



SMS

PDA

AV PRODUCTS

WIRELESS PRODUCTS

TFT TV

LCD

Third Quarterly 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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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.

THIRD QUARTER RESULTS (UNAUDITED)

The Board of Directors (the “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 nine months and three months ended 31 December 2002, together with the comparative unaudited figures for the corresponding periods in 2001 (the “Relevant Periods”) as follows:

| | | Nine months ended 31 December | | Three months ended 31 December | |
|--|------|----------------------------------|------------|-----------------------------------|------------|
| | | 2002 | 2001 | 2002 | 2001 |
| | Note | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Turnover | 2 | 567,914 | 353,447 | 179,441 | 118,479 |
| Cost of sales | | (458,527) | (234,617) | (146,665) | (78,884) |
| Gross profit | | 109,387 | 118,830 | 32,776 | 39,595 |
| Other revenues | 2 | 636 | 483 | 196 | 93 |
| Selling and distribution expenses | | (7,631) | (8,272) | (1,707) | (2,784) |
| General and administrative expenses | | (54,868) | (37,886) | (18,098) | (13,775) |
| Disposal of fixed assets | | (821) | — | (821) | — |
| Operating profit | 3 | 46,703 | 73,155 | 12,346 | 23,129 |
| Finance costs | 5 | (4,934) | (2,215) | (2,122) | (981) |
| Profit before taxation | | 41,769 | 70,940 | 10,224 | 22,148 |
| Taxation | 6 | (8,000) | (12,175) | (2,190) | (4,054) |
| Profit after taxation | | 33,769 | 58,765 | 8,034 | 18,094 |
| Minority interests | | (21) | — | 842 | — |
| Profit attributable to shareholders | | 33,748 | 58,765 | 8,876 | 18,094 |
| Interim dividend per share | | 1.05 cents | 2.00 cents | 0.20 cent | 0.50 cent |
| Earnings per share - basic | 7 | 4.17 cents | 8.16 cents | 1.08 cents | 2.51 cents |

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 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 location-based technology devices and applications ("GPS") in Hong Kong. Revenues recognised during the Relevant Periods are as follows:

| | Nine months ended | | Three months ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | 31 December | | 31 December | |
| | 2002 | 2001 | 2002 | 2001 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| Turnover | | | | |
| Sales of goods at invoiced value, net of returns and discounts | 553,926 | 332,763 | 174,489 | 108,383 |
| Royalty income | 13,988 | 20,684 | 4,952 | 10,096 |
| | <u>567,914</u> | <u>353,447</u> | <u>179,441</u> | <u>118,479</u> |
| Other revenues | | | | |
| Interest income | 479 | 250 | 112 | 24 |
| Software and internet service income | 157 | 233 | 84 | 69 |
| | <u>636</u> | <u>483</u> | <u>196</u> | <u>93</u> |
| Total revenues | <u><u>568,550</u></u> | <u><u>353,930</u></u> | <u><u>179,637</u></u> | <u><u>118,572</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 For the nine months ended 31 December 2002 HK\$'000 | Sales of software and engineering solutions excluding GPS For the nine months ended 31 December 2001 HK\$'000 | Sales of GPS For the nine months ended 31 December 2002 HK\$'000 | Sales of GPS For the nine months ended 31 December 2001 HK\$'000 | Group For the nine months ended 31 December 2002 HK\$'000 | Group For the nine months ended 31 December 2001 HK\$'000 |
|-------------------------------------|--|--|---|---|--|--|
| Turnover | <u>510,779</u> | <u>330,938</u> | <u>57,135</u> | <u>22,509</u> | <u>567,914</u> | <u>353,447</u> |
| Segment results | <u>46,660</u> | <u>76,247</u> | <u>43</u> | <u>(3,092)</u> | 46,703 | 73,155 |
| Finance costs | | | | | <u>(4,934)</u> | <u>(2,215)</u> |
| Profit before taxation | | | | | 41,769 | 70,940 |
| Taxation | | | | | <u>(8,000)</u> | <u>(12,175)</u> |
| Profit after taxation | | | | | 33,769 | 58,765 |
| Minority interests | | | | | <u>(21)</u> | <u>—</u> |
| Profit attributable to shareholders | | | | | <u>33,748</u> | <u>58,765</u> |

3. Operating profit

Operating profit is stated after charging the following:

| | For the nine months ended 31 December 2002 HK\$'000 | For the nine months ended 31 December 2001 HK\$'000 |
|----------------------------------|--|--|
| Depreciation: | | |
| Owned fixed assets | 15,094 | 9,417 |
| Leased fixed assets | 285 | 263 |
| Loss on disposal of fixed assets | 821 | — |
| | <u>16,200</u> | <u>9,680</u> |

