

**FIH**<sup>®</sup> 富智康<sup>™</sup>

**FIH Mobile Limited**

(Incorporated in the Cayman Islands with limited liability)

Stock Code: 2038

**2019**  
*Interim Report*

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## CORPORATE INFORMATION

### FIH MOBILE LIMITED

(the “Company”, and together with its subsidiaries, the “Group”)

#### EXECUTIVE DIRECTORS

CHIH Yu Yang (*Acting Chairman and Chief Executive Officer*)

WANG Chien Ho

KUO Wen-Yi

#### INDEPENDENT NON-EXECUTIVE DIRECTORS

LAU Siu Ki

Daniel Joseph MEHAN

TAO Yun Chih

#### COMPANY SECRETARY

WONG Kin Yan, Vanessa

#### REGISTERED OFFICE

P. O. Box 31119 Grand Pavilion  
Hibiscus Way  
802 West Bay Road  
Grand Cayman, KY1-1205  
Cayman Islands

#### HEAD OFFICE

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Langfang City  
Hebei Province  
People’s Republic of China

#### PRINCIPAL PLACE OF BUSINESS IN HONG KONG

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538 Castle Peak Road  
Cheung Sha Wan  
Kowloon  
Hong Kong

#### AUDITOR

Deloitte Touche Tohmatsu

#### LEGAL ADVISORS

Clifford Chance, Hong Kong  
Freshfields Bruckhaus Deringer,  
Hong Kong  
Mayer Brown, Hong Kong

#### PRINCIPAL BANKERS

Agricultural Bank of China  
Bank of Beijing  
Bank of China  
Bank of Communications  
China Guangfa Bank  
China Merchants Bank  
Chinatrust Commercial Bank  
Citibank  
DBS Bank  
Deutsche Bank  
Industrial Bank  
ING Bank  
Mizuho Corporate Bank  
OCBC Bank  
Santander Bank  
Standard Chartered Bank  
Sumitomo Mitsui Banking Corporation  
Taipei Fubon Bank  
The Hongkong and Shanghai Banking Corporation Limited

#### PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

SMP Partners (Cayman) Limited  
Royal Bank House — 3rd Floor  
24 Shedden Road, P.O. Box 1586  
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Cayman Islands

#### HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited  
46th Floor, Hopewell Centre  
183 Queen’s Road East  
Wan Chai  
Hong Kong

#### STOCK CODE

2038

# REPORT ON REVIEW OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

# Deloitte.

# 德勤

TO THE BOARD OF DIRECTORS OF FIH MOBILE LIMITED

## Introduction

We have reviewed the condensed consolidated financial statements of FIH Mobile Limited (the “Company”) and its subsidiaries (collectively referred to as the “Group”) set out on pages 4 to 39, which comprise the condensed consolidated statement of financial position as of 30 June 2019 and the related condensed consolidated statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the six-month period then ended, and certain explanatory notes. The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of a report on interim financial information to be in compliance with the relevant provisions thereof and International Accounting Standard 34 “Interim Financial Reporting” (“IAS 34”) issued by the International Accounting Standards Board. The directors of the Company are responsible for the preparation and presentation of these condensed consolidated financial statements in accordance with IAS 34. Our responsibility is to express a conclusion on these condensed consolidated financial statements based on our review, and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## Scope of Review

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the Hong Kong Institute of Certified Public Accountants. A review of these condensed consolidated financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

## Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed consolidated financial statements are not prepared, in all material respects, in accordance with IAS 34.

## Deloitte Touche Tohmatsu

*Certified Public Accountants*

Hong Kong

9 August 2019

## CONDENSED CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

FOR THE SIX MONTHS ENDED 30 JUNE 2019

		<b>Six months ended</b>	
	<i>NOTES</i>	<b>30.6.2019</b>	30.6.2018
		<b>US\$'000</b>	US\$'000
		<b>(unaudited)</b>	(unaudited)
Revenue	3	<b>6,389,177</b>	6,563,291
Cost of sales		<b>(6,345,574)</b>	(6,598,202)
Gross profit (loss)		<b>43,603</b>	(34,911)
Other income, gains and losses		<b>107,066</b>	7,331
Selling expenses		<b>(7,879)</b>	(60,851)
General and administrative expenses		<b>(115,033)</b>	(134,004)
Research and development expenses		<b>(86,603)</b>	(118,425)
Finance costs		<b>(22,058)</b>	(9,422)
Share of profit of associates		<b>4,166</b>	1,110
Share of profit (loss) of joint ventures		<b>5</b>	(73)
Loss before tax		<b>(76,733)</b>	(349,245)
Income tax (expense) credit	4	<b>(7,106)</b>	678
Loss for the period	5	<b>(83,839)</b>	(348,567)
Other comprehensive income (expense):			
<i>Item that will not be reclassified to profit or loss:</i>			
Fair value gain on investments in equity instruments at fair value through other comprehensive income		<b>8,040</b>	6,073
<i>Items that may be reclassified subsequently to profit or loss:</i>			
Exchange differences arising on translation of foreign operations		<b>3,548</b>	(70,527)
Share of translation reserve of associates		<b>146</b>	(489)
Share of translation reserve of joint ventures		<b>(21)</b>	(70)
		<b>3,673</b>	(71,086)
Other comprehensive income (expense) for the period		<b>11,713</b>	(65,013)
Total comprehensive expense for the period		<b>(72,126)</b>	(413,580)

## CONDENSED CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

	<b>Six months ended</b>	
NOTE	<b>30.6.2019</b>	30.6.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
(Loss) profit for the period attributable to:		
Owners of the Company	<b>(84,083)</b>	(348,061)
Non-controlling interests	<b>244</b>	(506)
	<hr/>	<hr/>
	<b>(83,839)</b>	(348,567)
	<hr/>	<hr/>
Total comprehensive (expense) income attributable to:		
Owners of the Company	<b>(72,315)</b>	(412,914)
Non-controlling interests	<b>189</b>	(666)
	<hr/>	<hr/>
	<b>(72,126)</b>	(413,580)
	<hr/>	<hr/>
Loss per share	7	
Basic	<b>(US1.0 cent)</b>	(US4.3 cents)
	<hr/>	<hr/>

# CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AT 30 JUNE 2019

	NOTES	30.6.2019 US\$'000 (unaudited)	31.12.2018 US\$'000 (audited)
Non-current assets			
Property, plant and equipment	8	993,062	1,002,393
Right-of-use assets	8	70,185	–
Investment properties		4,546	4,747
Prepaid lease payments		–	47,809
Financial assets at fair value through profit or loss			
– Equity instruments		4,934	13,082
Financial assets at fair value through other comprehensive income			
– Equity instruments		127,533	119,232
Interests in associates		25,284	20,972
Interests in joint ventures		–	2,390
Deferred tax assets	9	24,798	20,300
Deposit for acquisition of right-of-use assets/ prepaid lease payments		27,747	27,785
		<b>1,278,089</b>	1,258,710
Current assets			
Inventories		974,140	1,400,388
Trade and other receivables	10	2,840,892	4,305,578
Financial assets at fair value through profit or loss			
– Short-term investments		226,700	454,421
Bank deposits		80,759	66,697
Bank balances and cash		1,582,272	1,418,569
		<b>5,704,763</b>	7,645,653
Current liabilities			
Trade and other payables	11	3,605,877	5,091,425
Contract liabilities		23,646	20,063
Lease liabilities		2,828	–
Bank borrowings	12	1,085,225	1,427,217
Provision	13	57,764	102,719
Tax payable		78,354	81,373
		<b>4,853,694</b>	6,722,797
Net current assets		<b>851,069</b>	922,856
Total assets less current liabilities		<b>2,129,158</b>	2,181,566

## CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION *(Continued)*

AT 30 JUNE 2019

	NOTES	30.6.2019 US\$'000 (unaudited)	31.12.2018 US\$'000 (audited)
Capital and reserves			
Share capital	14	328,563	328,563
Reserves		1,743,464	1,815,779
Equity attributable to owners of the Company		2,072,027	2,144,342
Non-controlling interests		6,128	5,939
Total equity		2,078,155	2,150,281
Non-current liabilities			
Deferred tax liabilities	9	11,192	10,441
Deferred income	15	19,998	20,844
Lease liabilities		19,813	–
		51,003	31,285
		2,129,158	2,181,566



# CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE SIX MONTHS ENDED 30 JUNE 2019

	Attributable to owners of the Company								Non-controlling interests	Total equity	
	Share capital	Share premium	Special reserve	Revaluation reserve	Other reserve	Legal reserve	Translation reserve	Retained profits			Total
	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	
At 1 January 2018 (audited)	323,739	1,195,623	15,514	(16,109)	(1,302)	168,899	179,622	1,308,028	3,174,014	6,610	3,180,624
Loss for the period	-	-	-	-	-	-	-	(348,061)	(348,061)	(506)	(348,567)
Other comprehensive income (expense) for the period	-	-	-	6,073	-	-	(70,926)	-	(64,853)	(160)	(65,013)
Total comprehensive income (expense) for the period	-	-	-	6,073	-	-	(70,926)	(348,061)	(412,914)	(666)	(413,580)
Balance at 30 June 2018 (unaudited)	323,739	1,195,623	15,514	(10,036)	(1,302)	168,899	108,696	959,967	2,761,100	5,944	2,767,044
Balance at 1 January 2019 (audited)	<b>328,563</b>	<b>1,203,407</b>	<b>15,514</b>	<b>(48,526)</b>	<b>(998)</b>	<b>168,899</b>	<b>26,576</b>	<b>450,907</b>	<b>2,144,342</b>	<b>5,939</b>	<b>2,150,281</b>
(Loss) profit for the period	-	-	-	-	-	-	-	(84,083)	(84,083)	244	(83,839)
Other comprehensive income (expense) for the period	-	-	-	8,040	-	-	3,728	-	11,768	(55)	11,713
Total comprehensive income (expense) for the period	-	-	-	8,040	-	-	3,728	(84,083)	(72,315)	189	(72,126)
Profit appropriation	-	-	-	-	-	4,091	-	(4,091)	-	-	-
Balance at 30 June 2019 (unaudited)	<b>328,563</b>	<b>1,203,407</b>	<b>15,514</b>	<b>(40,486)</b>	<b>(998)</b>	<b>172,990</b>	<b>30,304</b>	<b>362,733</b>	<b>2,072,027</b>	<b>6,128</b>	<b>2,078,155</b>

# CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE SIX MONTHS ENDED 30 JUNE 2019

	<b>Six months ended</b>	
	<b>30.6.2019</b>	30.6.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Net cash from (used in) operating activities	<b>153,666</b>	(342,375)
Investing activities		
Purchase of short-term investments	<b>(571,156)</b>	(1,368,214)
Purchase of property, plant and equipment	<b>(88,054)</b>	(125,830)
(Placement) withdrawal of bank deposits for investing purpose	<b>(16,313)</b>	9,196
Purchase of equity instruments at fair value through other comprehensive income	<b>(260)</b>	(63,982)
Proceeds from disposal of property, plant and equipment	<b>3,183</b>	5,962
Proceeds from disposal of equity instrument at fair value through profit or loss	<b>11,910</b>	–
Proceeds from disposal of financial assets at fair value through profit or loss	<b>228,665</b>	–
Proceeds on settlements of short-term investments	<b>807,916</b>	1,399,107
Dividend income from an associate	–	80
Net cash from (used in) investing activities	<b>375,891</b>	(143,681)
Financing activities		
Bank borrowings repaid	<b>(2,914,156)</b>	(2,955,312)
Interest paid	<b>(21,910)</b>	(11,322)
Repayment of lease liabilities	<b>(4,317)</b>	–
Bank borrowings raised	<b>2,569,584</b>	3,498,419
Net cash (used in) from financing activities	<b>(370,799)</b>	531,785
Net increase in cash and cash equivalents	<b>158,758</b>	45,729
Cash and cash equivalents at 1 January	<b>1,418,569</b>	1,979,905
Effect of foreign exchange rate changes	<b>4,945</b>	(33,869)
Cash and cash equivalents as at 30 June, representing bank balances and cash	<b>1,582,272</b>	1,991,765

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 1. BASIS OF PREPARATION

The condensed consolidated financial statements have been prepared in accordance with International Accounting Standard 34 “Interim Financial Reporting” issued by the International Accounting Standards Board (“IASB”) as well as the applicable disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”).

The Company and its subsidiaries (hereinafter collectively referred to as the “Group”) are principally engaged as a vertically integrated manufacturing services provider for handset industry worldwide. The Group provides a wide range of manufacturing services to its customers in connection with the production of handsets.

## 2. PRINCIPAL ACCOUNTING POLICIES

The condensed consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair values, as appropriate.

Other than changes in accounting policies resulting from application of new and amendments to International Financial Reporting Standards (“IFRSs”), the accounting policies and methods of computation used in the condensed consolidated financial statements for the six months ended 30 June 2019 are the same as those followed in the preparation of the Group’s annual financial statements for the year ended 31 December 2018.

### Application of new and amendments to IFRSs

In the current interim period, the Group has applied, for the first time, the following new and amendments to IFRSs issued by the IASB which are mandatory effective for the annual period beginning on or after 1 January 2019 for the preparation of the Group’s condensed consolidated financial statements:

IFRS 16	Leases
IFRIC 23	Uncertainty over Income Tax Treatments
Amendments to IFRS 9	Prepayment Features with Negative Compensation
Amendments to IAS 19	Plan Amendment, Curtailment or Settlement
Amendments to IAS 28	Long-term Interests in Associates and Joint Ventures
Amendments to IFRSs	Annual Improvements to IFRSs 2015–2017 Cycle

Except as described below, the application of the new and amendments to IFRSs in the current period has had no material impact on the Group’s financial performance and positions for the current and prior periods and/or on the disclosures set out in these condensed consolidated financial statements.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

### 2.1 Impacts and changes in accounting policies of application on IFRS 16 “Leases” (“IFRS 16”)

The Group has applied IFRS 16 for the first time in the current interim period. IFRS 16 superseded IAS 17 “Leases” (“IAS 17”), and the related interpretations.

#### 2.1.1 Key changes in accounting policies resulting from application of IFRS 16

The Group applied the following accounting policies in accordance with the transition provisions of IFRS 16.

##### *Definition of a lease*

A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

For contracts entered into or modified on or after the date of initial application, the Group assesses whether a contract is or contains a lease based on the definition under IFRS 16 at inception or modification date. Such contract will not be reassessed unless the terms and conditions of the contract are subsequently changed.

##### *As a lessee*

Allocation of consideration to components of a contract

For a contract that contains a lease component and one or more additional lease or non-lease components, the Group allocates the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.

As a practical expedient, leases with similar characteristics are accounted on a portfolio basis when the Group reasonably expects that the effects on the financial statements would not differ materially from individual leases within the portfolio.

##### *Short-term leases and leases of low-value assets*

The Group applies the short-term lease recognition exemption to leases of properties, machinery and equipment that have a lease term of 12 months or less from the commencement date and do not contain a purchase option. It also applies the recognition exemption for lease of low-value assets. Lease payments on short-term leases and leases of low-value assets are recognised as expense on a straight-line basis over the lease term.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

### 2.1 Impacts and changes in accounting policies of application on IFRS 16 “Leases” (“IFRS 16”) *(Continued)*

#### 2.1.1 Key changes in accounting policies resulting from application of IFRS 16 *(Continued)*

*As a lessee (Continued)*

Right-of-use assets

Except for short-term leases and leases of low value assets, the Group recognises right-of-use assets at the commencement date of the lease (i.e. the date the underlying asset is available for use). Right-of-use assets are measured at cost, less any accumulated depreciation and impairment losses, and adjusted for any remeasurement of lease liabilities.

The cost of right-of-use asset includes:

- the amount of the initial measurement of the lease liability;
- any lease payments made at or before the commencement date, less any lease incentives received;
- any initial direct costs incurred by the Group; and
- an estimate of costs to be incurred by the Group in dismantling and removing the underlying assets, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories.

Right-of-use assets in which the Group is reasonably certain to obtain ownership of the underlying leased assets at the end of the lease term is depreciated from commencement date to the end of the useful life. Otherwise, right-of-use assets are depreciated on a straight-line basis over the shorter of its estimated useful life and the lease term.

