ArtsGroup

# ARTS OPTICAL INTERNATIONAL HOLDINGS LIMITED

# 雅視光學集團有限公司*

*(Incorporated in Bermuda with limited liability)*

**(Stock Code: 1120)**

## INTERIM RESULTS
## FOR THE SIX MONTHS ENDED 30TH JUNE, 2006

### INTERIM RESULTS

The board of directors (the "Board") of Arts Optical International Holdings Limited (the "Company") is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (together, the "Group") for the six months ended 30th June, 2006 together with comparative figures for the corresponding period in 2005.

### CONDENSED CONSOLIDATED INCOME STATEMENT

| | Notes | Six months ended 30.6.2006 HK$'000 (unaudited) | 30.6.2005 HK$'000 (unaudited) |
|---|---|---|---|
| Turnover | 3 | **509,242** | 375,618 |
| Cost of sales | | **(354,682)** | (266,027) |
| Gross profit | | **154,560** | 109,591 |
| Other income | | **9,671** | 5,296 |
| Distribution costs | | **(24,183)** | (15,314) |
| Administrative expenses | | **(56,793)** | (43,537) |
| Other expenses | | **(8,168)** | (602) |
| Finance costs | 4 | **–** | (15) |
| Profit before taxation | | **75,087** | 55,419 |
| Taxation | 5 | **(9,280)** | (6,482) |
| Profit for the period | 6 | **65,807** | 48,937 |
| Attributable to: | | | |
| Equity holders of the parent | | **67,441** | 49,037 |
| Minority interests | | **(1,634)** | (100) |
| | | **65,807** | 48,937 |
| Dividend paid | 7 | **26,856** | 34,122 |
| Earnings per share | 8 | | |
| – Basic | | **17.6 HK cents** | 12.9 HK cents |
| – Diluted | | **N/A** | 12.8 HK cents |

### CONDENSED CONSOLIDATED BALANCE SHEET

| | As at 30.6.2006 HK$'000 (unaudited) | 31.12.2005 HK$'000 (audited) (restated) |
|---|---|---|
| **Non-current Assets** | | |
| Investment property | **3,600** | 3,600 |
| Property, plant and equipment | **299,128** | 254,745 |
| Prepaid lease payments | **25,873** | 40,598 |
| Deposits paid for property, plant and equipment | **5,962** | 4,064 |
| Intangible assets | **4,680** | – |
| Loan receivable | **16,352** | 17,589 |
| Goodwill | **1,274** | 1,274 |
| Available-for-sale investments | **13,358** | 13,358 |
| Deferred tax assets | **53** | 53 |
| | **370,280** | 335,281 |
| **Current Assets** | | |
| Inventories | **169,995** | 162,300 |
| Debtors, deposits and prepayments | **263,496** | 244,321 |
| Loan receivable | **2,248** | 2,262 |
| Prepaid lease payments | **634** | 972 |
| Taxation recoverable | **106** | 263 |
| Bank balances and cash | **81,154** | 65,006 |
| | **517,633** | 475,124 |
| Asset classified as held for sale | **17,773** | – |
| | **535,406** | 475,124 |
| **Current Liabilities** | | |
| Creditors and accrued charges | **211,293** | 170,206 |
| Taxation payable | **7,884** | 425 |
| | **219,177** | 170,631 |
| **Net Current Assets** | **316,229** | 304,493 |
| **Total Assets less Current Liabilities** | **686,509** | 639,774 |
| **Capital and Reserves** | | |
| Share capital | **38,365** | 38,365 |
| Reserves | **631,178** | 584,844 |
| Equity attributable to equity holders of the parent | **669,543** | 623,209 |
| Minority Interests | **1,622** | 3,256 |
| **Total Equity** | **671,165** | 626,465 |
| **Non-current Liabilities** | | |
| Deferred tax liabilities | **14,609** | 13,309 |
| Loans from minority shareholders | **735** | – |
| | **15,344** | 13,309 |
| | **686,509** | 639,774 |

### NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**1. BASIS OF PREPARATION**

The condensed consolidated financial statements have been prepared in accordance with the applicable disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

**2. PRINCIPAL ACCOUNTING POLICIES**

The condensed consolidated financial statements have been prepared on the historical cost basis except for investment property which is measured at fair value.

The accounting policies used in the condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual audited financial statements for the year ended 31st December, 2005 except as described below.

