002 to shareholders whose names appear on the Register of Members of the Company at the close of business on Tuesday, 19 November 2002. Together with an interim dividend of HK0.35 cent per share for the three months ended 30 June 2002 paid to the shareholders on 23 August 2002, total dividends for the six months ended 30 September 2002 amounted to HK0.85 cent per share.

CLOSURE OF REGISTER OF MEMBERS

The Register of Members of the Company will be closed from Monday, 18 November 2002 to Tuesday, 19 November 2002, both days inclusive, during which period no share transfers will be registered. In order to qualify for the interim dividend for the three months ended 30 September 2002, all transfer documents accompanied by relevant share certificates must be lodged with the Company's Share Registrar, Computershare Hong Kong Investor Services Limited, Shop 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong not later than 4:00 p.m. on Friday, 15 November 2002.

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Performance

During the first half of the financial year, the Group continued to operate under difficult market conditions. For the six months ended 30 September 2002, the Group recorded unaudited consolidated turnover and profit attributable to shareholders of HK\$388 million and HK\$25 million respectively.

The increase in unaudited consolidated turnover over the corresponding period in 2001 was attributable to a shipment in relation to the 3C product solution for DVD applications and associated electronic components. A shift in 3C product mix towards faster-moving but lower-margin consumer electronics reduced the overall gross margin from 34% to 20% for the six months ended 30 September 2001 and 2002 respectively. Due to the significant decrease in the overall gross margin, profit attributable to shareholders reduced from HK\$ 41 million to HK\$25 million over the corresponding period in 2001 and 2002 respectively.

Business Review

When we reported our first quarterly results for the three months ended 30 June 2002 in July 2002, we expected the global 3C products market to remain bleak. In line with our expectation, as a result of the continued downturn of the global economy, consumers took a step back in 3C products spending, in particular, in the area of consumer electronics. Consumption of 3C products has further reduced since July 2002, especially in the area of consumer electronics. It has been reported by some of the world's largest retailers for consumer electronics that they were seeing their sales figures fall below estimates.

The demands for high-end consumer electronics remain weak. The price competition and bleak outlook have combined to make the product developers and marketers more conservative, rather than becoming more aggressive in launching new products, in particular, in launching high-end products. The slowing down and/or holding back in launching new products by product developers negatively impacted our core business as providers of quick time-to-market and high value-added proprietary embedded solutions for high-end 3C products with innovative and/or technologically advanced functions and features. As another result of such slowdowns and delays, the Group had a limited number of new solutions/products launching and many of the revenue producing solutions sold during the quarter were solutions developed and launched in previous years and had entered the mature stage of the product life cycle. These matured products were, in particular, facing pricing pressure and in turn thinning the profit margin. The number of new embedded software solutions launched in the market dropped remarkably in the first half of the year. The combination of these factors led to a lower gross margin for the period.

Hong Kong, Shenzhen and Shanghai Operations

Since the establishment of the Shanghai office in October 2001, the local staff have been active in working with our Hong Kong and Shenzhen staff to secure new contracts for 3C products and solutions. Their hard work in opening up a new market for the Group's products is beginning to show promise. This is evident in the new contact between the Group and Shanghai Hong Sheng (Norcent) Technology Company Limited.

Pursuant to the agreement between the Group and Shanghai Hong Sheng (Norcent) Technology Company Limited relating to the supply of solutions and electronic components for audio visual products, the Group has shipped out approximately 300,000 sets of 3C product solutions for DVD applications and associated electronic components in the month of September 2002.

Amongst the Group's 3C products, demand for consumer electronics were the strongest, while computer peripherals and consumer communication products remained relatively weaker. The demand for consumer communication products such as cordless telephone and network phones were among the weakest. The Group also observed a moderate pickup in the demand for computer peripherals, mainly in TFT-LCD computer displays as most personal computer manufacturers and after-market distributors aggressively promoted their low-priced models in the month of September 2002.

Regarding research and development on Bluetooth, the Group continued the development of various solutions and applications for the technology and is set to make a name for itself in Bluetooth technology and its applications. Although, the commercial launching of Bluetooth products is much slower than everyone had expected and much of the products being launched into the market are still restricted to the simplest applications such as headsets and accessories, the Group is optimistic about the prospects of Bluetooth technology and expects the technology will be a technology driver that revolutionize the 3C products industry.