The Group presents right-of-use assets that do not meet the definition of investment property as a separate line item on the consolidated statement of financial position. The right-of-use assets that meet the definition of investment property are presented within “investment properties”.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

### 2.1 Impacts and changes in accounting policies of application on IFRS 16 “Leases” (“IFRS 16”) *(Continued)*

#### 2.1.1 Key changes in accounting policies resulting from application of IFRS 16 *(Continued)*

*As a lessee (Continued)*

Leasehold land and building

For payments of a property interest which includes both leasehold land and building elements, the entire property is presented as property, plant and equipment of the Group when the payments cannot be allocated reliably between the leasehold land and building elements, except for those that are classified and accounted for as investment properties.

Refundable rental deposits

Refundable rental deposits paid are accounted under IFRS 9 “Financial Instruments” (“IFRS 9”) and initially measured at fair value. Adjustments to fair value at initial recognition are considered as additional lease payments and included in the cost of right-of-use assets.

Lease liabilities

At the commencement date of a lease, the Group recognises and measures the lease liability at the present value of lease payments that are unpaid at that date. In calculating the present value of lease payments, the Group uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable.

The lease payments include:

- fixed payments (including in-substance fixed payments) less any lease incentives receivable;
- variable lease payments that depend on an index or a rate;
- amounts expected to be paid under residual value guarantees;
- the exercise price of a purchase option reasonably certain to be exercised by the Group; and
- payments of penalties for terminating a lease, if the lease term reflects the Group exercising the option to terminate.

After the commencement date, lease liabilities are adjusted by interest accretion and lease payments.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

### 2.1 Impacts and changes in accounting policies of application on IFRS 16 "Leases" ("IFRS 16") *(Continued)*

#### 2.1.1 Key changes in accounting policies resulting from application of IFRS 16 *(Continued)*

*As a lessee (Continued)*

*Lease liabilities (Continued)*

The Group remeasures lease liabilities (and makes a corresponding adjustment to the related right-of-use assets) whenever:

- the lease term has changed or there is a change in the assessment of exercise of a purchase option, in which case the related lease liability is remeasured by discounting the revised lease payments using a revised discount rate at the date of reassessment.
- the lease payments change due to changes in market rental rates following a market rent review, in which cases the related lease liability is remeasured by discounting the revised lease payments using the initial discount rate.

*Lease modifications*

The Group accounts for a lease modification as a separate lease if:

- the modification increases the scope of the lease by adding the right to use one or more underlying assets; and
- the consideration for the leases increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.

For a lease modification that is not accounted for as a separate lease, the Group remeasures the lease liability based on the lease term of the modified lease by discounting the revised lease payments using a revised discount rate at the effective date of the modification.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

### 2.1 Impacts and changes in accounting policies of application on IFRS 16 “Leases” (“IFRS 16”) *(Continued)*

#### 2.1.1 Key changes in accounting policies resulting from application of IFRS 16 *(Continued)*

##### *As a lessee (Continued)*

##### Taxation

For the purposes of measuring deferred tax for leasing transactions in which the Group recognises the right-of-use assets and the related lease liabilities, the Group first determines whether the tax deductions are attributable to the right-of-use assets or the lease liabilities.

For leasing transactions in which the tax deductions are attributable to the lease liabilities, the Group applies IAS 12 “Income Taxes” requirements to right-of-use assets and lease liabilities separately. Temporary differences relating to right-of-use assets and lease liabilities are not recognised at initial recognition and over the lease terms due to application of the initial recognition exemption.

##### *As a lessor*

##### Allocation of consideration to components of a contract

Effective on 1 January 2019, the Group applies IFRS 15 “Revenue from Contracts with Customers” (“IFRS 15”) to allocate consideration in a contract to lease and non-lease components. Non-lease components are separated from lease component on the basis of their relative stand-alone selling prices.

##### Refundable rental deposits

Refundable rental deposits received are accounted under IFRS 9 and initially measured at fair value. Adjustments to fair value at initial recognition are considered as additional lease payments from lessees.

##### Sublease

When the Group is an intermediate lessor, it accounts for the head lease and the sublease as two separate contracts. The sub-lease is classified as a finance or operating lease by reference to the right-of-use asset arising from the head lease, not with reference to the underlying asset.

##### Lease modification

The Group accounts for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.



# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 2. PRINCIPAL ACCOUNTING POLICIES (Continued)

### 2.1 Impacts and changes in accounting policies of application on IFRS 16 “Leases” (“IFRS 16”) (Continued)

#### 2.1.2 Transition and summary of effects arising from initial application of IFRS 16

##### *Definition of a lease*

The Group has elected the practical expedient to apply IFRS 16 to contracts that were previously identified as leases applying IAS 17 and IFRIC 4 “Determining whether an Arrangement contains a Lease” and not apply this standard to contracts that were not previously identified as containing a lease. Therefore, the Group has not reassessed contracts which already existed prior to the date of initial application.

For contracts entered into or modified on or after 1 January 2019, the Group applies the definition of a lease in accordance with the requirements set out in IFRS 16 in assessing whether a contract contains a lease.

##### *As a lessee*

The Group has applied IFRS 16 retrospectively with the cumulative effect recognised at the date of initial application, 1 January 2019. Any difference at the date of initial application is recognised in the opening retained profits and comparative information has not been restated.

When applying the modified retrospective approach under IFRS 16 at transition, the Group applied the following practical expedients to leases previously classified as operating leases under IAS 17, on lease-by-lease basis, to the extent relevant to the respective lease contracts:

- i. relied on the assessment of whether leases are onerous by applying IAS 37 “Provisions, Contingent Liabilities and Contingent Assets” as an alternative of impairment review;
- ii. elected not to recognise right-of-use assets and lease liabilities for leases with lease term ends within 12 months of the date of initial application;

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

### 2.1 Impacts and changes in accounting policies of application on IFRS 16 “Leases” (“IFRS 16”) *(Continued)*

#### 2.1.2 Transition and summary of effects arising from initial application of IFRS 16 *(Continued)*

*As a lessee (Continued)*

- iii. excluded initial direct costs from measuring the right-of-use assets at the date of initial application; and
- iv. applied a single discount rate to a portfolio of leases with a similar remaining terms for similar class of underlying assets in similar economic environment. Specifically, discount rate for certain leases of machinery and equipment in the People’s Republic of China (the “PRC”) was determined on a portfolio basis.

On transition, the Group has made the following adjustments upon application of IFRS 16:

The Group recognised lease liabilities of US\$11,929,000 and right-of-use assets of US\$59,738,000 at 1 January 2019. The directors of the Company considered that there was no material impact of transition to IFRS 16, therefore no adjustment is made to retained profits at 1 January 2019.

When recognising the lease liabilities for leases previously classified as operating leases, the Group has applied incremental borrowing rates of the relevant group entities at the date of initial application. The weighted average lessee’s incremental borrowing rate applied is 4.73%.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 2. PRINCIPAL ACCOUNTING POLICIES (Continued)

### 2.1 Impacts and changes in accounting policies of application on IFRS 16 "Leases" ("IFRS 16") (Continued)

#### 2.1.2 Transition and summary of effects arising from initial application of IFRS 16 (Continued)

As a lessee (Continued)

	Note	<b>At 1 January 2019</b> US\$'000
Operating lease commitments disclosed as at 31 December 2018		23,752
Lease liabilities discounted at relevant incremental borrowing rates		23,442
Add: Lease liabilities resulting from lease modifications of existing leases	#	11,323
Less: Recognition exemption — short-term leases		(22,836)
Lease liabilities relating to operating leases recognised upon application of IFRS 16		<u>11,929</u>
Analysed as		
Current		1,225
Non-current		10,704
		<u>11,929</u>

# The Group renewed the leases of several existing properties by entering into new lease contracts which commence after date of initial application, these new contracts are accounted as lease modifications of the existing contracts upon application of IFRS 16.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 2. PRINCIPAL ACCOUNTING POLICIES (Continued)

### 2.1 Impacts and changes in accounting policies of application on IFRS 16 “Leases” (“IFRS 16”) (Continued)

#### 2.1.2 Transition and summary of effects arising from initial application of IFRS 16 (Continued)

As a lessee (Continued)

The carrying amount of right-of-use assets as at 1 January 2019 comprises the following:

	Note	Right-of-use assets US\$'000
Right-of-use assets relating to operating leases recognised upon application of IFRS 16		11,929
Reclassified from prepaid lease payments	(a)	47,809
		<u>59,738</u>
By class:		
Leasehold lands		47,809
Land and buildings		8,179
Plant and machinery		3,184
Fixtures and equipment		566
		<u>59,738</u>

Note:

- (a) Upfront payments for leasehold lands in the PRC, Vietnam and India were classified as prepaid lease payments as at 31 December 2018. Upon application of IFRS 16, the prepaid lease payments amounting to US\$47,809,000 were reclassified to right-of-use assets.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 2. PRINCIPAL ACCOUNTING POLICIES *(Continued)*

### 2.1 Impacts and changes in accounting policies of application on IFRS 16 "Leases" ("IFRS 16") *(Continued)*

#### 2.1.2 Transition and summary of effects arising from initial application of IFRS 16 *(Continued)*

*As a lessor*

In accordance with the transitional provisions in IFRS 16, except for sub-leases in which the Group acts as an intermediate lessor, the Group is not required to make any adjustment on transition for leases in which the Group is a lessor but account for these leases in accordance with IFRS 16 from the date of initial application and comparative information has not been restated.

- (a) Upon application of IFRS 16, new lease contracts entered into but commence after the date of initial application relating to the same underlying assets under existing lease contracts are accounted as if the existing leases are modified as at 1 January 2019. The application has had no impact on the Group's condensed consolidated statement of financial position at 1 January 2019. However, effective 1 January 2019, lease payments relating to the revised lease term after modification are recognised as income on straight-line basis over the extended lease term.
- (b) Effective on 1 January 2019, the Group has applied IFRS 15 to allocate consideration in the contract to each lease and non-lease components. The change in allocation basis has had no material impact on the condensed consolidated financial statements of the Group for the current period.

## 3. REVENUE AND SEGMENT INFORMATION

The Group determines its operating segments based on internal reports reviewed by the chief operating decision maker, the Chief Executive Officer, for the purpose of allocating resources to the segment and to assess its performance.

The Group's operations are organised into three operating segments based on the location of customers — Asia, Europe and America.

The Group's revenue is mainly arising from the manufacturing services and distribution income amounting to US\$6,389,177,000 and nil (2018: US\$6,512,335,000 and US\$50,956,000), respectively, to its customers in connection with the production of handsets. From 1 January 2019, the Group ceased its distribution business. For the six months ended 30 June 2019, pre-tax profit and operating expenses in relation to the distribution business are amounting to US\$19,755,000 (2018: pre-tax loss of US\$23,804,000) and US\$5,196,000 (2018: US\$73,417,000) respectively.

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 3. REVENUE AND SEGMENT INFORMATION *(Continued)*

The following is an analysis of the Group's revenue and results by operating and reportable segments:

	<b>Six months ended</b>	
	<b>30.6.2019</b>	30.6.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Segment revenue (external sales)		
Asia	<b>5,346,674</b>	5,567,823
Europe	<b>556,802</b>	925,458
America	<b>485,701</b>	70,010
	<hr/>	<hr/>
Total	<b>6,389,177</b>	6,563,291
	<hr/>	<hr/>
Segment profit (loss)		
Asia	<b>58,795</b>	42,672
Europe	<b>7,383</b>	(126,527)
America	<b>20,851</b>	4,695
	<hr/>	<hr/>
	<b>87,029</b>	(79,160)
Other income, gains and losses	<b>55,761</b>	(9,261)
General and administrative expenses	<b>(115,033)</b>	(134,004)
Research and development expenses	<b>(86,603)</b>	(118,425)
Finance costs	<b>(22,058)</b>	(9,422)
Share of profit of associates	<b>4,166</b>	1,100
Share of profit (loss) of joint ventures	<b>5</b>	(73)
	<hr/>	<hr/>
Loss before tax	<b>(76,733)</b>	(349,245)

Majority of the Group's sales to Asian and European customers are attributed to the PRC and Finland included in Asia and Europe respectively.

Segment profit (loss) represents the gross profit earned (loss incurred) by each segment, and the service income (included in other income) after deducting all selling expenses. This is the measure reported to the Chief Executive Officer for the purposes of resources allocation and performance assessment.

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 4. INCOME TAX EXPENSE (CREDIT)

The charge (credit) comprises:

	<b>Six months ended</b>	
	<b>30.6.2019</b>	30.6.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Current tax:		
– Hong Kong	–	–
– Other jurisdictions	<b>10,470</b>	14,137
	<b>10,470</b>	14,137
Underprovision in prior periods:		
– Hong Kong	–	–
– Other jurisdictions	–	83
	–	83
Deferred tax (note 9)		
Current period	<b>(3,364)</b>	(15,299)
Change in tax rate	–	401
	<b>(3,364)</b>	(14,898)
	<b>7,106</b>	(678)

No provision for Hong Kong Profits Tax has been made as the Group does not have assessable profits in Hong Kong.

Tax charge mainly consists of income tax in the PRC attributable to the assessable profits of the Company's subsidiaries established in the PRC. Under the law of the PRC on Enterprise Income Tax (the "EIT Law") and Implementation Regulation of the EIT Law, the tax rate of the PRC subsidiaries is 25% (2018: 25%). Two of the Company's PRC subsidiaries were awarded with the Advanced-Technology Enterprise Certificate and entitled for a tax reduction from 25% to 15% for a period of 3 years, i.e. effective from 2016 and 2017. Besides, one of the Company's PRC subsidiaries was entitled to a concessionary tax rate of 15% under the China's "Great Western Expansion" campaign. Except these subsidiaries, other PRC subsidiaries are subject to Enterprise Income Tax at 25% (2018: 25%).

Taxation arising in other jurisdictions is calculated at the rates prevailing in the relevant jurisdictions.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 5. LOSS FOR THE PERIOD

	<b>Six months ended</b>	
	<b>30.6.2019</b>	30.6.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Loss for the period has been arrived at after charging (crediting):		
Amortisation of intangible assets	–	4,750
Amortisation of prepaid lease payments (included in general and administrative expenses)	–	665
Depreciation of property, plant and equipment	<b>94,052</b>	84,505
Depreciation of right-of-use assets	<b>3,595</b>	–
Depreciation of investment properties	<b>535</b>	561
	<hr/>	<hr/>
Total depreciation and amortisation	<b>98,182</b>	90,481
Less: Depreciation and amortisation capitalised in inventories	<b>(72,705)</b>	(70,406)
Less: Depreciation and amortisation included in research and development expenses	<b>(3,807)</b>	(2,534)
	<hr/>	<hr/>
	<b>21,670</b>	17,541
	<hr/>	<hr/>
Cost of inventories recognised as expense	<b>6,289,895</b>	6,453,844
Loss (gain) on disposal of and write-off of property, plant and equipment	<b>909</b>	(544)
Provision for warranty	<b>7,975</b>	48,644
Write down of inventories to net realisable value	<b>47,704</b>	95,714
Impairment loss recognised in respect of trade receivables, net	<b>108</b>	57
Impairment loss recognised for interest in a joint venture	<b>2,374</b>	–
Net gain arising on short-term investments at fair value through profit or loss (“FVTPL”)	<b>(6,229)</b>	(9,299)
Net (gain) loss arising on equity instruments at FVTPL	<b>(3,762)</b>	25,591
Net exchange loss (included in other income, gains and losses)	<b>7,768</b>	88,197
Interest income from bank deposits	<b>(16,905)</b>	(16,421)
	<hr/>	<hr/>



## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 6. DIVIDENDS

No dividend was paid, declared or proposed for the six months ended 30 June 2019 and 30 June 2018. The directors did not recommend the payment of an interim dividend for the six months ended 30 June 2019 and 30 June 2018.