In the current interim period, the Group has applied, for the first time, a number of new standards, amendments and interpretations ("new HKFRSs") issued by the HKICPA that are either effective for accounting periods beginning on or after 1st December, 2005 or 1st January, 2006. The adoption of the new HKFRSs had no material effect on how the results for the current or prior accounting periods have been prepared and presented. Accordingly, no prior period adjustment has been required.

**Financial guarantee contracts**

In the current period, the Group has applied HKAS 39 and HKFRS 4 (Amendments) "Financial Guarantee Contracts" which is effective for annual periods beginning on or after 1st January, 2006.

A financial guarantee contract is defined by HKAS 39 "Financial Instruments: Recognition and Measurement" as "a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument".

*The Group acts as the issuer of the financial guarantee contracts*

Prior to 1st January, 2006, financial guarantee contracts were not accounted for in accordance with HKAS 39 and those contracts were disclosed as contingent liabilities. A provision for financial guarantee was only recognised when it was probable that an outflow of resources would be required to settle the financial guarantee obligation and the amount can be estimated reliably.

Upon the application of these amendments, a financial guarantee contract issued by the Group and not designated as at fair value through profit or loss is recognised initially at its fair value less transaction costs that are directly attributable to the issue of the financial guarantee contract. Subsequent to initial recognition, the Group measures the financial guarantee contract at the higher of: (i) the amount determined in accordance with HKAS 37 "Provisions, Contingent Liabilities and Contingent Assets"; and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 "Revenue".

The Group provided a guarantee to a financial institution in respect of banking facilities granted to a trade debtor. However, there was no material effect on the results for the current and prior accounting periods.

In addition, the Group has applied the following accounting policy during the current interim period:

**Interest in a jointly controlled entity**

Joint venture arrangements which involve the establishment of a separate entity in which venturers have joint control over the economic activity of the entity are referred to as jointly controlled entities.

The results and assets and liabilities of jointly controlled entities are incorporated in the condensed consolidated financial statements using the equity method of accounting. Under the equity method, investments in jointly controlled entities are carried in the condensed consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the profit or loss and of changes in equity of the jointly controlled entities, less any identified impairment loss. When the Group's share of losses of a jointly controlled entity equals or exceeds its interest in that jointly controlled entity (which includes any long-term interests that, in substance, form part of the Group's net investment in the jointly controlled entity), the Group discontinues recognising its share of further losses. An additional share of losses is provided for and a liability is recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of that jointly controlled entity.

When a group entity transacts with a jointly controlled entity of the Group, unrealised profits or losses are eliminated to the extent of the Group's interest in the jointly controlled entity, except to the extent that unrealised losses provide evidence of an impairment of the asset transferred, in which case, the full amount of losses is recognised.

**Intangible assets**

Intangible assets represent trademarks with indefinite useful lives and are carried at cost less any subsequent accumulated impairment losses.

Intangible assets with indefinite useful lives are tested for impairment annually by comparing their carrying amounts with their recoverable amounts, irrespective of whether there is any indication that they may be impaired. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years.

Gains or losses arising from derecognition of an intangible asset are measured at the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is derecognised.

**Standards issued but not yet effective**

The Group has not early applied all the new standard, amendment or interpretations that have been issued but are not yet effective. The directors of the Company (the "Directors") anticipate that the application of these new standard, amendment or interpretations will have no material impact on the results and the financial position of the Group.

**3. SEGMENT INFORMATION**

**Geographical segments**

The Group's primary format for reporting segment information is geographical segments by location of customer.

| | Six months ended 30.6.2006 Revenue HK$'000 | 30.6.2006 Results HK$'000 | 30.6.2005 Revenue HK$'000 | 30.6.2005 Results HK$'000 |
|---|---|---|---|---|
| Europe | **325,020** | **51,560** | 213,235 | 36,226 |
| United States | **134,185** | **22,966** | 110,903 | 15,351 |
| Asia | **38,437** | **862** | 38,304 | 3,752 |
| Other regions | **11,600** | **1,266** | 13,176 | 1,906 |
| | **509,242** | **76,654** | 375,618 | 57,235 |
| Unallocated corporate income | | **2,249** | | 486 |
| Unallocated corporate expenses | | **(3,816)** | | (2,287) |
| Finance costs | | **–** | | (15) |
| Profit before taxation | | **75,087** | | 55,419 |
| Taxation | | **(9,280)** | | (6,482) |
| Profit for the period | | **65,807** | | 48,937 |

**4. FINANCE COSTS**

The finance costs represent interest expense on bank borrowings wholly repayable within five years.