Korea Operation

In July 2002 and previously disclosed in the first quarterly results, the Group commenced an operating unit with initially 10 staffs in Korea with the objective to capture the technology expertise in the latest flat panel display technology, particularly in TFT-LCD computer displays and Plasma panel television embedded with the Group's proprietary solutions. This Korean unit is expected to generate and transfer technologies and research and development results to the Group in the coming months. The Group expects customers from China will place orders for these products in the next few months and products will be delivered to these customers in the financial year 2003.

Management Appointments

In order to further strengthen the management team, in August 2002, the Group appointed Mr. Francis Leung as the deputy chief executive officer of the Group. Mr. Leung reports to the chief executive officer and is responsible for the overall management and administration, business and finance as well as key operating and investment decisions of the Group. Mr. Leung is expected to play a leading role in the Group's strategic and investment directions and in guiding the Group to achieve its business and corporate objectives. Mr. Leung has accumulated over 20 years of experience in finance, management and administration. Prior to joining the Group, Mr. Leung was the managing director of Chubb Hong Kong Limited, a company engaged in the provision of security and protection services.

In August 2002, the Group also appointed Mr. Edwin Yip as the Chief Financial Officer of the Group. Mr. Yip is responsible for the overall financial planning, management and accounting of the Group. He is a fellow member of the Chartered Association of Certified Accountants, a fellow member of the Hong Kong Society of Accountants, and an associate member of the Faculty of Secretaries and Administrators and the Taxation Institute of Hong Kong. Mr. Yip has over 30 years of experience working in senior finance and accounting positions in Hong Kong companies.

Financial Resources and Liquidity

As at 30 September 2002, the Group had total assets of approximately HK\$724 million, which were financed by current liabilities of approximately HK\$199 million, non-current liabilities of approximately HK\$55 million and shareholders' equity of approximately HK\$470 million.

Current assets amounted to approximately HK\$624 million, of which approximately HK\$60 million were cash and bank deposits. The Group had a working capital ratio of approximately 3.14.

Fixed assets of the Group maintained at approximately HK\$100 million during the first half of the year.

The revenues of the Group are denominated mostly in Hong Kong Dollars and U.S. Dollars. The Group has minimal exposure to foreign exchange fluctuations and seldom needs to make use of financial instruments for hedging purposes.

The Group's banking facilities were secured by corporate guarantees given by the Company and there were approximately HK\$166 million utilized banking facilities, mainly trade financing, as at 30 September 2002. Bank borrowing to equity ratio was 0.35.

The directors believe that the Group has a strong financial position through the continuously profitable operation of the Group. The Group is comfortable that existing financial resources will be sufficient for future expansion plans. Should other opportunities arise requiring additional funding, the Directors believe that the Group is in a good position to obtain financing on favourable terms.

Employees

As at 30 September 2002, the Group had 192 full-time employees who were engaged in the following operations:

Engineering and R&D	123
Sales and marketing (including field application engineers)	16
Finance, accounting, operation and administration	53
	<hr/>
Total headcount	192
	<hr/> <hr/>

The Group believes that the quality of its employees is the most important factor in sustaining the Group's growth and improving its profitability. Employees are remunerated according to their performance and work experience. In addition to basic salaries, staff benefits include medical scheme, share options and performance bonus.

Future Prospects

Looking into the second half of the year, there are still uncertainties with the overall global economy. The outlook for the global 3C products industry will remain bleak and visibility will remain short-term and limited in new product offerings. It will be extremely difficult to predict when the global economy and the high-end 3C products market will completely recover. Looking back, the global 3C products industry's cyclical peak occurred between 2000 and 2002 when massive sales growth was fuelled by consumer optimism, product

innovations and new technologies which spurred large-scale new product launching. However, the 3C products industry appeared to have just entered into a cyclical downturn. As such, we are witnessing customers, and in turn, global consumers catching a break. The global 3C product industry is, at this point in time, lacking in prospective drivers.