### 7. LOSS PER SHARE

The calculation of the basic loss per share attributable to the owners of the Company is based on the following data:

	<b>Six months ended</b>	
	<b>30.6.2019</b>	30.6.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
<b>Loss attributable to the owners of the Company</b>		
Loss for the purposes of basic loss per share	<b>(84,083)</b>	(348,061)
	<hr/>	
	<b>Six months ended</b>	
	<b>30.6.2019</b>	30.6.2018
<b>Number of shares</b>		
Weighted average number of ordinary shares for the purpose of basic loss per share	<b>8,214,074,906</b>	8,093,480,291
	<hr/>	

### 8. MOVEMENTS IN PROPERTY, PLANT AND EQUIPMENT AND RIGHT-OF-USE ASSETS

During the current period, the Group acquired property, plant and equipment and recognised right-of-use assets of approximately US\$88,054,000 and US\$14,146,000 (for the six months ended 30 June 2018: US\$125,830,000 and nil) respectively.

In addition, the Group disposed of and wrote off certain property, plant and equipment with an aggregate carrying amount of US\$4,092,000 (for the six months ended 30 June 2018: US\$5,418,000) for proceeds of US\$3,183,000 (for the six months ended 30 June 2018: US\$5,962,000), resulting in a loss on disposal and write-off of US\$909,000 (for the six months ended 30 June 2018: gain of US\$544,000).

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 9. DEFERRED TAXATION

The following are the major deferred tax (assets) liabilities recognised and movements thereon for the period:

	Allowances for inventories and trade and other receivables <i>US\$'000</i>	Warranty provision <i>US\$'000</i>	Accelerated tax depreciation <i>US\$'000</i>	Tax losses <i>US\$'000</i>	Deferred income <i>US\$'000</i>	Others <i>US\$'000</i> <i>(Note)</i>	Total <i>US\$'000</i>
At 1 January 2018 (audited)	(13,098)	(17,498)	11,190	(2,514)	(5,120)	(11,530)	(38,570)
Charge (credit) to profit or loss for the period	770	(3,019)	(5,425)	(237)	621	(8,009)	(15,299)
Effect of change in tax rate	64	8	-	-	-	329	401
Exchange adjustments	143	8	6	73	43	915	1,188
At 30 June 2018 (unaudited)	(12,121)	(20,501)	5,771	(2,678)	(4,456)	(18,295)	(52,280)
At 1 January 2019 (audited)	<b>(5,742)</b>	<b>(471)</b>	<b>10,414</b>	<b>(4,190)</b>	-	<b>(9,870)</b>	<b>(9,859)</b>
(Credit) charge to profit or loss for the period	<b>(4,830)</b>	<b>190</b>	<b>6,098</b>	<b>(1,468)</b>	-	<b>(3,354)</b>	<b>(3,364)</b>
Exchange adjustments	<b>(212)</b>	<b>(4)</b>	<b>185</b>	<b>(175)</b>	-	<b>(177)</b>	<b>(383)</b>
At 30 June 2019 (unaudited)	<b>(10,784)</b>	<b>(285)</b>	<b>16,697</b>	<b>(5,833)</b>	-	<b>(13,401)</b>	<b>(13,606)</b>

*Note:* Others mainly represent temporary difference arising from accrued expenses.

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 9. DEFERRED TAXATION *(Continued)*

For the purposes of presentation in the condensed consolidated statement of financial position, certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	<b>30.6.2019</b>	31.12.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
Deferred tax assets	<b>(24,798)</b>	(20,300)
Deferred tax liabilities	<b>11,192</b>	10,441
	<b>(13,606)</b>	(9,859)

At 30 June 2019, the Group has not recognised deductible temporary differences on allowances for inventories, trade and other receivables, warranty provision, deferred income and other accrued expenses of approximately US\$280,037,000 (31.12.2018: US\$259,033,000) as it is not probable that taxable profit will be available against which the deductible temporary difference can be utilised.

At 30 June 2019, the Group has unused tax losses of approximately US\$1,661,903,000 (31.12.2018: US\$1,604,045,000) available for offset against future profits. A deferred tax asset had been recognised in respect of approximately US\$19,473,000 (31.12.2018: US\$14,004,000) of such losses. No deferred tax asset has been recognised in respect of the remaining tax losses of approximately US\$1,642,430,000 (31.12.2018: US\$1,590,041,000) either due to the unpredictability of future profit streams or because it is not probable that the unused tax losses will be available for utilisation before their expiry. The unrecognised tax losses will expire by 5 consecutive years.

Under the EIT Law, withholding tax is imposed on dividends declared in respect of profits earned by PRC subsidiaries from 1 January 2008 onwards. No deferred tax liability has been recognised in respect of temporary differences associated with undistributed earnings of subsidiaries from 1 January 2008 onwards of approximately US\$1,157,100,000 (31.12.2018: US\$1,213,508,000) as at the end of the reporting period because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 10. TRADE AND OTHER RECEIVABLES

	<b>30.6.2019</b>	31.12.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
Trade receivables	<b>2,355,347</b>	3,640,165
Less: Allowance for credit losses	<b>(1,903)</b>	(1,795)
	<b>2,353,444</b>	3,638,370
Other taxes recoverables	<b>278,697</b>	549,483
Other receivables, deposits and prepayments	<b>208,751</b>	117,725
Total trade and other receivables	<b>2,840,892</b>	4,305,578

The Group normally allows an average credit period of 30 to 90 days to its trade customers, except certain customers with a good track record which may be granted a longer credit period.

The following is an aged analysis of trade receivables net of allowance for credit losses as presented based on the invoice dates at the end of the reporting period, which approximated the respective revenue recognition dates:

	<b>30.6.2019</b>	31.12.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
0 – 90 days	<b>2,329,960</b>	3,598,003
91 – 180 days	<b>2,929</b>	30,350
181 – 360 days	<b>14,882</b>	2,331
Over 360 days	<b>5,673</b>	7,686
	<b>2,353,444</b>	3,638,370

During the current interim period, the Group provided impairment allowance of US\$1,903,000 (for the six months ended 30 June 2018: US\$890,000) based on the Group's expected credit loss assessment on its trade receivables.

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 11. TRADE AND OTHER PAYABLES

	<b>30.6.2019</b>	31.12.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
Trade payables	<b>2,686,351</b>	3,920,741
Accruals and other payables	<b>919,526</b>	1,170,684
	<b>3,605,877</b>	5,091,425

The following is an aged analysis of trade payables as presented based on the invoice dates at the end of the reporting period:

	<b>30.6.2019</b>	31.12.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
0 — 90 days	<b>2,495,894</b>	3,678,586
91 — 180 days	<b>73,165</b>	182,819
181 — 360 days	<b>63,300</b>	39,059
Over 360 days	<b>53,992</b>	20,277
	<b>2,686,351</b>	3,920,741

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 12. BANK BORROWINGS

	<b>30.6.2019</b>	31.12.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
Bank loans	<b>1,085,225</b>	1,427,217

Analysis of bank borrowings by currency:

United States dollars ("US\$" or "USD")	<b>1,046,990</b>	1,427,217
Renminbi ("RMB")	<b>29,100</b>	–
Indian rupee ("INR")	<b>9,135</b>	–
	<b>1,085,225</b>	1,427,217

The bank borrowings as at the end of the reporting period are unsecured, with original maturity of one to six months (31.12.2018: two to twelve months), repayable within one year and carry interest at fixed interest rates ranging from 2.85% to 4.00% (31.12.2018: 2.76% to 4.40%) per annum.

### 13. PROVISION

	<b>Warranty provision</b>
	<i>US\$'000</i>
At 1 January 2018	96,896
Exchange adjustments	(554)
Provision for the period	69,877
Utilisation of provision	(63,500)
	<b>102,719</b>
At 31 December 2018	<b>18</b>
Exchange adjustments	<b>7,975</b>
Provision for the period	<b>(52,948)</b>
Utilisation of provision	<b>(52,948)</b>
	<b>57,764</b>
At 30 June 2019	<b>57,764</b>

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 13. PROVISION *(Continued)*

The warranty provision represents management's best estimate of the Group's liability under twelve to twenty-four months' warranty granted on handset products, based on prior experience and industry averages for defective products.

## 14. SHARE CAPITAL

	Number of shares	Amount US\$'000
Ordinary shares of US\$0.04 each, authorised:		
Balance at 1 January 2018, 31 December 2018 and 30 June 2019	20,000,000,000	800,000
Ordinary shares of US\$0.04 each, issued and fully paid:		
Balance at 1 January 2018	8,093,480,291	323,739
Issue pursuant to the share scheme (note 17(b))	120,594,615	4,824
Balance at 31 December 2018 and 30 June 2019	8,214,074,906	328,563

## 15. DEFERRED INCOME

	30.6.2019 US\$'000 (unaudited)	31.12.2018 US\$'000 (audited)
Government subsidies	19,998	20,844

Government subsidies granted to the Company's subsidiaries in the PRC are released to income over the useful lives of the related depreciable assets.

## 16. CAPITAL COMMITMENTS

	30.6.2019 US\$'000 (unaudited)	31.12.2018 US\$'000 (audited)
Commitments for the acquisition of property, plant and equipment contracted but not provided for	8,551	7,923

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 17. SHARE-BASED PAYMENT TRANSACTIONS

### (a) Equity-settled share option scheme

In order to ensure the continuity of a share option scheme for the Company to reward, motivate and retain eligible persons, the Company adopted a share option scheme (the “Option Scheme”) on 26 November 2013, which will expire on 25 November 2023, unless otherwise terminated in accordance with its terms.

Currently, no options have been granted under the Option Scheme. No share option is exercisable as at 30 June 2019 and 31 December 2018.

No expense in relation to the share options granted by the Company was recognised by the Group for the six months ended 30 June 2019 and 30 June 2018.

### (b) Other share-based payment plan

In order to ensure the continuity of a share scheme for the Company to reward, motivate and retain eligible persons, the Company adopted a share scheme (the “Share Scheme”) on 26 November 2013, pursuant to which the Company might grant free shares to the directors or employees of the Company or its subsidiaries or third party service providers including employees of 鴻海精密工業股份有限公司 (Hon Hai Precision Industry Co. Ltd. for identification purposes only) (“Hon Hai”) and any of its subsidiaries.

Pursuant to the approval of the board of directors of the Company on 15 November 2018, the Company offered 146,963,583 ordinary shares to certain beneficiaries pursuant to the Share Scheme, of which 143,711,681 ordinary shares were granted without lock-up periods, while the remaining shares were granted with lock-up periods within one year from the grant date. No consideration was payable on the grant of the shares. 120,594,615 ordinary shares were issued on 15 November 2018 and 26,368,968 ordinary shares were purchased by the trustee of the Share Scheme from the stock market in November 2018.

No share was granted and no expense in relation to the shares granted under the Share Scheme was recognised by the Group for the six months ended 30 June 2019 and 30 June 2018.



## **NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS** *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### **18. FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS**

#### **Fair value of the Group's financial assets and financial liabilities that are measured at fair value on a recurring basis**

The board of directors of the Company has set up an investment team to determine the appropriate valuation techniques and inputs for fair value measurements.

Some of the Group's financial assets and financial liabilities are measured at fair value at the end of each reporting period. The following table gives information about how the fair values of these financial assets and financial liabilities are determined (in particular, the valuation technique(s) and inputs used), as well as the level of the fair value hierarchy into which the fair value measurements are categorised (levels 1 to 3) based on the degree to which the inputs to the fair value measurements are observable.

- Level 1 fair value measurements are based on quoted prices (unadjusted) in active market for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 18. FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS

(Continued)

**Fair value of the Group's financial assets and financial liabilities that are measured at fair value on a recurring basis (Continued)**

Financial assets	Fair value as at		Fair value hierarchy	Valuation technique(s) and key inputs	Significant unobservable input(s)	Sensitivity/relationship of unobservable inputs to fair value
	30.6.2019 US\$'000	31.12.2018 US\$'000				
Equity instrument at FVTPL	<b>Listed equity investments – 4,934</b>	Listed equity investments – 13,082	Level 1	Quoted bid prices in an active market	N/A	N/A
Forward foreign exchange contracts classified as other payables (31.12.2018: other receivables)	<b>Liabilities – 1,214</b>	Assets – 4,481	Level 2	Fair value derived from observable forward exchange rates at the end of the reporting period	N/A	N/A
Investment in interest bearing instruments classified as short-term investments classified as financial assets at FVTPL	<b>Investment in interest bearing instruments – 226,700</b>	Investment in interest bearing instruments – 454,421	Level 3	Income approach – discounted cash flow method was used to capture the present value of the expected return, assumed to approximate the minimum guaranteed return, based on the Group's experience with the deposits which have matured to date	Expected guaranteed interest rate, mainly taken into account different counterpart financial institution, which was 3.90% (31.12.2018: ranged from 3.95% to 4.10%) per annum	The higher the expected guaranteed interest rate, the higher the fair value, and vice versa
Equity instruments at fair value through other comprehensive income ("FVTOCI")	<b>Listed equity investments – 3,660</b>	Listed equity investments – 4,207	Level 1	Quoted bid prices in an active market	N/A	N/A
Equity instruments at FVTOCI	<b>Unlisted equity instruments – 15,660</b>	Unlisted equity instruments – 21,541	Level 2	Fair value derived from market value of the shares of equity instruments in recent investment transactions	N/A	N/A
Equity instruments at FVTOCI	<b>Unlisted equity instruments – 108,213</b>	Unlisted equity instruments – 93,484	Level 3	Income approach – discounted cash flow method was used to capture the present value of the expected return	Weighted average cost of capital ("WACC") and discount for lack of control ranged from 20.17% to 45.00% and 24.20% to 55.00% (31.12.2018: 20.11% to 40.00% and 24.60% to 45.00%) respectively	The lower the WACC or discount for lack of control, the higher the fair value, and vice versa

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 18. FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS

(Continued)

#### Reconciliation of Level 3 fair value measurements of financial assets

	Unlisted equity instruments US\$'000	Short-term investments US\$'000
At 1 January 2018 (audited)	58,204	426,554
Net fair value gains (losses)		
– in profit or loss	–	9,299
– in other comprehensive income	(27,000)	–
Purchases	–	1,368,214
Settlements	–	(1,399,108)
Exchange adjustments	(99)	(4,538)
	<hr/>	<hr/>
At 30 June 2018 (unaudited)	31,105	400,421
	<hr/>	<hr/>
At 1 January 2019 (audited)	<b>93,484</b>	<b>454,421</b>
Net fair value gains (losses)		
– in profit or loss	–	6,229
– in other comprehensive income	(2,997)	–
Purchases	–	571,156
Settlements	–	(807,916)
Transfer into Level 3	17,755	–
Exchange adjustments	(29)	2,810
	<hr/>	<hr/>
At 30 June 2019 (unaudited)	<b>108,213</b>	<b>226,700</b>

For the other financial assets and financial liabilities, the directors of the Company consider that the carrying amounts of financial assets and financial liabilities recorded at amortised cost in the condensed consolidated financial statements approximate their fair values.

Out of the total gains or losses for the period included in the profit or loss, US\$1,193,000 (for the six months ended 30 June 2018: US\$1,572,000) related to net unrealised gains of short-term investments classified as financial assets at FVTPL at the end of current reporting period, which are included in “other income, gains and losses”.

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 18. FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS

(Continued)

#### Financial assets and financial liabilities subject to offsetting

The disclosures set out in the table below include financial assets and financial liabilities that are offset in the Group's condensed consolidated statement of financial position.

The Group currently has a legally enforceable right to set off certain bank balances with bank borrowings at the same banks that are due to be settled on the same date and the Group intends to settle these balances on a net basis.

