Artel Group
宏 通 集 團

ARTEL SOLUTIONS GROUP HOLDINGS LIMITED
宏通集團控股有限公司*

(Incorporated in the Cayman Islands with limited liability)
(Stock code: 931)

2005 INTERIM RESULTS

RESULTS

The board of directors (the "Board") of Artel Solutions Group Holdings Limited (the "Company") is pleased to announce the unaudited consolidated interim results of the Company and its subsidiaries (the "Group") for the six months ended 30 June 2005 (the "Period") together with the comparative figures for the previous corresponding period prepared in accordance with generally accepted accounting principles in Hong Kong.

CONDENSED CONSOLIDATED INCOME STATEMENT

	Notes	Six months ended 30 June 2005 HK$'000 (Unaudited)	2004 HK$'000 (Unaudited)
Turnover	3	**853,792**	830,283
Cost of sales		**(811,408)**	(785,023)
Gross profit		**42,384**	45,260
Other operating income		**6,381**	2,891
Distribution costs		**(3,010)**	(4,288)
Administrative expenses		**(13,390)**	(16,372)
Profit from operations	4	**32,365**	27,491
Finance costs		**(9,190)**	(6,046)
Share of results of associates		**13**	–
Impairment loss recognised in respect of goodwill of associates	5	**(10,605)**	–
Profit before taxation		**12,583**	21,445
Taxation	6	**(4,185)**	(398)
Profit for the period attributable to equity shareholders of the Company		**8,398**	21,047
Dividend	7	**–**	7,200
Earnings per share (HK cents)			
Basic	8	**0.5**	1.3
Diluted	8	**0.5**	1.3

CONDENSED CONSOLIDATED BALANCE SHEET

	Notes	30 June 2005 HK$'000 (Unaudited)	31 December 2004 HK$'000 (Audited)
Non-current assets			
Plant and equipment		**9,995**	11,353
Interests in associates		**4,935**	14,653
		14,930	26,006
Current assets			
Inventories		**319,425**	361,288
Trade receivables, prepayments and deposits	9	**523,116**	452,473
Taxation recoverable		**7,081**	10,532
Pledged bank deposits		**88,956**	67,493
Bank balances and cash		**8,382**	50,753
		946,960	942,539
Current liabilities			
Trade payables, sales deposits and accrued charges	10	**87,339**	97,839
Bank overdrafts and short-term bank borrowings		**397,329**	387,487
Derivative financial instruments		**271**	–
		484,939	485,326
Net current assets		**462,021**	457,213
Total assets less current liabilities		**476,951**	483,219
Capital and reserves			
Share capital		**16,000**	16,000
Reserves		**444,251**	435,853
Equity attributable to equity shareholders of the Company		**460,251**	451,853
Non-current liabilities			
Long-term bank borrowings		**15,400**	30,800
Deferred taxation		**1,300**	566
		16,700	31,366
		476,951	483,219

NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS

1. **Basis of preparation**

The condensed financial statements have been prepared in accordance with the applicable disclosure requirements set out in Appendix 16 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and with Hong Kong Accounting Standard 34 "Interim Financial Reporting".

2. **Principal accounting policies**

The condensed financial statements have been prepared under the historical cost basis except for certain financial instruments which are measured at fair value.

The accounting policies used in the condensed financial statements are consistent with those followed in the preparation of the Group's annual audited financial statements for the year ended 31 December 2004 except as described below:

In the current period, the Group has applied, for the first time, a number of new Hong Kong Financial Reporting Standards ("HKFRSs"), Hong Kong Accounting Standards ("HKASs") and Interpretations (hereinafter collectively referred to as "new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants that are effective for accounting periods beginning on or after 1 January 2005.

The application of the new HKFRSs has resulted in a change in the presentation of the income statement, balance sheet and the statement of changes in equity. The changes in presentation have been applied restrospectively. The adoption of the new HKFRSs has resulted in changes to the Group's accounting policies in the following areas that have an effect on how the results for current or prior accounting periods are prepared and presented.

HKFRS 2	Share-based Payment
HKFRS 3	Business Combinations
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 39	Financial Instruments: Recognition and Measurement

The Group has not early applied the following new Standards or Interpretations ("Int") that have been issued but are not yet effective. The directors anticipate that the application of these Standards or Interpretations will have no material impact on the financial statements of the Group.