4. Staff costs

| | For the nine months ended 31 December 2002 HK\$'000 | For the nine months ended 31 December 2001 HK\$'000 |
|--|--|--|
| Basic salaries, allowances and other benefits in kind | 22,302 | 17,781 |
| Retirement scheme contributions | 473 | 489 |
| | <u>22,775</u> | <u>18,270</u> |

5. Finance costs

| | Nine months ended 31 December | | Three months ended 31 December | |
|--|--|-----------------|---|-----------------|
| | 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 | 4,878 | 2,159 | 2,104 | 962 |
| Interest element of finance leases | 56 | 56 | 18 | 19 |
| | <u>4,934</u> | <u>2,215</u> | <u>2,122</u> | <u>981</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 nine months ended 31 December 2002 is based on the Group's profit attributable to shareholders of approximately HK\$33,748,000 (2001: HK\$58,765,000) and 809,818,182 shares (2001: 720,000,000 shares) in issue during the period.

The calculation of basic earnings per share for the three months ended 31 December 2002 is based on the Group's profit attributable to shareholders of approximately HK\$8,876,000 (2001: HK\$18,094,000) 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. Movement of reserves

| | Share premium <i>HK\$'000</i> | Merger reserve <i>HK\$'000</i> | Exchange reserve <i>HK\$'000</i> | Retained earnings <i>HK\$'000</i> | Total <i>HK\$'000</i> |
|--|-------------------------------------|--------------------------------------|--|---|--------------------------|
| At 1 April 2002 | 74,242 | 20,943 | (122) | 170,413 | 265,476 |
| Issue of shares pursuant to placing | 113,000 | — | — | — | 113,000 |
| Share issuing expenses | (3,855) | — | — | — | (3,855) |
| Profit attributable to shareholders | — | — | — | 33,748 | 33,748 |
| 2002 Final dividend | — | — | — | (8,200) | (8,200) |
| 2003 Interim dividend | — | — | — | (6,970) | (6,970) |
| 2003 Proposed interim dividend | — | — | — | (1,640) | (1,640) |
| Exchange differences | — | — | (119) | — | (119) |
| | <u>183,387</u> | <u>20,943</u> | <u>(241)</u> | <u>187,351</u> | <u>391,440</u> |
| At 31 December 2002 | <u>183,387</u> | <u>20,943</u> | <u>(241)</u> | <u>187,351</u> | <u>391,440</u> |
| At 1 April 2001 | 84,737 | 20,943 | (99) | 128,001 | 233,582 |
| Profit attributable to shareholders | — | — | — | 58,765 | 58,765 |
| 2001 Final dividend | — | — | — | (10,800) | (10,800) |
| 2002 Interim dividend | — | — | — | (10,800) | (10,800) |
| 2002 Proposed interim dividend | — | — | — | (3,600) | (3,600) |
| Exchange differences | — | — | (330) | — | (330) |
| | <u>84,737</u> | <u>20,943</u> | <u>(330)</u> | <u>161,566</u> | <u>266,817</u> |
| At 31 December 2001 | <u>84,737</u> | <u>20,943</u> | <u>(429)</u> | <u>161,566</u> | <u>266,817</u> |

INTERIM DIVIDENDS

The Board recommends the payment of an interim dividend of HK0.20 cent per share for the three months ended 31 December 2002 (2001: HK0.50 cent). The dividend will be payable on Wednesday, 12 March 2003 to shareholders whose names appear on the Register of Members of the Company at the close of business on Monday, 3 March 2003. Together with interim dividends of HK0.85 cent per share for the six months ended 30 September 2002 paid to the shareholders on 23 August 2002 and 27 November 2002, total dividends for the nine months ended 31 December 2002 amounted to HK1.05 cents per share.

CLOSURE OF REGISTER OF MEMBERS

The Register of Members of the Company will be closed from Saturday, 1 March 2003 to Monday, 3 March 2003, 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 31 December 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, 28 February 2003.

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Performance

For the nine-month period ended 31 December 2002, the Group continued to operate under increasingly difficult market conditions, and in particular, experienced a weaker than expected holiday buying season and faced strong pricing pressures. During the period under review, the Group's unaudited consolidated turnover and profit attributable to shareholders are HK\$567.9 million (2001: HK\$353.4 million) and HK\$33.8 million and (2001: HK\$58.8 million) respectively. There is 60.7% increase in turnover with a 42.6% decline in profit attributable to shareholders over the corresponding period last year.

The increase in turnover was attributable to the continuous shifting of the product mix of the solutions towards the fast-moving consumer electronics and audio/visual products. The decline in profit attributable to shareholders is due to decrease in gross profit margin.

Gross profit was 18.3% and 19.3% respectively for the three and nine months period under review. The decline in gross profit is mainly caused by the keen competition in the global 3C products market and the relatively lower profit margin for our audio/visual product solutions shipped during the period under review.

General and administrative expenses decreased by 10% as compared with the last quarter because of the adoption of the new operation plan, which streamlined the operations and efficiently allocated resources.