	As at 30 June 2019		
	Gross amounts of recognised financial assets (liabilities) US\$'000	Gross amounts of recognised financial (liabilities) assets set off in the condensed consolidated statement of financial position US\$'000	Net amounts of financial assets (liabilities) presented in the condensed consolidated statement of financial position US\$'000
Bank balances	1,288,002	(1,288,002)	-
Bank borrowings	(1,288,002)	1,288,002	-
Interest receivables	18,459	(16,705)	1,754
Interest payables	(16,705)	16,705	-

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 18. FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS

(Continued)

**Financial assets and financial liabilities subject to offsetting (Continued)**

	As at 31 December 2018		
	Gross amounts of recognised financial assets (liabilities) US\$'000	Gross amounts of recognised financial (liabilities) assets set off in the consolidated statement of financial position US\$'000	Net amounts of financial assets (liabilities) presented in the consolidated statement of financial position US\$'000
Bank balances	1,098,738	(1,098,738)	-
Bank borrowings	(1,098,738)	1,098,738	-
Interest receivables	14,991	(13,612)	1,379
Interest payables	(13,612)	13,612	-

During the period, net interest income of US\$1,339,000 (for the six months ended 30 June 2018: US\$1,430,000) was included in interest income under the above arrangement.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

## 19. RELATED PARTY DISCLOSURES

- (a) During the current period, the Group entered into the following transactions with related parties, including Hon Hai, the ultimate holding company of the Company, and subsidiaries and associates of Hon Hai other than members of the Group:

	Six months ended	
	30.6.2019 US\$'000 (unaudited)	30.6.2018 US\$'000 (unaudited)
Hon Hai:		
Sales of goods	–	3,663
Purchase of goods	2,367	1,885
Sales of property, plant and equipment	119	–
Lease expense — real properties (Note)	110	345
Sub-contracting income	1,128	1,223
Consolidated services and sub-contracting expense	1,590	1,558
General services expense	5	18
Subsidiaries of Hon Hai:		
Sales of goods	24,604	69,559
Purchase of goods	108,044	189,077
Purchase of property, plant and equipment	7,875	19,998
Sales of property, plant and equipment	2,020	1,415
Lease income — real properties	2,239	1,896
Lease income — non-real properties	10	174
Lease expense — real properties (Note)	2,952	2,190
Lease expense — non-real properties (Note)	4,653	3,772
Sub-contracting income	8,731	6,760
Consolidated services and sub-contracting expense	111,929	115,825
General services income	152	136
General services expense	4,795	11,493
Associates of Hon Hai:		
Sales of goods	549,979	598,589
Purchase of goods	403,639	317,432
Purchase of property, plant and equipment	9,375	250
Lease income — real properties	44	71
Lease expense — real properties (Note)	33	6
Sub-contracting income	1,821	3,780
Consolidated services and sub-contracting expense	1,999	2,409
General services income	–	60
General services expense	23	229

Note: The amount represented the rental paid in current period.

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 19. RELATED PARTY DISCLOSURES (Continued)

(b) At the end of the reporting period, the Group had the following balances due from/to related parties included in:

	<b>30.6.2019</b> <b>US\$'000</b> <b>(unaudited)</b>	31.12.2018 <i>US\$'000</i> <i>(audited)</i>
Trade receivables:		
Hon Hai	<b>1,326</b>	1,412
Subsidiaries of Hon Hai	<b>37,087</b>	56,747
Associates of Hon Hai	<b>54,248</b>	70,783
	<b>92,661</b>	128,942
Other receivables:		
Subsidiaries of Hon Hai	<b>643</b>	204
Associates of Hon Hai	<b>1</b>	30
	<b>644</b>	234
	<b>93,305</b>	129,176
Trade payables:		
Hon Hai	<b>2,209</b>	2,056
Subsidiaries of Hon Hai	<b>266,453</b>	292,639
Associates of Hon Hai	<b>153,165</b>	143,770
	<b>421,827</b>	438,465
Other payables:		
Hon Hai	<b>92</b>	1,360
Subsidiaries of Hon Hai	<b>15,440</b>	13,765
Associates of Hon Hai	<b>730</b>	441
	<b>16,262</b>	15,566
Lease liabilities:		
Hon Hai	<b>308</b>	–
Subsidiaries of Hon Hai	<b>511</b>	–
Associates of Hon Hai	<b>155</b>	–
	<b>974</b>	–
	<b>439,063</b>	454,031

Balances due from/to related parties except for lease liabilities are unsecured, interest free and are repayable within one year.

## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

FOR THE SIX MONTHS ENDED 30 JUNE 2019

### 19. RELATED PARTY DISCLOSURES *(Continued)*

#### (c) Compensation of key management personnel

The remuneration of directors and other members of key management for the period was as follows:

	<b>Six months ended</b>	
	<b>30.6.2019</b>	30.6.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Short-term benefits	<b>1,511</b>	2,483
Share-based payments	<b>1,351</b>	7,902
	<b>2,862</b>	10,385

- (d) During the period, the Group entered into the following transactions with an associate (2018: associates):

	<b>Six months ended</b>	
	<b>30.6.2019</b>	30.6.2018
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Sales of goods	<b>22,614</b>	17,525
Purchase of goods	<b>2,057</b>	126,083
Other income	<b>3,554</b>	18,947
Other expense	<b>-</b>	2,780

The amounts due from associates were US\$2,730,000 (31.12.2018: US\$8,039,000), which were included in other receivables, as at 30 June 2019.

### 20. APPROVAL

The condensed consolidated financial statements on pages 4 to 39 were approved and authorised for issue by the board of directors of the Company on 9 August 2019.



## BUSINESS REVIEW

### IMPORTANT

The Group's consolidated interim results for the six-month period ended 30 June 2019 (the "current period") as set out in this interim report are unaudited but have been reviewed in accordance with the relevant financial standards. The Group's results of operations in the past have fluctuated and may in the future continue to fluctuate (possibly significantly) from one period to another period. Accordingly, the Group's results of operations for any period should not be considered to be indicative of the results to be expected for any future period.

On the basis of a preliminary review of the Group's latest unaudited management accounts and other information currently available, the Company expects the Group to record a loss, if any, for the year ending 31 December 2019 which is likely to be materially smaller than the Group's consolidated net loss of US\$857,115,000 for the year ended 31 December 2018. Various factors are relevant to the above, including those highlighted in the Company's profit warning announcement dated 3 May 2019. Those factors are expected to continue into, and new factors might emerge during, the remainder of 2019. For more details, please refer to the aforesaid announcement and the Company's announcement dated 18 July 2019 on additional inside information relating to last profit warning. At this stage, on the basis of a preliminary review of currently available information, apart from the aforesaid, the Company is unable to reasonably and meaningfully estimate a more precise likely magnitude of loss, if any, for the year ending 31 December 2019. The Company will make further announcement(s) in compliance with the Rules (the "Listing Rules") Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") and/or the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (the "SFO"), as appropriate. For more details, please see the "Outlook" section below.

This interim report contains forward-looking statements regarding the Company's expectations and outlook on the Group's business operations, opportunities and prospects. Such forward-looking statements do not constitute guarantees of the future performance of the Group and are subject to factors that could cause the Group's actual results to differ (possibly materially) from those expressed in the forward-looking statements. These factors may include, but not limited to, changes in general industry and macro-economic environment (such as intensifying trade wars and political conditions), changes in money markets (such as interest rate hikes and volatility in foreign exchange rates), changes in capital markets, competition, shifts in customers' demand and preferences, seasonality of sales, changes in sales and product mix, changes in commodity price, shortage of components, technology advancement, and changes in market/legal/regulatory/government/tax policy (e.g. government's blacklisting, export controls and bans against the Group's major customer). In addition, new risks emerge from time to time and it is not possible for the management to predict all such risk factors or to assess the impact of such risk factors on the Group's business. The Company undertakes no obligation to update or revise any such forward-looking statements to reflect any subsequent events or circumstances, except as otherwise required by applicable requirements laid down by the Listing Rules and the SFO.

Accordingly, the shareholders of the Company and potential investors are advised to exercise caution when dealing in the shares of the Company.

## **BUSINESS REVIEW** *(Continued)*

### **INTRODUCTION**

Since its activation in 2003 and the listing of its shares on the Main Board of the Stock Exchange in 2005, the Company has been a subsidiary of 鴻海精密工業股份有限公司 (Hon Hai Precision Industry Co. Ltd., for identification purpose only) (“Hon Hai”, together with its subsidiaries and associates, the “Hon Hai Group”). Hon Hai is a company incorporated in Taiwan whose shares are listed on the Taiwan Stock Exchange Corporation, and a leader in the handset industry worldwide as a vertically integrated manufacturing service provider offering a comprehensive range of end-to-end components and manufacturing and engineering services to its customers in respect of handsets and other wireless communication devices and consumer electronic products, including unique and innovative product development and design, casings (the casings may be sold to customers or used to manufacture complete handsets for delivery to customers), components, PCBA (Printed Circuit Board Assembly), full-system assembly etc., and supply chain services and solution, and repair and other after-sales services which are located close to the customers. In addition to handsets, the Group is engaged in the manufacturing of other wireless communication devices and consumer electronic products and accessories and related areas, such as e-Readers, tablets and voice interaction products.

The Group strives to provide its customers with not only manufacturing support, but also a full range of cost-competitive services including repair, service on a global basis, and the Company believes that this strategy differentiates the Group from its competitors and will help to support its customers’ products during their entire life cycles and reduce the time required to bring the products to market and fosters long term business relationships with customers.

### **DISCUSSION AND ANALYSIS**

#### **Key Relationships with Customers, Suppliers and Employees**

The Group’s major customers include top international brands and Chinese brands, therefore the Group has established manufacturing facilities and operations, Research and Development (“R&D”) centres and phone repair and refurbishment facilities located close to its customers across the Asia-Pacific region (e.g. China, India, Vietnam, Taiwan) and the America including Mexico to better facilitate their respective local needs and enable such customers to accelerate the launch of their products to market.

In relation to the Group’s continuous fostering and development of long-term relationships and partnerships with customers during the year under review, the Group entered into collaboration with a U.S.-based internet customer in 2018 who is one of the most innovative internet companies in the world to bring the most advanced AI technology-embedded smart phones to customers and consumers worldwide. As its sales grow, it has now become one of the Group’s top five customers.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Key Relationships with Customers, Suppliers and Employees** *(Continued)*

Our another customer, HMD global Oy (“HMD”), is headquartered in Espoo, Finland and is the home of Nokia-branded phones and the manufacturer of Nokia-branded smart phones and feature phones targeting worldwide mobile phone market with full price range. Sales to HMD is grouped under Europe segment. By working with best in-class industry partners, HMD has assembled an ecosystem of strong partnerships in imaging, software and manufacturing. With a commitment to innovation and quality, HMD is the exclusive licensee of the Nokia brand for phones and tablets. HMD is principally responsible for IP (Intellectual Property) right management, product development, sales and marketing for the mobile devices and related services. For details, please see “Investments” section below.

As a whole, the Group’s strategy is to work with the customers from the initial concept design stage up until the end of the production process managing all aspects of sourcing, development and assembly and services of phone and provide a complete range of cost-competitive and vertically-integrated global supply chain solutions for our customers and consumers. This enables our customers to leverage on our supply chain solutions to meet their product requirements throughout the life cycle of their products. The first half of 2019 has been challenging period for the whole handset industry due to many factors impacting competitive landscape while market has been shrinking in many geographies. There has been more than usual pressure on pricing coming from largest players in the industry fighting against recent trend in market share development and all of the Group’s customers have been facing challenges of various kinds.

Amongst the Group’s five largest customers (including HMD) during the current period which accounted for approximately 89.6% of the Group’s total revenue during such period, three of them have long-term and well-established relationships with the Group for more than five years, and the other two have been its customers for more than a year as well. These top five largest customers are largely the same as those for the first half of 2018 except the U.S.-based internet customer with whom the Group entered into collaboration in the second half year of 2018. These major customers are not required to commit to certain minimum purchase value or volume from us over a period of time. In the dynamic handset industry, where innovation and enhanced user experience are paramount and loss of or changes in market position of any of these customers or their products may materially and adversely affect the Group’s business, financial condition and results of operation, especially in view of the concentration of our sales to these customers. Our reliance on major customers means that our performance is directly affected by the performance of these customers in a challenging handset industry. Given that the industry is dominated by significant players, it would be difficult for the Group to develop new customers that have similar business scale as our existing major customers and affect to certain extent our bargaining power. Further, it takes time for us to gear up our production facilities to produce products and provide

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Key Relationships with Customers, Suppliers and Employees** *(Continued)*

services that are customised for new customers. It typically takes us approximately 2 months to 10 months to customise our production facilities depending on the complexity and sophistication of products if we switch to or add a new customer. In light of the handset market saturation, the Group focuses on technology innovation to ensure user experience and values the mutually beneficial relationships with its customers by providing them with high quality products and services of global standards at competitive prices, manufacturing industry-leading and state-of-the-art products for its customers in different countries like China and Vietnam and India, offering customised services and flexibility to clients, and creating customer delight among passionate people engaged in a world-class manufacturing environment, and continues to prolong, develop and foster closer relationships and partnerships with them for mutual benefit of the Group and such customers in the long run and secure optimal utilisation of manufacturing equipment and facilities of the Group. But as one of the core business of one major customer is not handset business, any change to its business strategy on the phone business may result in hit to the Group's business and this drives the Group to devote resources to this customer. Like many industries in today's globalised world, the handset market experiences continuous consolidation where smaller-by-smaller number of leading players tend to capture a relatively significant market share. As an OEM/ODM/IDM (Original Equipment Manufacture/Original Design Manufacture/Innovative Design Manufacture) and manufacturing solution-provider in the handset industry, the Group has proactively managed growth and concentration risk in a balanced manner in the dynamic and competitive market.

One of such five largest customers is Sharp Corporation, which is a connected person of the Company pursuant to the Listing Rules as it is an associate of Hon Hai, the ultimate controlling shareholder of the Company. The revenue derived from the sales of goods and rendering of services by the Group to Sharp Corporation accounted for approximately 8.5% of the Group's total revenue from the sales of goods and rendering of services for the current period.

The credit period granted to the Group's major customers ranges from 30 to 90 days, which is in line with those granted to other customers. The allowance for credit loss made for the current period was US\$0.11 million (when compared to the allowance for doubtful debt of US\$0.057 million for the same period in 2018), which allowance was made for specific exceptional circumstances and based on the expected credit allowance assessment. Subsequent settlements of trade receivables from these major customers have been reviewed and are satisfactorily resulting in no credit-impaired receivables noted for the current period.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Key Relationships with Customers, Suppliers and Employees** *(Continued)*

The Group's procurement team deals with over 3,000 suppliers that supply components and other materials necessary for the Group's businesses and most of them are reputable and qualified approved suppliers with long-term and stable relationships with the Group, in order to secure adequate supply of key parts, maintain stronger bargaining power, and source good quality materials with competitive prices in a time-efficient manner without the need of relying on some major suppliers. Bill of material (BOM) cost control is of critical importance.

The Group's suppliers include suppliers of raw materials, electronic components and parts, display module, camera module, battery, enclosure and packaging materials, and such suppliers are generally selected by the Group based on the quality and reliability of products, technical competence and engineering capability, on-time delivery, service quality, price competitiveness, commercial terms for supply transactions and specifications from its customers and industry reputation. Purchases from the Group's five largest suppliers accounted for approximately 71.8% of the Group's total purchases for the current period. Amongst these five largest suppliers, four of them have long-term and well-established relationships with the Group for more than five years, and the remaining one has been our supplier for a year. As our contracts with these major suppliers do not require them to reserve their production capacity to produce supplies to us or to guarantee minimum supplies to us, we could be exposed to the risk of unstable supplies. Notwithstanding the apparent concentration of procurements from these major suppliers, we are not exposed to any material risk of disrupted supplies from our suppliers as our procurement needs are well planned with sufficient buffer to address any possible material delay and there are a vast number of alternative suppliers in the market for the Group to choose from. We believe that we will not be subject to material costs or delay if we were to switch suppliers in case such needs arise. Notwithstanding that there are a great number of suppliers in the market that the Group could potentially choose from, we have over the years concentrated our procurement from major suppliers because of the ease of procurement process and the commercially sound terms offered by these suppliers. One of such five largest suppliers is the Hon Hai Group. Hon Hai is the ultimate controlling shareholder of the Company and hence a connected person of the Company pursuant to the Listing Rules. The purchases attributable to the Hon Hai Group accounted for approximately 9.5% of the Group's total purchases for the current period. For details, please refer to the "The Group's Value Chain" section of the Company's separate 2018 environmental, social and governance report as issued and published on 9 April 2019.