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
HKFRS 6	Exploration for and Evaluation of Mineral Resources
HKFRS-Int 4	Determining whether an Arrangement contains a Lease
HKFRS-Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds

3. **Segment information**

Business segments

The Group's primary format for reporting segment information is business segments:

Six months ended 30 June 2005:

	Distribution of computer components and information technology products HK$'000 (Unaudited)	Provision of integrated e-enabling solutions HK$'000 (Unaudited)	Consolidated HK$'000 (Unaudited)
TURNOVER			
External sales	**823,736**	**30,056**	**853,792**
SEGMENT RESULT	**23,341**	**4,539**	**27,880**
Other operating income			**6,381**
Unallocated corporate expenses			**(1,896)**
Profit from operations			**32,365**
Finance costs			**(9,190)**
Share of results of associates			**13**
Impairment loss recognised in respect of goodwill of associates			**(10,605)**
Profit before taxation			**12,583**
Taxation			**(4,185)**
Profit for the period attributable to equity shareholders of the Company			**8,398**

Six months ended 30 June 2004:

	Distribution of computer components and information technology products HK$'000 (Unaudited)	Provision of integrated e-enabling solutions HK$'000 (Unaudited)	Consolidated HK$'000 (Unaudited)
TURNOVER			
External sales	803,445	26,838	830,283
SEGMENT RESULT	27,563	804	28,367
Other operating income			2,891
Unallocated corporate expenses			(3,767)
Profit from operations			27,491
Finance costs			(6,046)
Profit before taxation			21,445
Taxation			(398)
Profit for the period attributable to equity shareholders of the Company			21,047

Geographical segments

	Six months ended 30 June 2005 HK$'000 (Unaudited)	2004 HK$'000 (Unaudited)
Turnover by geographical market		
The People's Republic of China (the "PRC")	**701,128**	519,236
Hong Kong	**152,664**	311,047
	853,792	830,283

4. **Profit from operations**

	Six months ended 30 June 2005 HK$'000 (Unaudited)	2004 HK$'000 (Unaudited)
Profit from operations has been arrived at after charging (crediting):		
Allowance for inventories	**10,379**	–
Depreciation of plant and equipment	**1,485**	513
Interest income	**(2,906)**	(301)
Share of tax of associates included in share of results of associates	**4**	–

* *For identification purpose only*

5. **Impairment loss recognised in respect of goodwill of associates**

Due to the changes in current market condition and probable future volatility, the Group has taken a prudent step to revise its cash flow forecasts for the associates. The goodwill included in interests in associates has therefore been reduced to its estimated recoverable amount through recognition of an impairment loss of HK$10,605,000.

The recoverable amount of the goodwill included in interests in associates are determined from value in use calculations.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management. The rate used in discounting the forecast cash flows from the associates is 5.2%.

6. **Taxation**

	Six months ended 30 June	
	2005	2004
	HK$'000	*HK$'000*
	(Unaudited)	(Unaudited)
The charge comprises:		
Hong Kong Profits Tax:		
Current year	**3,451**	398
Deferred tax	**734**	–
Taxation attributable to the Company and its subsidiaries	**4,185**	398

Hong Kong Profits Tax is calculated at 17.5% (2004: 17.5%) of the estimated assessable profit for the period.

No provision for taxation has been made in respect of the Company's subsidiaries operating in other jurisdictions as they did not have assessable profits for both periods.

7. **Dividends**

The directors do not recommend the payment of an interim dividend for the six months ended 30 June 2005 (2004: HK0.45 cent per share).

8. **Earnings per share**

The calculation of the basic earnings per share for the period is based on the net profit for the period of HK$8,398,000 (2004: HK$21,047,000) and on the 1,600,000,000 (2004: 1,600,000,000) shares in issue.

The calculation of the diluted earnings per share is based on the net profit for the period of HK$8,398,000 (2004: HK$21,047,000) and on 1,600,000,000 (2004: weight average of 1,606,283,400) shares in issue and issuable on the assumption that the outstanding options are exercised on the date on which they are granted.

The computation of diluted earnings per share in 2005 does not assume the exercise of the Company's outstanding share options as the exercise price of those options is higher than the average market price for shares during the period.

9. **Trade receivables, prepayments and deposits**

The credit terms of the Group range from 30 to 180 days. The aged analysis of trade receivables at the reporting date is as follows:

	30 June 2005	31 December 2004
	HK$'000	*HK$'000*
	(Unaudited)	(Audited)
Aged:		
0 to 30 days	**102,797**	114,548
31 to 60 days	**123,640**	62,355
61 to 90 days	**87,312**	65,310
91 to 180 days	**206,894**	207,238
Total trade receivables	**520,643**	449,451
Prepayments, deposits and other receivables	**2,473**	3,022
	523,116	452,473

10. **Trade payables, sales deposits and accrued charges**

The aged analysis of trade payables at the reporting date is as follows:

	30 June 2005	31 December 2004
	HK$'000	*HK$'000*
	(Unaudited)	(Audited)
0 to 30 days	**81,308**	88,480
31 to 60 days	**–**	–
61 to 90 days	**–**	–
over 90 days	**1,007**	561
Total trade payables	**82,315**	89,041
Sales deposits	**89**	3,483
Accrued charges	**4,935**	5,315
	87,339	97,839

MANAGEMENT DISCUSSION AND ANALYSIS

Business review

For the six months ended 30 June 2005, the Group's turnover rose 3% to HK$854 million while net profit dropped 60% to HK$8.4 million.