Audio/Visual Applications

As new technologies continue to be introduced at breakneck speed, we see consumer audio/visual (“A/V”) or home-theatre concept products to be a main driver for the consumer electronics sector over the short to medium term. We also see that there is a relatively stable and concentrated customer base in consumer A/V products. Falling price and new product launches are also helping to fuel demand for A/V products. As mentioned in the first quarterly report for the three months ended 30 June 2002, the Group has adjusted its strategic focus by shifting the immediate to medium term sales, research and development focus on faster moving consumer A/V products such as DVD players, TFT-LCD monitors and television, Plasma panel television, digital television, digital still cameras and MP3 players.

Amongst these new 3C products and solutions, we are particularly optimistic about the short to medium term prospect of flat-panel display devices such as TFT-LCD monitors and television, and Plasma panel based devices which consumers are treating as replacements for the traditional cathode-ray tube A/V products. We also anticipate this 3C product sector to benefit from the growing popularity of TFT-LCD monitors and television, with added impetus coming from the mass adoption or replacement of desktop PCs with notebook models with TFT-LCD panels. The increasing global demand for TFT-LCD panels and Plasma panel based devices will probably benefit the Group as the number of embedded solution providers who have readily available solutions and technologies on hand are limited. As the 5th generation TFT-LCD technology is fast becoming technically viable, the technology and products deriving from this technology will get a prospective driver in the medium term. In addition, the falling prices of TFT-LCD panels and Plasma panels will also help reduce the selling price and boost demand for these A/V display devices.

Digital Television Applications

The Group also has plans to initiate research and development projects on solutions for digital television and related technologies. In China, the government has selected Shanghai, Beijing and Shenzhen as pilot cities to test digital television service and plans to introduce a technical standard for digital television signals by 2003 and make all television programming nationwide digital by 2015, thus offering enormous business opportunities for solutions in digital television sets, digital converters and auxiliary A/V devices. With Shanghai, Beijing and Shenzhen already offering digital television programming on a trial basis since September 2002, we anticipate all major cities in China to offer digital programming in the next five years. The Group expects the next generation of digital A/V devices will offer cable, Internet and telecommunication network on a single platform which will attract a large number of digital television users to adopt these new digital A/V devices.

Market in China

From a market analysis and business opportunity point of view, we see China as a key growth market for the Group where we have particularly high expectations in terms of business opportunities for the Group. According to exports statistics, China is by far Hong Kong's largest market for electronics A/V products, absorbing over one-third of exports. As such, the Group will continue to put expansion in China at the forefront of the Group's business development priorities.

The Group's expansion plans will include both sales network and research and development. Over the past year, a new group of Asian consumer electronics industry players (outside of Japan) has been rapidly developing their technological expertise to close the gap with their western and Japanese counterparts. In particular, Korean and Taiwanese players have done so in high-end consumer electronics, including high end and high specification products such as Plasma, DVD and other A/V devices, while industry players in China currently engage in low- to mid-end consumer A/V electronics only, such as cathode-ray tube based television and white goods. In Hong Kong, most electronics industry players also run behind the rest of the technology world when new technologies are introduced. Indeed, the Group has a unique business advantage in China as it is one of the first and very few solution providers to partner with major consumer electronics companies in China to

develop higher-end and high value-added as well as technologically advanced A/V products for both domestic consumption and export. This clearly indicate that the Group is well positioned to benefit from customers such as consumer A/V manufacturers who are looking for high-end, high value-added A/V devices to sell to consumers and/or consumers looking for higher-end A/V product upgrade.

Lacking technology expertise, design capabilities and global market strategy, we believe consumer electronics industry players in China will expedite their research and development in this area by outsourcing to solution providers such as the Group to speed up new product launching so that they can enjoy first mover advantage in new product introduction. In some cases, the Group partnered with China's industry players to give these industry players access to the same latest technology as all major players in the technology world and had launched products in line with or before everyone else. The Group, therefore, expects the technological and product upgrading of consumer electronics manufacturers in China as a main sales driver for the Group in the next few years.