In response to the potential risks associated with the Group's reliance on its major customers and major suppliers, the Group has diversified customers, and suppliers base and has implemented and maintained sound and effective systems of internal control and enterprise risk management to assess and monitor such potential risks. For details, please refer to the "Accountability and Audit" section of the Company's 2018 corporate governance report, which forms part of the 2018 annual report as issued and published on 9 April 2019.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Key Relationships with Customers, Suppliers and Employees** *(Continued)*

Employees are valuable assets to the Group. Therefore, the Group has been working diligently in different countries to attract and retain talents. The Group recognises that its future success will be highly dependent on its continuity to attract and retain qualified employees by offering more equal employment opportunities, competitive compensation and benefits, more favourable working environment, broader customer reach, bigger scale in resources, training and job rotation and diversification, coupled with better career prospect across various products and business lines. The Group places great emphasis on career planning and talent development for employees in different countries by encouraging employees to attend internal and external training programs. Internal training programs include courses for core competency and professional competency and technical development to enhance employees' capabilities, while external training programs include seminars or conferences organised by external parties that provide excellent training opportunities for employees. The Group prides itself on providing a safe, effective and congenial working environment and it values the health and well-being of its staff. Adequate arrangements, training and guidelines have been implemented to ensure a healthy and safe working environment. The success of the Group is dependent on its talents, with its focus on human capital initiatives and strategic workforce planning in terms of talent acquisition, development, rewards and retention and localisation. The Group has built up an experienced R&D team in China and Taiwan to support its significant opportunities for business growth (such as new technology and materials and new customers) by investing in R&D on top of its strong manufacturing and engineering capabilities to implement and execute the corresponding R&D requirements of our customers. The Group strives to reinvent productivity to empower people and organisations to achieve more and increase agility, streamline engineering processes, move faster and more efficiently and simplify its organisation and optimise cost structure. By encouraging employees to bring up innovation at work, cooperating with customers on pioneer projects and supporting start-ups on manufacturing (or even with equity investments), the Group has successfully accumulated relevant experiences on procurement, value and design engineering and product development, quality management, production management, repair services and sales and marketing competence. As at 30 June 2019, the Group had a total of 94,387 (31 December 2018: 97,484) employees. Total staff costs incurred during the current period amounted to US\$296 million (US\$270 million for the first half of 2018 and US\$271 million for the second half of 2018), and the year-on-year increase was mainly due to introduction of a new customer in 2018 and rightsizing of staff force according to business needs. The Group offers a comprehensive remuneration policy which is reviewed by the management on a regular basis. The Company has adopted both a share scheme and a share option scheme, and the share option scheme complies with the requirements of Chapter 17 of the Listing Rules. The emoluments payable to the directors of the Company are determined by the board of directors of the Company (the "Board") from time to time with reference to the Company's performance, their duties and responsibilities with the Company, their contributions to the Company and the prevailing market practices as well as the recommendations of the Company's remuneration committee. For details, please refer to the "Human Capital — The Group's Greatest Asset" section of the Company's separate 2018 environmental, social and governance report as issued and published on 9 April 2019.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations**

##### **Financial Performance**

The financial KPIs (Key Performance Indicators) include the above-mentioned year-on-year changes in sales, gross margins, net margin and return on equity. For peer analysis, as peers may have different business strategies, business models, client mix, revenue and product mix (casing versus system assembly and other non-handset businesses), business segments, pricing strategy and policy, geographical footprint, cost structure, it may be difficult to make direct comparisons at consolidated group account level as some peers may have business segments other than mobile phone casing and system assembly business.

For the current period, the Group recognised a consolidated revenue of US\$6,389 million, representing a decrease of US\$174 million or 2.65% when compared to US\$6,563 million for the same period last year. Net loss for the current period was US\$83.8 million, when compared to a net loss of US\$348.6 million for the same period last year. The Group's net loss is primarily attributable to various factors, including the following: (1) the challenging conditions that the Group has faced since late 2017 having continued through 2018 into 2019; (2) continued pressure on the Group's gross margins generally and the first half of 2019 gross profit margins was 0.68% (compared with a loss margin of around 0.53% for the first half of 2018); and (3) regarding the Group's cessation of its logistics and distribution business from 1 January 2019, such cessation has worsened the Group's gross profit as the Group lost distribution income (grouped under revenue) that would otherwise be generated from that business (sales income from that business for the year ended 31 December 2018 totalled around US\$61.77 million), on the flip side, those selling expenses which were incurred to generate distribution income reduced and as a whole the Group's selling expenses was US\$7.9 million for the first half of 2019 (compared with selling expense of US\$ 60.9 million for the first half of 2018). These factors are expected to continue into, and new factors might emerge during, the remainder of 2019.

Gross profit and gross margins of a manufacturing business are common financial KPIs measuring how much a company is generating from revenues (after deducting cost of sales) to cover operating expenses. A higher percentage of gross profit means a stronger ability to control cost of sales, which includes control of variable costs such as BOM cost, direct labour costs, variable manufacturing costs, overheads and yields, and efficiency which can improve the contribution margin to cover fixed overheads. The more profitable the business is, the more profit is available to cover operating expenses and ultimately to pass on to the shareholders. As explained in further detail below, these are key indicators of the Group's business as our performance has been impacted to a large extent by the challenges presented for our gross profit and gross margins.

Gross profit for the current period was US\$43.6 million, represented an increase of US\$78.5 million profit from that for the same period last year, mainly as a result of the adjustment to the collaboration model happened at the end of 2018 between the Group and HMD on Nokia-branded smart phone business. Gross margins for the current period was a profit of 0.68% and was better than the loss of 0.53% for the same period last year.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Financial Performance** *(Continued)*

In 2018, after operating for two years (since the acquisition of assets from Microsoft Mobile Oy (“Microsoft”) in December 2016), the challenging conditions faced by the Group started in the second half of 2017 and continued into 2018. During that period, BOM costs of smart phones remained higher than the selling prices. The volume of manufacturing of Nokia-branded smart phone business is directly related to success of its customer, HMD. However, the volume was below the levels that would drive economies of scale so that the Group’s sourcing could carry out supplier consolidation and allocate procurement to only a limited number of qualified suppliers to enable the Group to have a stronger bargaining power and buy at bulk and at more competitive prices. It was anticipated that it would take time to reach the required scale of production as HMD operates in a handset market which is highly competitive and market growth has slowed down and few markets have even contracted year-on-year. For the Nokia-branded phone business, the Group had to do the commodity and program sourcing work itself. To relieve its pricing and gross margin erosion pressure, BOM control is of critical importance. Key components in handset BOM cost include platform chipset, memory, display, camera module, enclosure/housing and battery which account for the top six items of cost in the dollar value. Due to the continuous year-on-year market decline in the Chinese consumer market, the material market situation has changed dramatically. The cost increases in the key components had affected profit margins because the rise in BOM cost could not be automatically transferred into customers without negative impact on the demand. Smart phone business continues being price-sensitive and retail selling prices of phones sold by distribution arm, TNS Limited (“TNS”), were required to be competitive in order to continue taking share in the market and increase the phone shipment volume to achieve a better bargaining power for the sourcing function of the Group. All those unfavourable factors including pressure in BOM costs, manufacturing costs and quality assurance costs of smart phones have affected the costs of smart phones manufactured by the Group which are sold to HMD and gross margins pressure were impacted significantly and this accounted for the huge gross loss.

Up to end of 2018, despite all the actions and efforts that have been taken by the Group’s Nokia-branded smart phone manufacturing business in the past two years, the overall performance was poor. As competition remains fierce and given the difficulties ahead in 2019, the Group critically reviewed its business strategy in 2018 year end and determined not to accept orders with poor margin in 2019 and ahead and at the same time, the Group’s partner, HMD (which has been in the dynamic and competitive handset market) came to a strategic decision at 2018 year end to deploy a multi-ODM partnership strategy and HMD will not only seek for the Group’s support but also contracts other ODMs.



## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Financial Performance** *(Continued)*

The first half of 2019 has been challenging period for the whole handset industry (including HMD) due to many factors impacting competitive landscape while market has been shrinking in many geographies. There has been more than usual pressure on pricing coming from largest players in the industry fighting against recent trend in market share development. This situation got even more challenging when U.S. decided to continue its efforts in limiting use of U.S. technology in foreign origin products for the security reasons. This was immediately impacting whole industry halting supply in some markets and generating high price erosion and sales pressure on others. This was clashing with HMD plan of cleaning the past business model generated liabilities generated during 2018 coming from old second and third generation/wave smart phone products in a steady manner and the Group has continued to manufacture HMD's loss making second and third generation/wave old smart phone products until the end of the product lifecycle and only accept the design and manufacture of Nokia-branded feature phone programs and new smart phone programs of satisfactory margin and such change in the collaboration model has gradually decrease the sales to HMD in the first half of 2019 and the sale drop to HMD can be partially offset by sale to the new U.S. internet customer. As the first three generations of Nokia-branded smart phones have been introduced in the market for a period of time, when those generations of products of which performance in gross margin has been poor are approaching the end of their life cycle, the gross loss is expected to be lesser in the second half of 2019 and the Group's gross margin (excluding the impact to gross margin triggered by the discontinuance of phone distribution business) will improve gradually. Now the Group can refocus on Nokia-branded smart phone projects with optimised profit margins and this will ease the margin erosion pressure. All the challenges and factors listed above posed huge pressure on gross margins and the majority of the poor performance was reflected in the loss-making Europe segment (please refer to note 3 of "Revenue and Segment Information").

As a whole, there is a continuous need to drive for better internal operational efficiency of assembly, testing processes, inventory and supply chain management, quality management, improve yields to lower manufacturing costs, conduct the benchmarking of cost leaders' processes and costs of external EMS (Electronic Manufacturing Services) to improve the competitiveness of the Group's manufacturing costs, yield and efficiency. In short, good vendor management, supply chain management, manufacturing management, quality management, order fulfilment and inventory management are critical to ensure cost efficient operations.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Financial Performance** *(Continued)*

For TNS, coupled with the refocusing, the Group implemented cost down exercises to lower its overhead and operating expenses to maintain a healthy cash flow to keep its ability to sustain in the highly competitive mobile phone market. Accordingly, TNS decided to discontinue its distribution business at the end of 2018 and cut the headcounts and consequently terminated the customer and distributor agreements of distribution business. Such cessation has worsened the Group's gross profit as the Group lost distribution income (grouped under revenue) that would otherwise be generated from that business, on the flip side, those selling expenses which were incurred to generate distribution income reduced and as a whole the Group's selling expenses has declined year-on-year.

Apart from the Nokia-branded phone manufacturing business, the Group's casing and system assembly business also continued to face many tremendous challenges. There was surplus capacity for the casing industry sector as there had been excessive investments in mechanical capacities (such as CNC (Computer Numerical Control) Machines) in previous years by peers and competition of system assembly business was also keen and coupled with shrinking of the markets in many geographies, the price and margin erosion pressure for both casing (and mechanical) and system assembly businesses were extremely high. At the same time, there had been a change in our sales and product mix and there had been some decline in our casing business (partly due to the change in product mix from high-end and mid-range products to low-end ones) whilst weight of system assembly business of comparatively low gross margins increased. For our peers of casing business, they are companies listed in the Mainland, Hong Kong or Taiwan and have been the vendors of our customers for a long time with well-established business relationships with our customers. They also have customers which are not the customers of the Group. They have strong cost competitiveness and they are innovative (like having glass casing capabilities and IMT (In-Mould Transfer) technology on plastic casing), have become increasingly strong and competitive in all areas at a fast pace and their margins are in general better than the Group. A research in analyst reports and quarterly reports (in 2019 quarterly results) and annual reports of the 5 major competitors/peers had been conducted in-house and the study showed that their performances varied but was in general deteriorating in the first quarter of 2019. These peers' core businesses are diversified. Apart from mechanical business, they also engage in other businesses. For these 5 peers, their core and other businesses and 2019 first quarter performance are listed as follows:

- i. Peer 1 is a Hong Kong listed company whose core businesses are acoustics and haptics optical applications. Its 2019 first quarterly report showed its whole revenue decreased 19% year-on-year and gross margin decreased 36% year-on-year due to the deduction of order and shipment of customers. For mechanical, it also mentioned about the penetration rate in mainstream Android phones had increased in the first quarter, and the company expected it to keep increasing in second quarter of 2019;

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Financial Performance** *(Continued)*

- ii. Peer 2 is a Hong Kong listed company whose business includes handset component making (including casing, mould/keypads and battery chargers) and is an OEM/ODM service provider for handset EMS and also provider for a wide range of metal, glass, and ceramic designs. Its 2019 first quarter gross margin declined around 5% year-on-year but it did not state the reason;
- iii. Peer 3 is a People's Republic of China ("PRC") listed company whose shares listed in Shenzhen Stock Exchange and its core business also includes IMT casings and glass casings and water-proof components. Its 2019 first quarterly report showed its margin rate slightly bounced back after largely decreased in the first quarter of 2018 by developing international customers and extending the product mix to notebook computers, smart home products and wearable devices;
- iv. Peer 4 is a Hong Kong listed company whose business includes mobile communication terminal, digital and optoelectronic products such as precision mobile phone metal appearance, mobile phone metal frame, precision shielding, micro precision connectors respectively. Its 2019 first quarter business update showed the revenue decreased around 9% year-on-year even with contribution from an new Korean customer since the third quarter of 2018, which was partly resulted from the price decrease of metal case in 2019;
- v. Peer 5 is a Taiwan listed company which specialises in light metal casing and its products include computers, communication and other consumer electronics. According to its 2019 first quarterly financial statement and management report, the company recorded an improved gross margin of 2.5% but a deteriorated net loss of 10% (as compared to a gross margin of 1.5% and a net loss of 8% for the same period in 2018) due to the adjusted product lines (with low utilisation) and increased development cost.

With markets demanding multi-functionality, thinness and eco-friendly phones, metal materials have been a trend and gained widespread popularity. Apart from having high ventilation efficiency with great tensile strength, metal materials also look contemporary and stylish and this means that casing business is a sustainable business. Therefore, the Group is now devoting itself to improving existing technologies and manufacturing, delivering innovation on both processes and materials, enhancing the core competence and capability of mechanical engineering (which is critical to the successful running of casing business), quality and efficient customer responsiveness and speed, shorter mould manufacturing cycle time and cost effectiveness and efficiency of casing business and optimising production costs like direct labour costs and yields and benchmark costs of our own manufactured mouldings and tooling against market prices. China domestic labour costs have risen sharply, yet the efficiency of assembly line workers has not increased correspondingly and the cost advantage of China is no longer comparable with other countries in Southeast Asia like Vietnam and India in the medium term.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Financial Performance** *(Continued)*

System assembly business of OEM business model, which is the major business model of the Group, has a low barrier to entry and low gross margins. In terms of competition analysis, the Group only earns processing fees and manufacturing fees while yield, efficiency and quality differentiation are of critical importance to reducing customers' price sensitivity and developing long-term business relationship. But the amount working capital employed to finance system assembly business can be high. For our Indian operation, we are strong as we own very large system assembly capacity and there is vertical integration from PCBA to complete handset assembly. Peers of OEM business include Taiwan, China and U.S. companies. In relation to a Taiwan peer who is a Taiwan listed company which offers a wide range of electronics products in computing, it also engages in the development, design and manufacturing of peripherals and components of the above-mentioned products. Referring to its published first quarter results, its gross margins decreased from 3.3% in 2018 to 2.3% in 2019, and its net income also decreased from 0.7% in 2018 to 0.2% in 2019, which were mainly due to the financial loss of two subsidiaries, and the decline of utilisation resulting from the slowing demand of main customer. Another peer is a PRC listed company which started with OEM business and has become an OEM/ODM company as the competition in the system assembly industry is intense due to the low entry barrier that attracted a large number of competitors. The first quarter results showed its gross margin declined from 12% in 2018 to 7% in 2019 even though the revenue increased 180% due to an acquisition of a leading semiconductor company. The remaining peer is a reputable U.S. listed company which is an Electronics Manufacturing Services (EMS) provider focusing on delivering complete design, engineering and manufacturing services to aerospace and defense, automotive, computing, consumer, industrial, infrastructure, medical, clean technology and mobile OEMs. According to its fourth quarterly report of the financial year 2019 (for the three months ended March 31, 2019), the U.S. GAAP ("U.S. Generally Accepted Accounting Principles") revenue decreased by 3% year-on-year due to the improvement in quality of sales mix. The above comparison with the 3 peers showed that the market is highly competitive and the margins of system assembly business/industry is narrow due to the slowing demand of customers.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Financial Performance** *(Continued)*

Other income, gains and losses for the current period was US\$107.1 million, representing an increase of US\$99.8 million from that for the same period last year, mainly as a result of the significant year-on-year change in foreign exchange loss. The Group had experienced a foreign exchange loss of US\$7.8 million for the first half of 2019, when compared with the Group's foreign exchange loss of US\$88.2 million for the first half of 2018. For the first half of 2019, INR has experienced depreciation at first quarter and become appreciated after president Modi won the general election in May 2019. As the trade war tension between U.S.-China and potential U.S.-India will not reach conclusion in the near future, currency market will continue to be very volatile in the coming months. In order to reduce currency exposure and save hedging costs, the Group will modify the currency settlement mechanism business model with its customers in the 2019 second half for India business. Fair value gain of equity investments at fair value through profit or loss increased by US\$29.4 million to US\$3.8 million for the current period (2018 fair value loss was US\$25.6 million). Service income also increased by US\$35.2 million and service income for the current period is US\$51.3 million (2018: US\$16.1 million) and was mainly due to the product development service provided to customers.