**5. TAXATION**

| | Six months ended 30.6.2006 HK$'000 | 30.6.2005 HK$'000 |
|---|---|---|
| **Current taxation** | | |
| Hong Kong Profits Tax | **7,980** | 3,818 |
| **Deferred taxation** | | |
| Current year | **1,300** | 2,664 |
| | **9,280** | 6,482 |

The charge represents Hong Kong Profits Tax calculated at 17.5% (six months ended 30th June, 2005: 17.5%) of the estimated assessable profit for the period.

A portion of the Group's profits neither arises in, nor is derived from, Hong Kong. Accordingly, that portion of the Group's profit is not subject to Hong Kong Profits Tax. Further, in the opinion of the Directors, that portion of the Group's profit is not at present subject to taxation in any other jurisdiction in which the Group operates.

**6. PROFIT FOR THE PERIOD**

| | Six months ended 30.6.2006 HK$'000 | 30.6.2005 HK$'000 |
|---|---|---|
| Profit for the period has been arrived at after charging: | | |
| Amortisation of prepaid lease payments on land use rights | **431** | 468 |
| Depreciation of property, plant and equipment | **26,026** | 24,898 |
| Loss on disposal of property, plant and equipment | **1,543** | 196 |
| Net foreign exchange loss | **5,472** | – |

**7. DIVIDEND**

| | Six months ended 30.6.2006 HK$'000 | 30.6.2005 HK$'000 |
|---|---|---|
| Final dividend paid in respect of 2005 of 7 HK cents (2004: 9 HK cents) per share | **26,856** | 34,122 |

The interim dividend in respect of 2006 of 7 HK cents (2005: 9 HK cents) per share amounting to a total of HK$26,856,000 (2005: HK$34,528,000) has been approved by the Board on 21st September, 2006.

**8. EARNINGS PER SHARE**

The calculation of the basic and diluted earnings per share is based on the following data:

| | Six months ended 30.6.2006 HK$'000 | 30.6.2005 HK$'000 |
|---|---|---|
| **Earnings** | | |
| Earnings for the purposes of basic and diluted earnings per share – Profit for the period attributable to equity holders of the parent | **67,441** | 49,037 |
| **Number of shares** | | |
| Number of shares for the purpose of basic earnings per share | **383,650,000** | 379,130,000 |
| Effect of dilutive potential shares in respect of share options | | 3,123,534 |
| Weighted average number of shares for the purpose of diluted earnings per share | | 382,253,534 |

### DIVIDEND

The Board has resolved to declare an interim dividend of 7 HK cents per share for the six months ended 30th June, 2006 (2005: 9 HK cents per share). The interim dividend will be payable on 16th October, 2006 to shareholders whose names appear on the register of members of the Company on 8th October, 2006.

### CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from 6th October, 2006 to 8th October, 2006, both days inclusive, during which period no transfer of shares will be effected. All transfers, accompanied by the relevant share certificates, must be lodged with the Company's share registrar in Hong Kong, Secretaries Limited at 26/F., Tesbury Centre, 28 Queen's Road East, Hong Kong for registration not later than 4:30 p.m. on 5th October, 2006 in order to qualify for the interim dividend mentioned above.

## BUSINESS REVIEW

### Summary of results

The Group's consolidated turnover and profit attributable to the equity holders of the Company increased by 36% and 38% to HK$509.2 million and HK$67.4 million respectively (2005: HK$375.6 million and HK$49.0 million) in the six months ended June, 2006. Basic earnings per share increased by 36% to 17.6 HK cents (2005: 12.9 HK cents) in the period under review.

Although the gross margin of the Group was still under severe pressure imposed by higher raw material costs, labour wages, record energy prices and appreciation of Renminbi, the trend of declining gross margin was successfully reversed in the first half of 2006 due to the positive effects of the economies of scale arising from the increase in volume output by 24% as compared with the corresponding period of 2005. Gross margin percentage increased by 1.2% from 29.2% in the first six months of 2005 to 30.4% in the corresponding period of 2006. Net profit margin percentage (ratio of profit attributable to the equity holders of the Company to turnover) also increased slightly by 0.1% from 13.1% to 13.2%.