Following the footsteps of other fast developing cities in the Pearl River Delta and Yangze River Delta, Bohai economic region of China is rapidly emerging into the third contract electronics manufacturing platform of global 3C products. We see the consumer electronics and A/V industry in China is growing strongly and these three production bases in China will become the major manufacturing platform for the global 3C products market. The Group will continue looking for a strategic partner with strong business networking to expedite the business development plans for the market in China.

Although we cannot control the global economy and we cannot control when the high-end 3C products market comes back, we can control our operation. As such, we will continue to streamline operations and efficiently allocate resources to facilitate core growth areas, in particular, the business development in the PRC. The Group has aggressive growth targets for the PRC market that not only take into account the current state of the global market situation but also future projected outsourced research and development demand.

On the whole, gross margin of the embedded software solutions, previously the Group's core business, showed a decline compared with the margin recorded in the last corresponding period. We expect the margin for embedded

software solutions to be stabilized in the second half of the financial year. However, due to the changes in product mix towards the low value and fast moving consumer electronics items such as DVD devices have brought the overall gross margin down substantially. In anticipation of the further shipment of the DVD devices, we expect the situation to continue into the second half of the financial year. In the longer term, we expect the overall margin to improve when the Group has successfully launched the newly developed turnkey device solutions for TFT-LCD TV and Plasma TVetc. The tentative timetable for launching these new solutions is expected to be in FY2003.

What is at present perceived to be a gloomy scenario in the global 3C products industry is seen as a great challenge but also an opportunity for Arcontech to consolidate and re-focus on future research and development needs. We aim to maintain our position as our client's solution/business partner in terms of research and development and are determined to keep our position in the industry and ride-out the downturn of this business cycle by continuing to enhance the Group's competitive advantages.

Business Objectives Review

An analysis comparing of business objectives as stated in the prospectus dated 8 August 2000 with the Group's actual business progress up to 30 September 2002 is set out below:

Business Objectives:

Actual Business Progress:

Revenue

- | | |
|--|---|
| <ul style="list-style-type: none">• expand the proportion of sales from self-initiated turnkey devices solutions | <ul style="list-style-type: none">• the sales turnkey devices solutions has increased to account for over 30% of the total turnover |
|--|---|

Product launches, sales and marketing

- launch turnkey device solutions for TFT-LCD controllers, digital healthcare devices and home appliances with voice recognition
- the Group has launched turnkey device solutions for TFT-LCD controllers and home appliances with voice recognition during the period. It is expected that TFT-LCD controllers and home appliances with voice recognition will make contribution to the Group's sales in the current year. However, due to market conditions, launching of digital healthcare devices is slower than expected.
- apply for approvals by relevant overseas medical authorities for digital healthcare products
- the Group is finalizing its digital healthcare products with overseas requirements for overseas medical authorities, and are expected to be put into testing in the current year
- identify sales opportunities for GPS devices and applications targeted to public and private sector users overseas
- the Group, through its subsidiary, Satellite Device Corporation, is negotiating with companies for business opportunities of its GPS devices and applications in the PRC, U.S. as well as Europe. Also, the Group is planning to exhibit its products in a number of exhibitions and shows overseas to enhance sales opportunities

Research & development

- commence trial run and fine-tuning of auto-navigation system, electronic road pricing and diagnostic rescue system for GPS applications
- commence R&D of embedded software solutions for applications utilizing micro-pressure sensors and pattern recognition technologies, and of turnkey device solutions for walking PCs speech-to-text features
- commence R&D and integration of Bluetooth technologies, voice recognition and environment control features for applications in intelligent home appliances and other consumer electronics
- the Group is fine-tuning its auto-navigation system while testing running by a number of potential customers. For electronic road pricing and diagnostic rescue system for GPS applications, the Group is still studying the market potential for these products before increasing the resources in these researches
- the Group is finalizing its development plans for products utilizing micro-pressure sensors and pattern recognition technologies, and has started the research on solutions for walking PCs speech-to-text features
- the Group is studying the market potential for products with integration of Bluetooth technologies, voice recognition and environment control features for applications in intelligent home appliances and other consumer electronics

Human resources, operations and administration

- establish sales and/or R&D base outside Hong Kong and the PRC
- recruit additional operational and engineering staff, and dedicated sales staff for the Group's expansion
- the Group has established an operating unit in South Korea during the period and is studying the possibility of further expansion of the operations
- As at 30 September 2002, the total headcount of the Group had exceeded 150 and there were more than 100 engineers within the Group