Regarding operating expenses, for the current period was US\$210 million, when compared with US\$313 million for the same period last year. With the discontinuance of its logistic and distribution business since January 2019 and the decrease in Nokia-branded smart phone business, there was a year-on-year decrease in selling expenses and R&D expenses. For selling expenses, there was a year-on-year decrease of US\$53 million and the decrease was mainly due to the decrease of marketing expenses like digital and below-the-line marketing and communication and advertising expenses, expenses for external cooperative field force and promoters and sales incentive, etc., for marketing smart phones associated with a decrease in distribution volume of Nokia-branded phones. For general and administrative ("G&A") expenses, with the effort of cost savings, there was a year-on-year decrease by US\$19 million, For R&D expenses, there was a year-on-year decrease of US\$32 million and the decrease was mainly contributed by the optimisation and rightsizing of staff force and stringent overheads and costs control.

In light of the factors as mentioned above, loss attributable to owners of the Company for the current period was US\$84 million, as compared to a net loss attributable to owners of the Company of US\$348 million for the corresponding period last year. The net loss margin for the current period was 1.32%, as compared to the net loss margin of 5.3% for the same period last year.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Financial Performance** *(Continued)*

Net profit and net profit margin are the financial KPIs measuring earnings/losses resulting from subtracting operating expenses and other gains and losses (such as equity investments fair value change) and tax and interest costs from gross profit earned. It measures the ability to control operating expenses and optimise tax and interest costs and minimise other kinds of gains and losses (such as equity investments fair value change). These are key indicators of the Group's business as explained above. In light of the factors mentioned above, loss attributable to owners of the Company for the current period was US\$84 million, as compared to a net loss attributable to the owners of the Company of US\$348 million for the corresponding period last year. The net loss margin for the current period was 1.32%, as compared to the net loss margin of 5.3% for the same period last year. The net loss decreased by US\$265 million for the first half of 2019, with net loss of US\$509 million for the second half of 2018.

As at 30 June 2019, the ROE (Return on Equity, representing the amount of net income returned as a percentage of shareholders' equity, which measures a company's profitability by revealing how much profit such company generates with the money that its shareholders have invested) was 4.05% negative, when compared with the ROE as at 31 December 2018 of 39.97% negative. The Group strived to achieve a better ROE during the current period.

Income tax expense during the current period was US\$7.1 million, when compared to income tax credit of US\$0.7 million for the same period last year. The increase in income tax expense was mainly due to income tax incurred in certain profitable entities during the current period.

During the period ended 30 June 2019 and 2018, no impairment was recognised for property, plant and equipment. Besides, impairment loss of US\$2.4 million was recognised for interest in a joint venture during the current period.

Basic loss per share for the current period was US1 cent.

##### **Dividends**

On 9 August 2019, the Board resolved not to recommend the payment of an interim dividend for the six months ended 30 June 2019.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Sales**

For the first half of 2019, the Group recognised a consolidated revenue of US\$6,389 million, representing a decrease of US\$174 million or 2.65%, when compared to US\$6,563 million for the same period last year. Since 2017, the Group started to generate growing sales revenue via manufacturing and selling phones to HMD and distribution service income from such collaboration until the adjustment to the collaboration model happened in the end of 2018 and terminated its logistic and distribution business which inevitably impacted the performance of sales of this part of business and gross margin of the Group. But the Group continues to manufacture Nokia-branded feature phones. Thanks to the Group's continuous development and penetration of the Chinese and international brand customers and efforts to expand its global production footprint, the sale drop to HMD was partially offset by the sale to the new U.S. internet customer. For other major customers, there was not much dramatic year-on-year change as the market is really competitive and the customers face a lot of challenges. System assembly sales (of low gross margins) remained flat in the current period whilst casing business continued to decline in the current period due to those unfavorable abovementioned. The Group will continue to provide system assembly service of consumer electronic products such as e-Readers, tablets and voice interaction products to an international brand and strive to maintain a healthy customer mix and sales mix.

The Group started its business serving international brands by manufacturing feature phones. With the launch of smart phones and the subsequent popularisation which has driven smart phone outsourcing, the Group has benefited from the trend. In the past couple of years, there have been market share reshuffles between international brands and other market players (such as Chinese brands), and the Group saw diversing performance across its customers and there was rapid shift among certain Chinese OEMs manufacturers and the market shares of some of the Group's major customers belonging to international brands had declined quite dramatically in 2016, and hence some of them had drastically changed their outsourcing strategies through restructuring and in-house production, thereby cutting down the previously established outsourcing business with the Group, which had a direct impact on the Group's sales in 2016. From 2017 to 2019, the competition continued to be fierce and price and margin erosion was still ongoing. Various research companies remained cautious of future smart phone shipment growth. Looking at some of the research reports of leading research firms, we can realise the risks and concerns over future growth of handset shipment.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Sales** *(Continued)*

According to the IDC (International Data Corporation) Worldwide Quarterly Mobile Phone Tracker, published on 30 May 2019, the year 2019 will be another challenging year for global smartphone shipments with volumes forecast to decline 1.9% from 2018. This will mark the third consecutive year of market contraction driven by highly saturated markets in developed countries and slower churn in some developing economies. Smart phone shipments are forecasted to drop by 1.9% in 2019 to 1.375 billion units, downed from 1.462 billion units in 2018 and 1.465 billion units in 2017 and the expected shipments in the first half of 2019 will be down 5.5% compared to the first half of 2018. "Overall growth expected in the second half of this year is inclusive of a 5% decline in China during this time. China should be close to flat growth in the first half of 2020 and return to positive territory in second half of 2020 as heavy 5G marketing inclusive of device subsidies is imminent", said Ryan Reith, program vice president with IDC's Worldwide Mobile Device Trackers. In developed markets where replacement cycles were lengthening with overall smart phone features and design reaching its peak, the further growth of smart phone will be driven by 5G adaption (predicted 26.3% of worldwide shipments in 2013), a growing selection of lower-priced premium handsets, and on-going uplift from markets like India.

In contrast with the negative growth smart phone market, Counterpoint released a report on 13 March 2019 showing the shipments of feature phones will reach more than a billion over next three years and, in fact, the feature phone market has continued to grow over the last three years. India and the Middle East Africa region will see cumulative shipments of around 800 million feature phones out of more than one billion global feature phone shipments over the next three years. "Globally, the feature phone segment is forecast to generate around US\$16 billion cumulatively in wholesale hardware revenues over the next three years", said Peter Richardson, Research Director at Counterpoint Research. Counterpoint highlighted two drivers which have been pushing the growth of feature phones in India, one is the revival of the Nokia-branded features phones and the other one is the smart feature phone offered by Jio. There are several reasons why feature phones are the preferred mobile phone in many markets globally, despite the tremendous adoption of smartphones, including affordability, utilisation of 4G network by 4G feature phone, and most importantly, longer battery life for emerging markets who have limited access to electricity. The report concluded with the belief of the markets in Africa, especially Kenya, Ethiopia, and Tanzania have the highest potential for feature phones. In terms of the total addressable market opportunity, India, Bangladesh, Nigeria, Pakistan, and South Africa remain the key markets.

In contrast to the decline in China smart phone market, according to a report from research firm Canalys published on April 2019, there was a 1.7% growth in Indian smart phone shipment with 30.1 million units and the market share of Chinese brands in the Indian smart phone market reached a record 65% during the first quarter of 2019, a 20% year-on-year growth.



## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **P&L (Profit and Loss)**

With diffusion of innovation and technology, the smart phone industry has been already commoditised. Highly homogenous products have increased the competition in the market as it became more fragmented and modular structure of the industry has lowered the barriers for the new entrants to enter the market and offer products with high specifications for an affordable price to consumers. The smart phone industry is characterised by modularity similar to the computer industry. The significance of modular designs has been linked to the rapid rate of innovation in the industry and contract manufacturing along with modularity has given rise to the competition in the industry as new players enter the business with the ability to produce at low cost but high efficiency. As mentioned in the above sections of “Financial Performance” and “Sales”, for the first half of 2019, the year-on-year decrease of sales was mainly attributable to the corresponding change of the collaboration model with HMD and the termination of the Group’s logistic and distribution business. The cessation of the logistics and distribution business worsened the Group’s gross profit as the Group lost distribution income (grouped under revenue) that would otherwise be generated from that business. But as the first three generations of Nokia-branded smart phones have been introduced in the market for a period of time, when those generations of products of which performance in gross margin has been poor are approaching the end of their life cycle, the Company has taken measures with the aim to achieving the objective that the gross loss margin of Nokia-branded smart phone manufacturing may become lesser in the second half of 2019 and the Group’s gross margin (excluding the impact to gross margin triggered by the discontinuance of phone distribution business) may improve gradually. Now the Group can refocus on the Nokia-branded smart phone projects with optimised profit margins and this will ease the margin erosion pressure. But at the same time, there are changes in product mix and crowded competition in casing business (resulting from surplus capacity in the casing sector) and weak system assembly business margin and growingly high manufacturing costs, all these have induced heavy pricing pressure on the Group and hence inevitably imposed pressure on gross margins.

In general, the Group has strived to improve efficiency and maintain a good and stable yield by enhancing production automation and asset utilisation and capacity optimisation and also quality assurance and quality control and tighter control on manufacturing overheads. The Group’s automation engineering team has continued to increase automation coverage across different manufacturing processes to lighten the impact of rising labour cost and enhance efficiency. The Group’s dedicated and professional procurement team is leveraged to sourcing materials with competitive prices. Furthermore, there has been continuous strong support from the Hon Hai Group to offer in scale, solid component support and stable supply of key components and a vertically integrated supply chain that allows for production synergies. The Group can leverage on the Hon Hai Group’s resources, giving the Group more flexibility in outsourcing capacity.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

#### **Geographical segment (please refer to note 3 of “Revenue and Segment Information”)**

- Asia segment:

Asia segment was the Group's core performance contributor in terms of sales turnover and segment profit and this will continue in 2019. The revenue of Asia segment in the current period was US\$5,347 million, representing a decrease of 3.97% from that for the same period last year (30 June 2018: US\$5,568 million) and the decline was mainly due to the reduction of support to HMD's Nokia-branded smart phone business but meaningfully offset by the other Chinese and international brand customers. In the current period, Asia segment's recorded earnings were US\$59 million which were higher than the recorded earnings of US\$43 million for the same period last year, mainly because of reduction of support to HMD's Nokia-branded smart phone business. Segment profit (loss) represents the gross profit earned (loss incurred) by each segment and the service income (included in other income) after deducting all selling expenses. The margin compression risk will continue as Asia segment sales growth is driven by system assembly business which has a lower gross margin. Due to crowded competition and excess capacity in casing industry, gross margins of casing business will continue to face pressure this year. Amid fierce competition, China smart phone market continues to be the focus of the Group. Years ago, the Group has shifted the gravity of operations and devoted resources to Asia segment including India and Vietnam after the downsizing of European sites so as to further enhance the capacity, capability, competence and presence of the Group in Asia segment and develop more new businesses and customers and also serve existing customers in a well manner.

The Company believed that outside Asia Pacific, the biggest regions for growth will be the Africa, Middle East, and Latin America. All these three regions have relatively low penetration rates and plenty of upsides. In anticipation of the good opportunities mentioned above, the Group has already set up and maintained handset assembly factories in India and Vietnam for years and has helped certain Chinese brand customers to develop business and grasp more market shares in Asia and overseas markets and outside of China in the past couple of years. With the lingering of trade war, customers are now flocking to Asia countries like Vietnam and the Group has kept reviewing its global capacities to optimise resources and capacity in emerging markets including India and Vietnam and further align its manufacturing capacities with the geographic production demands of customers and expand the capacity and capability there. Sales of the Group's Indian operations in the current period were about 31% of the total sales of the Group due to the continuous growth of the business of a Chinese brand customer in India. The Group's factory operation in India is one of the largest contract manufacturers in India and the Group will continue to optimise infrastructure and capacity in anticipation of more new Chinese customers in India and the Group has injected additional capital of US\$100 million in its operation in India in January 2018.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

#### **Geographical segment (please refer to note 3 of “Revenue and Segment Information”) *(Continued)***

- Europe segment:

The recorded revenue of Europe segment in the current period was US\$557 million when compared with the recorded revenue of US\$925 million for the same period last year and the revenue of Europe segment decreased in the current period. Despite all the actions and efforts that have been taken by the Group’s Nokia-branded phone business in the past two and half years, the overall performance is poor. As competition remains fierce and given the difficulties ahead in 2019, the Group has critically reviewed its business strategy at 2018 year end and will not accept Nokia-branded phone orders with poor margin and at the same time, the Group’s partner, HMD (which is a Finnish company and has been in the dynamic handset market) came to a strategic decision to deploy a multi-ODM partnership strategy and HMD will not only seek for the Group’s support but also contracts other ODMs. As a result of such adjustment to the collaboration model with HMD, number of Nokia-branded smart phones sold to HMD (which is a Finnish company) decreased. The recorded earning of this segment in the current period was US\$7 million, when compared with the recorded loss of US\$127 million for the same period last year and there was improvement as less loss making smart phones were sold. In previous two years, the performance of Europe segment has deteriorated dramatically which has affected the performance of the Group adversely and the Group has therefore taken actions to reduce the scale of this business and diminish the impact of the loss-making of this segment on the Group. As the first three generations of Nokia-branded smart phones have been introduced in the market for a period of time, when those generations of products of which performance in gross margin has been poor are approaching the end of their life cycle, the Company has taken measures with the aim to achieving the objective that the gross loss margin of Nokia-branded smart phone manufacturing may be lesser in the second half of 2019 and the Group’s gross margin (excluding the impact to gross margin triggered by the discontinuance of phone distribution business) may improve gradually and the Group will continue to closely monitor and assess the impact of this segment on the Group’s overall performance and cash flow.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

#### **Geographical segment (please refer to note 3 of “Revenue and Segment Information”)** *(Continued)*

- America segment:

For America segment, the recorded revenue of the first half of 2019 was US\$486 million when compared with the recorded revenue of US\$70 million for the same period last year and the year-on-year increase largely came from the increase of sales to a U.S. based internet customer. Core businesses (both now and under development) of American segment entities located in the States and Mexico are mainly provision of services including reverse logistics, repair and refurbishment of smart phone for OEMs and carriers and sales of phones to small U.S. customers. The recorded earnings for the current period were US\$21 million when compared with the recorded earnings of US\$5 million for the same period last year. Due to the increase of sales to the U.S. based internet company and the change to Group’s Nokia-branded smart phone business strategy (and some more phones will be sold to the States), the performance of America segment becomes to have a considerable impact on the Group’s overall performance. Group will closely monitor the future development of this segment.

#### **Investments**

On the basis that the value of each of the investments mentioned below as at 30 June 2019 does not exceed 5% of the Group’s total assets as at 30 June 2019, the Company does not consider any such investment as a significant investment for the purposes of the Listing Rules.