### Original design manufacturing (ODM) division

The Group had been incurring substantial capital expenditure since 2004 to boost its production capacity in order to meet the market demand for its products. Sales to ODM customers increased by 35% from HK$339.4 million in the first 6 months of 2005 to HK$458.3 million in the corresponding period of 2006. Europe and the United States remained as the main export markets of the Group's ODM division. As a result of the relatively robust performance of American economy and gradual transfer of sourcing from European manufacturers to Far East manufacturers, sales to Europe and the United States registered strong growth rates of 51% and 21% and amounted to HK$302.9 million and HK$130.8 million respectively (2005: HK$200.8 million and HK$108.1 million) during the period under review. On a geographical basis, sales to Europe, United States, Asia and other regions accounted for 66%, 29%, 4% and 1% respectively of the sales of this division during the period under review (2005: 59%, 32%, 7% and 2% respectively). Demand for quality and trendy sunglasses remained high, resulting in greater demand for plastic frames. Sales of sunglasses grew by 51% to HK$198.1 million (2005: HK$131.0 million) whereas sales of prescription frames also grew by 25% to HK$260.2 million (2005: HK$208.4 million). Sales of metal frames, plastic frames and spare parts accounted for 50%, 48% and 2% respectively during the period under review (2005: 53%, 44% and 3% respectively).

### Distribution and retailing divisions

Sales of the Group's own-branded and licensed branded products (including both spectacles and lenses) increased by 59% to HK$42.1 million in the six months ended 30th June, 2006 (2005: HK$26.5 million). Stepper eyewear, the German brand owned by the Group, remained as the best selling brand among the brand portfolio of this division. Successful commercial launch of Fiorucci eyewear, the licensed Italian fashion brand, in Europe and Asia also boosted the sales of the division in these two regions. Sales to Europe, Asia, North America and other regions increased by 61%, 123%, 13% and 10% and accounted for 48%, 30%, 12% and 10% respectively of the Group's turnover of distribution division in the period under review (2005: 47%, 21%, 17% and 15% respectively).

Turnover of the retailing division decreased by 9% to HK$8.8 million in the first half of 2006 (2005: HK$9.7 million), primarily due to the closure of non-performing shops during the period under review. The Group operated a total of 14 shops (31st December, 2005: 18) including 8 shops in Beijing and 6 shops in Shenzhen as at 30th June, 2006 (31st December, 2005: 10 and 8).

### Financial position and liquidity

During the period under review, the Group's operating activities generated a net cash inflow of HK$114.7 million (2005: HK$95.7 million). Capital expenditure incurred during the period amounted to HK$67.8 million (2005: HK$55.9 million) and was wholly financed by the Group's internal resources. The net cash position of the Group (bank and cash balance less bank borrowing, if any) increased from HK$65.0 million as at 31st December, 2005 to HK$81.2 million as at 30th June, 2006. The Group did not have any interest bearing borrowings at 30th June, 2006 and 31st December, 2005.

The current ratio of the Group as at 30th June, 2006 was 2.4 to 1 (31st December, 2005: 2.8:1) with HK$535.4 million of current assets (31st December, 2005: HK$475.1 million) and HK$219.2 million of current liabilities (31st December, 2005: HK$170.6 million). Inventory turnover period (ratio of inventory balance to cost of sales) increased from 83 days in the first six months of 2005 to 87 days in the corresponding period of 2006, but this was still shorter than the inventory turnover period of 104 days for the whole year of 2005. Debtors turnover period (ratio of the total of debtor and discounted bills balances, if any, to sales) increased from 88 days in the first six months of 2005 to 93 days in the corresponding period of 2006 and this was also shorter than the debtors turnover period of 108 days for the whole year of 2005.

The Group had 383,650,000 shares in issue as at both 30th June, 2006 and 31st December, 2005 with equity attributable to equity holders of the Company amounting to HK$669.5 million and HK$623.2 million as at 30th June, 2006 and 31st December, 2005 respectively. Net asset value per share (equity attributable to equity holders of the Company divided by the total number of shares in issue) as at 30th June, 2006 was HK$1.75 (31st December, 2005: HK$1.62). Total long term liabilities and debt to equity ratio (expressed as a percentage of total long term liabilities over equity attributable to equity holders of the Company) were HK$15.3 million (31st December, 2005: HK$13.3 million) and 2.3% (31st December, 2005: 2.1%) respectively.

The Group had limited exposure to foreign exchange rate fluctuations as most of its transactions were conducted in either United States dollars, Hong Kong dollars and Renminbi and the exchange rates movements between these currencies were relatively stable during the period under review, except to the extent of the gradual continuous appreciation of Renminbi against United States dollars and Hong Kong dollars.