Strategic acquisitions and alliances

- explore opportunities to acquire or form alliance with companies providing synergies and technological supports
- the Group is actively pursuing opportunities to establish or acquire technological alliance/ventures which are able to compliment the future business development of the Group. However, up to the end of this period, nothing concrete has been concluded

Use of Proceeds

The Group raised net proceeds of approximately HK\$156 million upon listing of the Company's shares on GEM of the Stock Exchange. By 30 September 2002, the Group had, for the most part, used up all the proceeds from the listing to achieve the business objectives as stated above and substantially in the manner as set out in the Prospectus. The proceeds have been applied as follows:

	According to the use of proceeds as stated in the prospectus dated 8 August 2000 <i>HK\$ million</i>	Amount utilized up to 30 September 2002 <i>HK\$ million</i>
Setting up SMS and City Band operating centre to facilitate sales of GPS and m-commerce applications	55	55
Setting up a shielded laboratory dedicated to the R&D of Bluetooth devices and purchase of related equipment (<i>Note 1</i>)	50	49
Upgrading the existing R&D facilities and equipment	15	15
On-going product development of GPS and m-commerce applications	10	10
On-going product development of digital healthcare devices (<i>Note 2</i>)	10	7
Enhancing sales and marketing efforts to further promote the Group's business	5	5
General working capital purposes	11	11
	<hr/>	<hr/>
Total	156	152
	<hr/> <hr/>	<hr/> <hr/>

Notes:

1. Due to the overall market conditions, Bluetooth products may take longer to fully penetrate into customer products market. The Group has taken a more cautious step in applying funds in this area, thus the application of the proceeds is a little bit slower than expected.
2. The development and testing of digital healthcare devices are slightly behind schedule, thus proceeds applied in this area is less than expected. The balance is expected to be used in the coming year when the products are expected to be ready for the market.

DIRECTORS' INTEREST IN SHARES AND OPTIONS

As at 30 September 2002, the interests of the Directors and their associates in the share capital of the Company and its associated corporations as required to be recorded in the register maintained under Section 29 of the Securities (Disclosure of Interests) Ordinance ("SDI Ordinance") of the Company or which required, pursuant to rules 5.40 to 5.49 of the GEM Listing Rules, to be notified to the Company and the Exchange were as follows:

A. Ordinary shares of HK\$0.10 each of the Company

Name	Type of interest	Number of shares	Percentage of issued share capital
Mr. Tsoi Siu Ching, Leo	Corporate (Note 1)	472,384,000	57.61%
Mr. Mak Kam Wah	Personal	3,814,000	0.47%
Mr. Tong Ka Ming, Patrick	Personal	3,000,000	0.37%

The Director's interest in Arcon Technology Limited, a subsidiary of the Group were as follows:

Name	Personal interests	Corporate interests	Total interests
Mr. Tsoi Siu Ching, Leo	10,250,000 Deferred Shares (Note 3)	5,000,000 Deferred Shares (Note 2 and 3)	15,250,000 Deferred Shares (Note 3)

The Director's interest in Satellite Devices Corporation, a subsidiary of the Group:

Name	Corporate interests	Total interests
Mr. Tsoi Siu Ching, Leo	387,888,000 Ordinary Shares (Note 4)	387,888,000 Ordinary Shares

Note 1: Mr. Tsoi Siu Ching, Leo held these shares through Upgrade Technology Limited, a company in which Mr. Tsoi Siu Ching, Leo holds 100% of its issued share capital.

Note 2: These deferred shares are held by Winland Nominees Limited as nominee of Mr. Tsoi Siu Ching, Leo.

Note 3: These deferred shares carry rights with regards to distribution of capital and voting as summarized in paragraph (j) under the subsection headed "Corporate reorganization" in the prospectus of the Company dated 8 August 2000.