The Group has continued to enhance its EMS and related fulfilment businesses to reinforce the Group’s dominant position in the mobile handset manufacturing industry through investments and M&A (mergers and acquisitions) opportunities and activities.

#### *Investments in Business relating to Nokia-branded Products*

On 18 May 2016, the Group entered into an agreement with Microsoft (as seller) and HMD (as another purchaser) to acquire certain assets of the Nokia-branded feature phone business then operated by Microsoft Corporation, comprising a manufacturing facility in Vietnam and certain other assets that were utilised in the conduct of such feature phone business at a total consideration of US\$350 million (US\$20 million of which being payable by HMD). This transaction included goodwill of US\$79.4 million. Due to the unsatisfactory performance in 2018 and based on the valuation carried out by independent professional valuer, the Group has fully impaired the goodwill of US\$79.4 million in 2018 year end.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Investments** *(Continued)*

##### *Investments in Business relating to Nokia-branded Products (Continued)*

With a keen eye on sustainable growth for the future, the first half of 2019 has been period of transformation for HMD and has been focusing on business model extension, supply chain expansion and liquidating product liabilities from the past. These necessary actions have been impacting HMD short-term performance, but these actions are important to build a business for the future. After TNS discontinued its logistics and distribution business, HMD moved forward in value chain and built up direct relationship and capability to sell to channel partners worldwide itself and at its own expenses. During April 2019, HMD expanded its team in Finland, India, and China to further develop capabilities to serve its entire customer base directly. This expansion was executed without any business disruption. This change enables HMD to manage the full value chain after factory including the aftersales in a more efficient manner.

The first half of 2019 has been challenging period for the whole handset industry due to many factors impacting competitive landscape while market has been shrinking in many geographies. There has been more than usual pressure on pricing coming from largest players in the industry fighting against recent trend in market share development. This situation got even more challenging when U.S. decided to continue its efforts in limiting use of U.S. technology in foreign origin products for the security reasons. This was immediately impacting whole industry halting supply in some markets and generating high price erosion and sales pressure on others. This tough business environment coupled with HMD's challenges of scaling the supply chain to meet the diverse portfolio needs had an adverse impact on HMD's sales in the first half of 2019. In May, HMD switched to a multi ODM set up to launch its new phones. This supply chain expansion from one supplier into multi ODM model have been motivated by improving purchase price competitiveness, faster time to market and stronger ramp up capability to capture early months demand with higher probability. New supply chain ramp up has been a success and early results are already visible in business performance. HMD launched 3 new smartphone models with 2 new ODMs before the end of the first half of 2019. Feature phone business has been managed conservatively with a focus on profitability to adapt into supply chain cost level and FIH is the sole supplier. HMD is committed to continuously drive meaningful innovation across its portfolio including the feature phone segment to maintain industry leadership. In smartphones, the focus remains on offering signature experiences that consumers have come to expect from a Nokia phone — durability, quality, design and long battery life.

Looking forward, HMD is optimistic that consumers are looking for options for Android phones which are not offering same level of security, software updates and upgrades. Mobile market has drifted towards fast paced and quick transition road mapping making new phone to feel old after short while. At the same time products are more and more differentiated on software than hardware. New innovations in the industry will be more software led. HMD's promise of always up-to-date Android is unique. It enables HMD to define products where Android services are flawlessly integrated into hardware experience. Good example of that is dedicated hardware key for Google Assistant in 2019 portfolio — aimed at offering a unique user experience to Nokia phone fans.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Investments** *(Continued)*

###### *Investments in Business relating to Nokia-branded Products (Continued)*

The promise of pure, secure and up-to-date Android has resonated very well with the enterprise customers, where typically Android adoption has been restricted unless separate expensive security solutions were used. Nokia smartphones offer a secure solution, right out of the box without any needs for additional investments from the enterprises. HMD has a broad portfolio of Android Enterprise Recommended smartphones for this segment. HMD is seeing a similar trend emerging among consumers who care about their privacy and in general want to own products which offer a secure software experience — one that keeps getting better through regular updates.

In the feature phone segment, HMD is striving to add new functionalities to offer a 'smarter' experience to the consumers. At the same time, HMD is helping operators transfer subscribers from 2G to 4G networks and offer them a more connected experience at an affordable price. With all of these efforts, backed by a more agile supply chain, HMD is predicting moderate growth both in smart and feature phones during the second half of 2019.

HMD started Series B funding round during the first half of 2019. This would be third funding round for the HMD after seeding round in start up phase and series A that was closed last year second quarter. Main purpose of Series B round is to collect funding to deliver growth plan and strengthen the balance sheet.

The Group previously invested US\$64.5 million in HMD, which represented about 10.10% (calculated on as-converted and fully-diluted basis) of the total issued shares of HMD as at 30 June 2019.

With reference to the valuation carried out by independent professional valuer, the management has assessed the fair value of the investment in HMD as at 30 June 2019. The Group did not recognised any fair value change for the Group's direct and indirect investment in HMD through other comprehensive income ("OCI") in the first half of 2019. As being told, HMD is under a new round of fund raising, investment team will monitor the progress of the fund raising and HMD's cash position and the Group's finance team will also continue to monitor closely cash position and credit status of HMD.

##### *Other Major Investments*

With the continuous development of Internet and the mobile ecosystem, the Group has partnered with some strong mobile application and services companies in order to capture the market growth, implementing the "Hardware and Software Integration" strategy and there is no performance guarantee in respect of any investment.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Investments** *(Continued)*

###### *Other Major Investments (Continued)*

The Group invested in Mango International Group Limited (“Mango”), a company which offers mobile services in the tourism sector. The Group has fully impaired the Group’s investment in Mango in year 2018. In April 2019, considering the material uncertainties and doubts of going concern, the Group decided to sell the convertible note to an institutional private investment firm (“Buyer”), specialising in Chinese distressed debt and structured credit, to maximise the Group’s return in this investment, and resigned from the board. Therefore, the investment in Mango is reclassified from interest in associates to financial assets at fair value through other comprehensive income (“FVTOCI”). The Group and the founders of Mango (“Founders”) also entered into an agreement that the Group has the right to request the Founders to transfer certain number of their own shares to the Group to compensate the loss. During the transaction, the Group had evaluated Mango’s management accounts, monthly cash flow and conducted a valuation analysis. All the negotiations and documentation were fully recorded for the monthly summary report to the Board. In June 2019, the Buyer converted part of the convertible note and became the biggest shareholder with over 60% shares of Mango. The Group’s total investment in Mango has been diluted to around 5.5% of the total issued shares of Mango after such conversion.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Investments** *(Continued)*

###### *Other Major Investments (Continued)*

In August 2016, the Group invested approximately US\$50 million in Hike Global Pte. Ltd. (“Hike”), an Indian-based social media application developer. Hike built up an instant peer-to-peer messaging application with localised lifestyle functions. In March 2019, Hike officially launched a new application called Hike Sticker Chat, which allows user to communicate by sending predictive sticker-based messages to reduce the dependency on the keyboard, and the new application successfully crossed 1 million of DAU (Daily Active Users) and 3 millions of MAU (Monthly Active Users) during the first half of 2019 without doing any major marketing investment. Hike also invested in the first local real money casual gaming platform with 20+ games and a great GMV (Gross Merchandise Volume). In the second half of 2019, Hike will launch Hike Sticker Chat in Bangladesh and extend to other international markets, and start experiment on monetisation models via focusing on messaging, stickers and gaming platform. While the company would still need more time to increase its users and revenue size to reach an economics of scale. Based on the performance in the first half of 2019 and the forecast for the next three to five years, the Group took corresponding adjustment to the fair value change in this investment. The amount is measured using the fair value model based on a valuation performed by an independent qualified professional valuer (the “Valuer”). In determining the fair value of the investment in Hike, the Valuer has applied income approach. The income approach was considered to be an appropriate valuation approach in the valuation, as it takes the future growth potential and firm-specific issues of Hike into consideration. Under the income approach, the DCF (Discounted Cash Flow) method is adopted in the valuation. The DCF method is the most fundamental and prominent method of the income approach. In applying the DCF method, the free cash flows of the subject asset in future years are determined from the net income after tax plus non-cash expenses, such as depreciation and amortisation expenses, and after-tax interest expense; the result is then less non-cash incomes, investment in capital expenditure and investment in net working capital.

###### *Other Investments*

The Group invested about US\$5 million in Razer Inc. (the shares of which are listed and traded on the Stock Exchange with stock code: 1337, “Razer”), a leading global lifestyle brand for gamers, with dual headquarters in San Francisco and Singapore. Razer is one of the most recognised brands in the global gaming and e-sports communities. Razer has designed and built the world’s largest gamer-focused ecosystem of hardware, software and services. Razer’s revenue increased 38% and its loss decreased by 41% in 2018, and Razer has continuously practicing share buy-back from the stock market, in fact, Razer bought back over 2% of its stocks in the first half of 2019. Due to the improvement in financial performance and shares buy-back, the shares price increased 60% (from HKD1.05 per share to HKD1.68 per share) in the first half of 2019. Thus, there was US\$1.9 million of fair value gain recognised in profit or loss during the first half of 2019 for the Group. As at 30 June 2019, the fair value amount of Razer is US\$4.9 million and the Group holds about 0.26% of the total issued share of Razer.



## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Investments** *(Continued)*

###### *Other Investments (Continued)*

The Group invested in CExchange, LLC (“CEX”), which engages in the business of consumer electronics trade-in and buy-back in the U.S. since 2014, for a cumulated US\$11.8 million in the past few years. In 2018, the loss of a significant customer and low sales volume impacted CEX’s overall income, which resulted in a sustaining loss. Due to CEX’s tight cash flow and lower-than-expected improvement in financial and business recovery, CEX has started looking for potential investor in order to survive. Recently, there is a strategic investor who has interest in buying all 49% of the Group’s membership interests of CEX and the Investment team is under the negotiation of the terms and conditions at this stage. The Group had evaluated CEX’s management accounts, monthly cash flow and conducted a valuation analysis and had tried to reach different potential buyers. The Group will choose the best buyer after rounds of negotiation for the best price and conditions. All negotiations and documentation were fully recorded for monthly summary report to the Board. As at 30 June 2019, the Group’s investment represented 49% of the total membership interests of CEX.

The Group invested US\$1 million in CloudMinds Inc. (“CloudMinds”), an operator of cloud-based AI robots in China in 2015. During the first half of 2019, CloudMinds successfully closed series B financing, and filed with the U.S. Securities and Exchange Commission to propose maximum aggregate offering price US\$500 million in July 12, 2019. The Group engages an independent professional valuer to estimate its share of the present value based on the valuation in series B and other considerations, and recognised a fair value gain of US\$13.8 million in other comprehensive income during the first half of 2019. As at 30 June 2019, the fair value of CloudMinds is US\$14.8 million and the Group’s investment represented 0.88% of CloudMinds on a fully-diluted basis.

The Group invested around US\$2.5 million in Jiangsu Liangjin Electronic Commerce Share Co., Ltd (“Liangjin”), a distributor of mobile devices and accessories, which is quoted and traded on the PRC’s National Equities Exchange and Quotations, also known as the “New Third Board”, with stock code 834438. In April 2019, Liangjin released its qualified audit report due to the inestimable impact of an ongoing lawsuit and material uncertainty related to going concern because of its negative net value as at 31 December 2018, and Liangjin’s first quarter report in 2019 also showed its current assets was largely lower than its current liabilities. In addition, all transaction of Liangjin’s shares were suspended because of the lack of support from sufficient market makers since 5 June 2019. Considering Liangjin’s performance and the liquidity of its shares, the Group considered the fair value of the Group’s investment in Liangjin approximated to zero. As at 30 June 2019, the Group’s investment represented 4.41% of Liangjin’s total issued shares.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Investments** *(Continued)*

###### *Other Investments (Continued)*

The Group invested in Ways Technical Corp. Ltd. (“Ways”) since 2008, which was founded in 2001 and specialising in plastic surface decorating techniques. The shares of which are listed and traded on the Gre Tai Securities Market of Taiwan with stock code: 3508 since 2007. During the period from December 2018 to April 2019, the Group disposed of all remaining 12,105,248 shares, represented 11.8% of Ways, for around US\$11.9 million during the first half of 2019 to maintain a healthy cash flow for its core business.

The Group also made certain investments in other companies designated as FVTOCI mainly in China, India and U.S. in the past few years. In China, the Group’s investments mainly include a smart home company who provides smart door lock and other IoT (Internet of Things) products, a technology company who provides educational robots, and a company who provides medical devices for people with myopia. In India, the Group’s investments mainly include a data-driven advertising technology company. In U.S., the Group’s investments mainly include a digital photography company that has developed a multi-lens and multi-sensor camera designed for embedding in smart phones and mobile devices, and a high-end Android smart phone company led by a group of experienced experts in the mobile industry.

As at 30 June 2019, the fair value of the Group’s equity investments designated as FVTOCI was US\$127.5 million represented 1.83% of the Group’s total assets.

###### *Other Investment-related Matters*

In such a dynamic and volatile equity investment market, the Group’s investment team is cautious always, and therefore the team will continue to monitor the performance and financial position, cash flow, burn rate and fund-raising activities of investees, related macro-economic factors and competition landscape and technological changes and innovation, viability of business models as well as execution capabilities of the respective management teams of those investees. In the first half of 2019, the Group had disposed of some investments, and also impaired a few investments which had less than ideal performance. The investment team maintains a close relationship with the managed investees, and conducts periodical in-house analyses. Based on the result of the analyses, the investment team will consider hedging the risk exposure should the need arise. The Group is not currently aware of any potential cause which would lead to any substantial loss arising from the change in the fair value of the Group’s investments in certain listed companies in the rest of 2019.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Investments** *(Continued)*

##### *Other Investment-related Matters (Continued)*

In order to have a better utilisation of the cash and enrich the investment portfolio, the Group has been actively exploring and evaluating good investment potential opportunities that can add value to the Group and the Group's investment strategies will be adjusted to be more focused on 5G and AI for building up the phone ecosystem portfolio including but not limited to IoT smart devices, smart home products, online gaming or others for synergies creation via establishing strategic partnerships with technology companies. Among the characteristics that we look for in determining the attractiveness of investment candidates are complementary technology ancillary to and in support of the Group's business operations; favourable long-term growth prospects; and cultural fit with the Group. The Group has an experienced investment team and will continue to hire talents and has prioritised investments of comparatively low risks and with long-term growth prospect which may take years before the investment can be realised. As a whole, the Group will be cautious on expanding its investment portfolio to create synergies but at the same time to cope with the possible uncertain economic environment and volatility of the capital market throughout 2019. There had been no material acquisitions and disposals of the Group's subsidiaries, associates and joint ventures for the current period.

##### **Compliance with Relevant Laws and Regulations**

During the current period, the Group has complied in all material respects with the relevant laws and regulations that have a significant impact on the Group, examples of which include those relating to foreign investment, taxation, import and export, foreign exchange control and intellectual property in the principal jurisdictions in which the Group's operations and investments are situated, and (as the shares of the Company have been listed and traded on the Stock Exchange) applicable requirements under the Listing Rules and the SFO.

The Group has been operating multi-nationally (coupled with investments) in its principal operating segments, namely Asia, America and Europe. In particular, the Group's legal structures, investment structures, funding arrangements, business models, supply chain and general operations have been structured and optimised in a tax-efficient, cost-effective and robust manner, taking into account (among other things) commercial and financial perspectives and applicable legal/regulatory requirements in the relevant jurisdictions. The Group's major operating subsidiaries fall under different tax regimes in the PRC, Taiwan, India, Vietnam, Finland, Mexico and the U.S., where different tax laws and regulations as well as specific concessionary incentives apply.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

#### **Compliance with Relevant Laws and Regulations** *(Continued)*

During the current period, as advised by the relevant local legal advisers, the newly-promulgated local laws and regulations applicable to the Group's operations in the PRC, India and Vietnam (being the jurisdictions which are considered, in terms of the scale of businesses and operations as well as the number of employees, factory units and office units, to reflect the comparatively significant impacts of the Group's overall business unit/group operations) that have a significant impact on the Group are highlighted and summarised as follows:

#### *PRC*

For value-added tax (VAT), further to the background and previous developments as described in page 28 of the Company's 2018 annual report as issued and published on 9 April 2019, on 20 March 2019, the Ministry of Finance (MOF), the State Administration of Taxation (SAT) and the General Administration of Customs jointly issued a new circular ([2019] No. 39, or Circular 39) to further reduce the VAT tax rate for manufacturers from 16% to 13%. From an enterprise's perspective, this VAT reform has been good news and favourable to the Group since its promulgation as less cash has been and will be needed for domestic purchases.