### Contingent liabilities

| | **30.6.2006** | 31.12.2005 |
|---|---|---|
| | ***HK$'000*** | *HK$'000* |
| Corporate guarantee to a financial institution in respect of banking facilities granted to a trade debtor | **9,687** | 9,750 |

### Employee and remuneration policies

The Group employed approximately 10,500 full time staff as at 30th June, 2006. The Group remunerates its employees based on their performance, experience, qualifications and prevailing market price while performance bonuses are granted on a discretionary basis after considering individual performance and the operating results of the Group. Other employee benefits include insurance and medical cover, subsidised educational and training programmes, mandatory provident fund scheme as well as a share option scheme.

## PROSPECTS

### ODM division

Despite the Group's success in reversing the downward trend of the gross margin in the first half of 2006, the management maintains its vigilance of potential market upheaval arising from unexpected slowdown in the global economy, volatile interest rates and commodity prices movements. The management will continue to execute its capacity expansion plan after due consideration of latest market development and availability of internal resources. Costs pressure on the Group's products remains high, but the management believes that through the lowering of average fixed costs by output expansion and modest price adjustments on its products since late 2005, the Group can still maintain a satisfactory and stable margin in the second half of 2006. The Group currently has three months sales orders on hand and the management anticipates this to remain stable in the second half of 2006.

### Distribution and retailing divisions

The well established global network of over 30 distributors for Stepper eyewear provides an excellent platform for the future growth of the Group's distribution business. The successful launch of the Fiorucci eyewear collections in the Asian and European markets reinforces the Group's determination in further penetrating into un-tapped markets and strengthening its brand portfolio by additions of more house and licensed brands.

In view of the intensifying competition in the retail business environment in mainland China, the Group intends to maintain its current scale of operations and its current focus on the cities of Beijing and Shenzhen. The management continues to place emphasis on profitability enhancement by internal streamlining and closure or relocation of non-performing shops.

### Summary

The management believes that the encouraging financial results reported in the first half of 2006 is attributable to its adherence to its guiding principle of balance sheet management and emphasis on cash earnings. The adjustment on the dividend payout in the first half of 2006 reflects the cautiousness of management in implementing the expansion plan. Despite the challenges discussed above, the Directors are still optimistic about the financial performance of the Group in the second half of 2006.

## CORPORATE GOVERNANCE

The Company has complied with all of the code provisions in the Code on Corporate Governance Practices (the "CG Code") as set out in Appendix 14 to the Listing Rules throughout the six months period ended 30th June, 2006, with deviations from code provision A.2.1 of the CG Code only. Code provision A.2.1 of the CG Code stipulates that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. Mr. Ng Hoi Ying, Michael ("Mr. Ng") is the founder and chairman of the Group. The Company does not at present have any officer with the title "chief executive officer" and Mr. Ng has been carrying out the duties of both the chairman and chief executive officer since the establishment of the Group and the Company. The Board intends to maintain this structure in future as it believes that this structure can ensure efficient and effective formulation and implementation of business strategies without compromising the balance of power and authority between the Board and management of the Company.

An Audit Committee has been established by the Company since 1998 to act in an advisory capacity and make recommendations to the Board. The Committee currently comprises Messrs. Wong Chi Wai, Chung Hil Lan Eric and Francis George Martin, all of whom are independent non-executive Directors of the Company. The duties of the Audit Committee include review of the interim and annual reports of the Group as well as various auditing, financial reporting and internal control matters with the management and/or external auditors of the Company. The Group's unaudited financial statements for the six months ended 30th June, 2006 have been reviewed by the Audit Committee and the Company's auditors, Deloitte Touche Tohmatsu.

A Remuneration Committee was established in 2003 and currently comprises Messrs. Francis George Martin, Wong Chi Wai and Chung Hil Lan Eric, all of whom are independent non-executive Directors. The duties of the Remuneration Committee include the determination of remuneration of executive Directors and review of remuneration policy of the Group.

## PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SHARES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed shares during the six months ended 30th June, 2006.

## DIRECTORS

The Board comprises seven Directors, four of whom are executive Directors, namely Mr. Ng Hoi Ying, Michael, Ms. Hui Pui Woon, Mr. Ng Kim Ying and Mr. Lee Wai Chung and three are independent non-executive Directors, namely Mr. Francis George Martin, Mr. Wong Chi Wai and Mr. Chung Hil Lan Eric.

By order of the Board
**Ng Hoi Ying, Michael**
*Chairman*

Hong Kong, 21st September, 2006

* *For identification purpose only*