Business Review

During the period under review, the Group faced severe challenges. These challenges included weak global economies, continuous weakening consumer spending in high-end 3C products and in particular, increasingly fierce competition in the 3C products industry and the dominance of low-end and/or basic functionalities products. Marketers were adopting aggressive pricing strategies to bolster sales and conservative attitude towards inventories. During the period, due to the lack of new product launch in high-end consumer electronics and weak demand in consumer communication and IT products, the overall 3C product market was dominated by low-end products with basic functions and features in similar quality with intensified competition among marketers, which exerted strong pressure on the gross profit margin of the Group's embedded software and turnkey device solutions business. Although, the retail sales during the U.S. holiday shopping season was rather disappointing, most major U.S. retail outlets reported that consumer electronics was still one of the strongest categories for the December sales.

Combinations of these factors negatively impacted gross profit margin for the period under review. However, this was to some extent compensated by the strong growth in the turnover of the audio-visual and fast moving consumer electronics products such as DVD players, MP3, flat-panel display TV and digital still cameras ... etc. In addition, the Group was subjected to a one off charge on the relocation of the Group's Hong Kong office in October and restructuring expenses to realign the Group's structure. All in all, the profit attributable to shareholders dropped by 42.6% from the last corresponding period. During the period under review the Group implemented a number of risk management measures, adopted rigorous cost and credit control policies and strengthened the management to monitor its operations.

The Group took an important step in account receivable management to reduce the credit risk on account receivables by covering the risk with credit insurance policy. Since October, over 50% of the newly generated sales/account receivables were covered by credit insurance policy. At the same time, the management has set up a special team to carry out systematic credit assessment on all its customers and to closely monitor their payment records.

The management also realigned the organizational structure of the Group and adopted a new operational plan, which streamlined the operation and increased the operational efficiency.

PROSPECTS

Looking ahead into the last quarter of the financial year, there are still uncertainties with the global economy. The outlook for the global 3C products industry remains bleak. In addition, as mentioned in the interim report, the 3C products industry has just entered into a cyclical downturn. In order to meet the challenges arising from the weak demand for high-end products, increasingly intensified competition amongst industry players and pricing pressure on all level of the industry and to take advantage of new opportunities, the Group will prepare itself and to lay foundation for the Group's long-term development by repositioning and realigning its existing businesses to focus more on turnkey device solutions on broad based products and targeting China as a key growth market.

On product launches, sales and marketing, the Group will start launching the newly developed turnkey device solutions for flat-panel display devices including TFT-LCD TV and Plasma TV in the coming quarter. In addition, the Group will also launch its first group of IEEE 802.11b and/or Wi-Fi devices, which include, headset, Wi-Fi PC card and USB-dongle. On the product development side, the Group will adjust its short-term product development strategies to focus more on fast moving consumer items such as audio-visual products, Wi-Fi devices and simple digital devices. Although, in general, these items command a relatively lower profit margin, the volume of such fast moving items will compensate the effect of the lowered margin. The Group's new turnkey device solutions for flat-panel display products such as TFT-LCD TV and Plasma TV are also expected to help to improve the overall gross profit margin in the coming quarter. In addition, the Group is also studying the Chinese mobile handset market. As such market is growing at a fast pace and creating space for new entrants, the Group has plans to develop turnkey device solutions for mobile handsets for the new entrants.

On the management side, the Group will continue to strengthen its marketing network, tighten its control on operating costs and the credit limit and turnover of accounts receivable. Although, in the near-term the gross profit margin of the Group's embedded software solutions and turnkey device solutions businesses will be inevitably under pressure. Nonetheless, we strongly believe that the management team is making the right moves to secure the long-term growth and position itself for meeting the bigger challenges ahead.

DIRECTORS' INTEREST IN SHARES AND OPTIONS

As at 31 December 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% |

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

| Name | Personal Interests | Corporate Interests | Corporate 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 of 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 31 December 2002, no other options has been granted under the Scheme and none of the options has been exercised. However, options to subscribe for 7,200,000 shares lapsed on 20 September 2002 and 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 | Share Option Scheme |
|---------------------------------------|--|------------------------------------|
| | <i>Number of underlying shares</i> | |
| <i>Directors:</i> | | |
| Mr. Mak Kam Wah | — | 3,600,000 |
| Mr. Chu Ho Hwa, Howard | 3,600,000 | — |
| Mr. Wang Wei Hung | 3,600,000 | — |
| <i>Senior Management:</i> | | |
| The estate of late 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 |
| Mr. Tong Ka Ming, Patrick | — | 3,600,000 |

SUBSTANTIAL SHAREHOLDERS

As at 31 December 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 31 December 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 nine months ended 31 December 2002, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

AUDIT COMMITTEE

The Company has established an audit committee with written terms of reference in compliance with Rules 5.23 to 5.25 of the GEM Listing Rules. 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, 12 February 2003