During the period under review, distribution of central processing units ("CPU") was still the Group's main revenue. Together with other computer components, these products contributed 96% of our total turnover. The provision of integrated e-enabling solutions business accounted for the other 4%.

As distribution of Intel's CPU is the Group's main business, we always pay heed to the results and contribution of this core business. In the first half of 2005, it was hardly to boost the sales of CPU. Nevertheless, despite the adverse situation, the Group still achieved a similar takings as last corresponding period in this category. A steady turnover was recorded with a slight increase from HK$803 million to HK$824 million for the period under review.

In retrospect, there was an over-supply of thin film transistor liquid crystal display ("LCD") panels in 2004. Prices were dwindling throughout the year and we were able to procure enough LCD panels for our business. On the contrary, during the reviewed period, the supply of LCD panels was relatively tight and as a result we were far from easy to get sufficient LCD panels for distribution. Moreover, coupled with price competition in the Mainland China, revenue from LCD products was to some extent affected and dropped 28% to HK$88 million.

Provision of integrated e-enabling solutions is the Group's fast-growing business, including Digital Home and Digital Enterprise solutions just penetrated into the Mainland China. Its turnover grew 12% for the reporting six-month period. To support the solutions business, we have set up 17 customer service centers and strategically located them in different major cities in the Mainland China. These service centers directly provide technical solutions to business and individual customers. Their proximity to major cities of the Mainland China also drives up our market share and customer base, which in turn helps boost the sales of computer components.

The Group has been constantly reviewing the distribution processes and procedures, and maintaining an optimum inventory level to achieve favourable order fill rates. During the period under review, with the similar turnover level, we were able to cut down our inventory level by 7% at the period end. This achievement helped reduce relevant operating costs, such as inventory insurance and warehouse rent.

The Group acquired 30% of issued share capital of a well-established logistics company in Hong Kong in June 2004. This investment paid off as we have been fully utilising the logistics facilities of this associated company. The Group's distribution costs were considerably lower under the reviewed period and the cost reduction directly improved the overall operating margins.

Financial review

The Group's turnover for the six months ended 30 June 2005 amounted to HK$854 million, increased 3% when comparing with last year's HK$830 million. CPU and other computer components sales increased 3% to HK$824 million while revenue from provision of integrated e-enabling solutions rose 12% to HK$30 million.

The Group's gross margin recorded a decrease from 5.5% to 5.0% for the six months ended 30 June 2005.

The Group successfully implemented effective cost control measures. Compared with last corresponding period, the distribution costs and administrative expenses for the reporting period were HK$4 million less.

During the period under review, the Group entered into several forward contracts and recorded an income of HK$3 million.

The savings in operating costs and gain on forward contracts improved the overall operating profit. However, the advancement in operating profit was offset. Due to the changes in current market condition and probable future volatility, the Group has taken a prudent step to revise its cash flow forecasts for the associates. The goodwill included in interests in associates has therefore been reduced to its estimated recoverable amount through recognition of an impairment loss of HK$10.6 million. As a result, net profit for the period was down 60% to HK$8.4 million and net margin decreased from 2.5% to 1.0%.

Interest rate has been increasing since second quarter of 2005. During the reviewed period, finance costs were inevitably affected and increased by HK$3 million.

Liquidity and financial resources

The Group's current assets and current liabilities as at 30 June 2005 were HK$947 million and HK$485 million, respectively (31 December 2004: HK$943 million and HK$485 million, respectively). The current ratio was 2.0 as at 30 June 2005, which was almost the same as the ratio as at 31 December 2004.

As at 30 June 2005, the Group's cash and bank deposits, including pledged bank deposits, amounted to HK$97 million (31 December 2004: HK$118 million). Total utilised banking facilities at the period end were HK$413 million while the figure was HK$418 million as at 31 December 2004. The gearing ratio, calculated as a ratio of total bank loans to total assets, was 43% as at both 30 June 2005 and 31 December 2004.

Transactions of the Group are mainly denominated either in Hong Kong dollar or United States dollar. The risk of exposure to fluctuations in exchange rates is therefore low.