Note 4: Mr. Tsoi Siu Ching, Leo held 57.61% of the issued share capital of the Company through Upgrade Technology Limited, a company which is wholly and beneficially owned by Mr. Tsoi Siu Ching, Leo. The Company is interested in 387,888,000 shares of Satellite Devices Corporation held by its wholly owned subsidiary Arcon Solutions (BVI) Limited.

Save as disclosed above, none of the Directors or their associates had any interests in the share capital of the Company or its associated corporations as defined in the SDI Ordinance.

B. Share options

The Company has adopted a Pre-IPO Share Option Plan (the "Plan") and a Share Option Scheme (the "Scheme") on 19 July 2000. Options to subscribe for an aggregate of 64,800,000 Shares at an exercise price HK\$1.18 have conditionally been granted by the Company on 20 July 2000 under the Plan & Scheme. The Options granted under the Scheme are exercisable at any time within 3 years from 16 August 2000 while the options granted under the Plan are exercisable at any time within 3 years after the expiry of 6 months from 16 August 2000. Each of these shall lapse in accordance with the Plan & Scheme if the relevant grantee ceases to be employed by the Group.

As at 30 September 2002, no other options has been granted under the Scheme and none of the options has been exercised. However options to subscribe for 3,600,000 has lapsed on 20 September 2002 and options to subscribe for 3,600,000 will lapse on 2 December 2002 as certain grantees have ceased to be employees of the Group. All options under the Plan & Scheme have been granted to each grantee in consideration for the payment of HK\$1.00. Particulars of the outstanding options granted to the Directors, the senior managers and certain employees of the Group are set out below:

Name	Pre-IPO Share Option Plan Number of underlying shares	Share Option Scheme
<i>Directors:</i>		
Mr. Mak Kam Wah	—	3,600,000
Mr. Tong Ka Ming, Patrick	—	3,600,000
Mr. Chu Ho Hwa, Howard	3,600,000	—
Mr. Wang Wei Hung	3,600,000	—
<i>Senior Management:</i>		
Mr. Tien Chang Lin	14,400,000	—
Mr. Cheng Lee Lung	7,200,000	—
Ms. Ho Kwan Yin	—	14,400,000
Mr. Ching Man Leuk	—	3,600,000
Mr. Lee Lai Shing	—	3,600,000

SUBSTANTIAL SHAREHOLDERS

As at 30 September 2002, according to the register of substantial shareholders maintained under section 16(1) of the SDI Ordinance, the following person is interested in 10% or more of the Company's issued share capital:

Name	Number of shares	Percentage of issued share capital
Upgrade Technology Limited (<i>Note 1</i>)	472,384,000	57.61%

Note 1: Mr. Tsoi Siu Ching, Leo held these shares through Upgrade Technology Limited, a company in which Mr. Tsoi Siu Ching, Leo holds 100% of its issued share capital.

COMPETING INTERESTS

None of the Directors or the management shareholders of the Company (as defined in the GEM Listing Rules) has an interest in a business which competes or may compete with the business of the Group.

SPONSOR'S INTERESTS

As updated and notified by the Company's sponsor, ICEA Capital Limited (the "Sponsor"), as at 30 September 2002, an employee of the Sponsor not involved in providing advice to the Company held 30,000 shares in the Company. In addition, an employee of the Sponsor not involved in providing advice to the Company held 3,000 shares in the Satellite Devices Corporation, a subsidiary of the Group.

Save as disclosed above, neither the Sponsor nor its directors or employees or associates (as referred to in Note 3 to Rule 6.35 of the GEM Listing Rules) had any interests in the securities of the Company or any member of the Group or any rights to subscribe for or to nominate persons to subscribe for the securities of the Company or any member of the Group.

Pursuant to the sponsorship agreement dated 7 August 2000 entered into between the Company and the Sponsor, the Sponsor will receive sponsorship fees for acting as the Company's retained sponsor until 31 March 2003.

PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

During the six months ended 30 September 2002, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

AUDIT COMMITTEE

As required by Rules 5.23 to 5.25 of the GEM Listing Rules, the Company established an audit committee with written terms of reference which deal clearly with its authority and duties. The primary duties of the audit committee are to review and supervise the financial reporting process and internal control of the Group.

By Order of the Board
Tsoi Siu Ching, Leo
Chairman

Hong Kong, 1 November 2002