Prospects

The traditional information technology distribution industry continues to undergo changes due to a number of factors. As margins have narrowed on hardware and software products, suppliers and resellers have gone through a transition from a product-focused to a more solution-oriented business model. Reseller customers adjust their business models from selling products to selling solutions, however, they still continue to depend on our services, such as products and services, marketing, credit and technical support. As a value-added solutions provider, the Group plans to expand more solutions service centers in order to widen geographic reach in the PRC and respond with more enhanced value-added solutions and services that customized to the needs of our customers. We believe that the Group is able to enlarge our solutions business in original equipment manufacturer ("OEM") market and consumer electronic ("CE") market and enhance the profitability under our efficient channel management and customer satisfaction.

In respect of LCD product line, LCD design-in television ("TV") is still the fastest growing segment of LCD products. In view of the enormous potential in LCD TV market in the PRC, the Group actively seeks more new digital technology suppliers in order to meet the robust demand for LCD products in the huge PRC market. In the third quarter of 2005, the Group successfully obtained the distribution rights of LCD products in the PRC and Hong Kong from上海廣電集團銷售有限公司, a manufacturer of new photoelectron display products, such as LCD TVs and LCD panels, as well as a provider of network and information services and whose holding company, SVA Group Co., Ltd. ("SVA"), is listed on the Shanghai Stock Exchange. The cooperation with SVA will strengthen our LCD product line supply chain which can enable us to meet the customers inventory needs in OEM market and CE market. The boost in turnover will also leverage economies of scale and maximise profit as well.

The Group continuously improves its operations by enhancing capabilities while reducing costs to provide a more efficient flow of products and services. The Group has expanded the development in the vertical industry, that is, the logistics industry, which did and will benefit us from inventory consolidation and providing on-time delivery to our customers that allows us costs saving and improving customer service levels simultaneously. Additionally, the Group strives to create an optimal cost structure for our business through process improvements, leveraging economies of scale and cultivating a strong and capable workforce.

INTERIM DIVIDEND

The directors do not recommend the payment of an interim dividend in respect of the six months ended 30 June 2005.

EMPLOYEES

As at 30 June 2005, the Group had about 70 full time employees. The Group remunerated its employees mainly based on industry practice and individual's performance and experience. Apart from the basic remuneration, discretionary bonus and share option may be granted to eligible employees by reference to the Group's performance as well as individual's performance. Other benefits include medical and retirement schemes.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

The Company has not redeemed any of its listed securities during the period. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's listed securities during the period.

AUDIT COMMITTEE

The principal activities of the Audit Committee include the review and supervision of the Group's financial reporting process and internal controls. The Audit Committee has reviewed the financial statements of the Group for the six months ended 30 June 2005.

The Audit Committee comprises three independent non-executive directors, namely Dr. Liu James Juh, Ms. Hu Gin Ing and Mr. Yim Hing Wah.

CORPORATE GOVERNANCE

The Company has complied with all Code Provisions of the Code of Corporate Governance Practices as set out in Appendix 14 of the Listing Rules throughout the six months ended 30 June 2005 except for the following deviations:

1. The positions of chairman and chief executive officer of the Company are held by Mr. Yu Pen Hung. The Board believes that the holding both the positions of chairman and chief executive officer with the same person allows for more effective planning and execution of business strategies. Also, Mr. Yu possesses extensive valuable experience that is essential for the Group's operations. The Board has full confidence in Mr. Yu and believes that his dual roles will be beneficial to the Company.
2. Independent non-executive directors of the Company are not appointed for specific terms but they are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the Articles of Association of the Company.
3. Directors of the Company do not retire by rotation at least once every three years. However, pursuant to the Articles of Association of the Company, one-third of the directors for the time being (or if their number is not a multiple of three, the number nearest to but not greater than one-third) should retire from office by rotation and be eligible for re-election at the annual general meeting of the Company.
4. At the end of the reporting period, a Remuneration Committee has not yet been established. The directors are prepared to set up a Remuneration Committee with written terms of reference in the second half of 2005.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted the Model Code for Securities Transactions by Directors (the "Model Code") as set out in Appendix 10 of the Listing Rules. Having made specific enquiry of all directors, they have confirmed that they complied with the required standards as set out in the Model Code during the six months ended 30 June 2005.

REVIEW OF INTERIM RESULTS

The unaudited interim results of the Group for the six months ended 30 June 2005 have been reviewed by the Audit Committee and the Company's auditors, Deloitte Touche Tohmatsu.

BOARD OF DIRECTORS

As at the date of this announcement, the directors of the Company comprise two executive directors, namely, Mr. Yu Pen Hung and Mr. Yen Chung Chuan, and three independent non-executive directors, namely, Dr. Liu James Juh, Ms. Hu Gin Ing and Mr. Yim Hing Wah.

On behalf of the Board
YU Pen Hung
Chairman

Hong Kong, 23 September 2005