There are also other tax cut measures. For example, on 23 April 2019, the MOF and SAT jointly issued a circular (Caishui [2019] No. 66) to extend accelerated depreciation method for fixed assets from some selected sectors to all of the manufacturing companies, in order to encourage technology upgrades and equipment replacement. That circular has taken effect from 1 January 2019 retroactively. It has been a benefit for the Group's profitable PRC manufacturing subsidiaries when accelerated depreciation on fixed assets has implemented and the depreciation expenses have been subtracted from profits, so that such subsidiaries could pay less income tax in respect of the current period, and hence have more cash for investments and other business purposes.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

#### **Compliance with Relevant Laws and Regulations** *(Continued)*

##### *PRC (Continued)*

In respect of foreign investment laws and regulations, on 15 March 2019, the National People's Congress promulgated the new Foreign Investment Law (FIL), which will come into force on 1 January 2020. The FIL will replace and repeal the Sino-Foreign Equity Joint Venture Law, Sino-Foreign Cooperative Joint Venture Law and Foreign Enterprise Law (collectively representing the existing laws regulating foreign-invested entities (FIEs) in the PRC, whether wholly-foreign-owned or sino-foreign-jointly-owned) with a single unified law with effect from 1 January 2020. Upon the FIL taking effect, the organisation structure, governance structure and operating rules of existing FIEs in the PRC which are corporate entities will be governed by the PRC Company Law. This means that the existing PRC FIEs of the Group should prepare for changes to their corporate governance structure to conform with the PRC Company Law, which may imply additional costs of regulatory compliance. For example, under the PRC Company Law, the highest governing body of a company will be the shareholders' meeting, whereas for an existing FIE established under the Sino-Foreign Equity Joint Venture Law or Sino-Foreign Cooperative Joint Venture Law, the highest governing body will be the board of directors. Therefore, the articles of association and (as appropriate) the joint venture contract of a FIE may need to be amended to accommodate the corporate governance structure under the PRC Company Law. That said, the FIL provides for a five-year grace period from 1 January 2020 for existing FIEs to conform with the PRC Company Law. The details on how the FIL will be implemented remain to be clarified and it is expected that further implementing regulations may be adopted to provide more clarifications.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

#### **Compliance with Relevant Laws and Regulations** *(Continued)*

##### *India*

Customs Notification 22/2019 dated 6 July 2019 (after the end of the current period) provides for exemptions for certain capital goods used in manufacturing printed circuit board assembly (PCBA) and/or flexible printed circuit assembly (FPCA), lithium ion cells, chargers/adapters, batteries, camera modules and other sub-assemblies of cellular mobile handsets from basic customs duty (BCD). It will reduce the customs duty payable by the Group's Indian subsidiaries in respect of any importation of certain notified capital goods, and in turn lead to a reduction in the operational costs of such subsidiaries.

##### *Vietnam*

The Vietnam Government is now tightening and strictly supervising importation of used machinery, equipment and production technology through the promulgation of Decree No. 18/2019/QD/TTg to replace Circular No. 23/2015/TTg, which Decree has taken effect from 15 June 2019. Some new conditions for importation of used machinery, equipment and production technology now have to be fulfilled, which may include, for instance, (i) in the case of used machinery and equipment, the machinery/equipment is not more than 10 years old from its manufacturing date (or 15 or 20 years old in certain special circumstances); and (ii) in the case of used production technology, the residual capacity or efficiency of the relevant production line must be no less than 85% of its designed capacity, and its consumption level of materials and energy should not exceed 15%, and the imported production technology must be used in at least three business establishments in countries of the Organisation for Economic Cooperation and Development (OECD). As the Group's principal Vietnamese subsidiary needs to import equipment and machinery from other countries for operation and production purposes, such subsidiary has been scrutinising and applying more resources and methods to evaluate and control any proposed importation into Vietnam of used machinery and equipment in order to meet the aforesaid new conditions.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

#### **Compliance with Relevant Laws and Regulations** *(Continued)*

Apart from the above, the Group also takes into account the relevant laws and regulations regarding transfer pricing, in order to ensure efficiency and sustainability of the operating models and global tax footprint as well as sufficient tax risk management. During the current period, apart from the above, there were no major changes in applicable tax laws and regulations which have a significant impact on the Group's tax expenses, and the Group will continue to monitor possible impacts and implications arising from applicable new and/or revised tax laws and regulations. Also, the Group has been closely following the global and local level developments following the Base Erosion and Profit Shifting (BEPS) Action Plans of the OECD. The Group is committed to duly comply with applicable laws and regulations introduced or updated due to the BEPS Action Plans, including more documentation requirements triggered by the local transfer pricing documentation and Country-by-Country Reporting (CbCR) obligations in the jurisdictions where the Group operates. The Group falls within the CbCR scope of the Company's ultimate controlling shareholder, Hon Hai, for such purposes.

The Group has kept abreast of the accelerating pace of tax, legal and regulatory developments in the different jurisdictions in which its key operations are located, and there are on-going reviews of existing investment holding structures and operations as well as business models and capital structures in light of the latest tax, legal/regulatory and business requirements and environment. In this respect, the Group's major operating subsidiaries have taken appropriate steps (e.g. by consulting with legal advisers) to ensure that each of them is aware of the local laws and regulations that have a significant impact on its business operations and takes these relevant local laws and regulations into account in relation to its business operations, business model(s) and value chain management, as appropriate. The Group believes that it complies with applicable relevant local laws and regulations in all material respects. The Group has also complied with applicable requirements laid down by the Listing Rules and the SFO.

The Group has also responded to trade restrictions imposed by the relevant jurisdictions on components or assembled products by obtaining and maintaining necessary import and export licences and paying necessary import and export duties and tariffs. In addition, the Group has abided by the relevant currency conversion restrictions and foreign exchange and repatriation controls on foreign earnings. Further, the Group has depended in part on its ability to provide its customers with technologically sophisticated manufacturing and production processes and innovative mechanical product designs and developments, and accordingly, has been protecting its and its customers' respective intellectual property rights.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Review of Results and Operations** *(Continued)*

##### **Compliance with Relevant Laws and Regulations** *(Continued)*

In relation to the Group's compliance with the relevant laws and regulations that have a significant impact on the Group in respect of environmental, social and governance aspects, apart from the above, please refer to the Company's separate 2018 environmental, social and governance report as issued and published on 9 April 2019.

The Group will continue to monitor compliance with all these relevant laws and regulations on an on-going basis.

#### **Liquidity and Financial Resources**

As at 30 June 2019, the Group had a cash balance of US\$1,582 million (31 December 2018: US\$1,419 million). Free cash flow, representing the net cash from operating activities of US\$154 million (31 December 2018: net cash used in operating activities of US\$814 million) minus capital expenditure of US\$88 million (31 December 2018: capital expenditure of US\$277 million), was US\$66 million inflows (31 December 2018: US\$1,091 million outflows). Free cash flow improved during the current period. The Group has abundant cash to finance its operations and investments. The Group's gearing ratio, expressed as a percentage of interest bearing external borrowings of US\$1,085 million (31 December 2018: US\$1,427 million) over total assets of US\$6,983 million (31 December 2018: US\$8,904 million), was 15.54% (31 December 2018: 16.03%). All of the external borrowings were denominated in USD, RMB and INR (31 December 2018: USD). The Group borrowed according to real demand and there were no bank committed borrowing facilities and no seasonality of borrowing requirements. The outstanding interest bearing external borrowings were all at a fixed rate ranging from 2.85% to 4.00% (31 December 2018: fixed rate ranging from 2.76% to 4.40%) per annum with an original maturity of one to six months (31 December 2018: two to twelve months).

As at 30 June 2019, the Group's cash and cash equivalents were mainly held in USD and RMB.

Net cash from operating activities for the six months ended 30 June 2019 was US\$154 million.



## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Liquidity and Financial Resources** *(Continued)*

Net cash from investing activities for the six months ended 30 June 2019 was US\$376 million, of which, mainly, US\$88 million represented the expenditures on property, plant and equipment related to the facilities in the Group's major sites in the PRC and India, US\$0.3 million represented acquisition of equity instruments at fair value through other comprehensive income, US\$16 million represented placement of bank deposits, US\$571 million represented purchase of short-term investments, US\$228 million represented proceeds from disposal of financial assets at fair value through profit or loss, US\$12 million represented proceeds from disposal of equity instrument at fair value through profit or loss, US\$3 million represented proceeds from disposal of property, plant and equipment and US\$808 million represented proceeds from settlements of short-term investments.

Net cash used in financing activities for the six months ended 30 June 2019 was US\$371 million, primarily due to net decrease in bank borrowings of US\$345 million, interest paid of US\$22 million and repayment of lease liabilities of US\$4 million.

#### **Exposures to Currency Risks and Related Hedges**

In order to mitigate foreign exchange risks, the Group actively utilised natural hedge technique to manage its foreign currency exposures by non-financial methods including managing the transaction currency, leading and lagging payments and receivable management.

Besides, the Group entered into short-term forward foreign exchange contracts (usually with tenors of less than three months) from time to time to hedge the currency risk resulting from its short-term bank borrowings (usually with tenors of one to three months) denominated in foreign currencies. Also, the Group, from time to time, utilised a variety of forward foreign exchange contracts to hedge its exposure to foreign exchange risks.

#### **Capital Commitments**

As at 30 June 2019, the capital commitments of the Group were US\$8.6 million (31 December 2018: US\$7.9 million). Usually, the capital commitments will be funded by cash generated from operations.

#### **Pledge of Assets**

There was no pledge of the Group's assets as at 30 June 2019 and 31 December 2018.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Outlook**

Smart phone shipments growth hits the ceiling and has been continuously slowing down since 2017. Although there are still opportunities from the implementation of the fifth generation communication technology (5G) and industrial innovation, the risk of saturation in the smart phone market remains high. Competition would therefore be increasingly intense, among OEMs as well as along supply chains, leading to price declines and affecting revenues and margins.

U.S. President Trump's tariffs on US\$34 billion worth of Chinese goods kicked off on 6 July 2018, escalating the war of words between the world's two super power nations into a full-blown trade conflict and no anywhere near any resolution. The tension of the trade war between the U.S. and China escalated to a historical high when both sides have imposed tariffs on billions of dollars' worth of goods. So far, the U.S. Government has imposed tariff on \$250 billion worth of Chinese goods, and has threatened to have US\$325 billion more. China, as retaliation, has applied tariffs on US\$110 billion worth of U.S. goods, and is threatening qualitative measures that would affect U.S. businesses operating in China. Out of a sudden, President Trump said on 1 August 2019, he would impose a 10% tariff on the US\$300 billion of Chinese imports starting from 1 September 2019, after negotiators failed to make progress in U.S.-China trade talks. With the market concerns around the U.S.-China trade war and its effects on China's weakening economic growth, RMB dropped to its lowest point (7 to the dollar) in more than a decade. In the statement issued by the People's Bank of China (PBOC), on 5 August 2019, noted that PBOC "has accumulated rich experience and policy tools, and will continue to innovate and enrich the control toolbox, and take necessary and targeted measures against the positive feedback behavior that may occur in the foreign exchange market." Hours after the statement, the U.S. Treasury Department took the action and announced the designation of China as a Currency Manipulator. "As a result of this determination, Secretary Mnuchin will engage with the International Monetary Fund to eliminate the unfair competitive advantage created by China's latest actions", the Treasury Department said. Currently, China Government already halted U.S. agricultural purchases and with the escalating trade war giving Beijing fewer reasons to maintain RMB stability, if Trump increases the tariff on the US\$300 billion of Chinese imports to 25%, some analysts said they expect the currency to continue to weaken further to as low as 7.8 to the dollar.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Outlook** *(Continued)*

The U.S. Department of Commerce shakes the smart phone world by placing Huawei Technologies Co. Ltd. (“Huawei”) and its affiliates on its “entity list” on 16 May 2019, which prohibits it from buying or selling anything from technology to components from U.S. firms. The loss of Huawei as a major player in the global smartphone market could also have a wider impact on the smartphones other vendors are pushing out. The Chinese brand’s aggressive development of new technological capabilities has forced rivals to significantly improve their devices and push out new advancements of their own, and any diminution of its influence would likely slow the rate of development. According to IDC Quarterly Mobile Phone Tracker April 2019, Huawei moved to the second position based on global market share and witnessed an impressive year-on-year growth of 50.3% in the first quarter of 2019 with volumes of 59.1 million units and a 19.0% market share. The ban on Huawei did not only bring financial damage to Huawei itself but also brought a huge damage on the entire smart phone ecosystem including chip architecture, Android software and services, RF (Radio Frequency) components, just to name a few. As the countermeasure, China announced that it will establish its very own unreliable entities list in retaliation to the U.S.’ entity list on 31 May 2019. China’s unreliable entities list will include foreign enterprises, organizations, and individuals that do not obey market rules, violate contracts, and block, cut off supply for non-commercial reasons, or severely damage the legitimate interests of Chinese companies. The Group will continue to monitor and assess the impact and the amount and take necessary steps to mitigate the risks.

Unlike the 90-day trade war trace made at last year’s G20 Summit in Buenos Aires, there was no deadline for the trade talk been imposed after this year G20 Summit in Osaka which means the trade tension will not be eased anytime soon. The Group will closely monitor the progress of the trade war and the resulting impact. It is expected that the Group’s expansion of its operations in India and Vietnam which help its customers to relocate their production will help to mitigate the adverse impact.

For handset market forecast, please refer to the “Sales” section. From market perspective, phones are now more capable and durable, which will extend the replacement cycle and consumers are not compelled to upgrade quickly. The market showed a matured growth pattern. As mentioned above, the Asia segment, with China as the focus, remains the Group’s core performance contributor. For China, still the world’s largest smart phone market which represents roughly one third of all smart phones consumed, will like be challenged for the remainder of 2019. As the replacement rates continue to slow, China smartphone volumes went down by 4.5% year-on-year and it was the eighth consecutive declined quarter, according to the latest report published by IDC on 30 April 2019.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Outlook** *(Continued)*

Although the Chinese market is shrinking, the top five brands can be comforted by the fact that it will continue to consolidate, and that their size will help them last longer than other smaller players. As a matter of fact, the top five brands acquired 90.9% of China domestic market share in the first quarter of 2019 when compared with 85.7% for the same period of last year. With the saturated smart phone market, competition among Chinese vendors will become fiercer. The rapid shift among certain Chinese OEMs may impact overall demand of the Group's end markets and future demands of the products and services to be provided by the Group. The Group's customers are striving for greater market share in the saturated market and hence the pricing of their products in the end market must be very competitive. In order to get adequate allocations from the customers and compete against players in the market, the Group has to accept the low gross margins of system assembly business with major customers. Similarly, as mentioned above, the profit margin of the casing business is also under pressure. As explained in financial performance section, due to excessive investments in mechanical capacities, the change of product mix and IMT technology on plastic casing in casing industry, our peers faced similar above risks.

The continuous decline in the Chinese market in the first quarter of 2019 led to the decline in the overall growth of some key Chinese brands. These brands have been investing in countries and regions outside China to offset the weak demand in the domestic market and the impact from U.S.-China trade war. The key markets for Chinese brands expansion so far are India, South-East Asia, Europe, Middle East and Africa. The Group has helped these Chinese brands to expand and internationalise rapidly in overseas markets, and these customers want to leverage on the Group to extend their footprints in India and other emerging markets. Since 2015, given the Group's leading industry experiences in managing Indian operations and providing a wide range of services in most parts of the value chain, the Group has been expanding its local manufacturing service and component supply chain support in India to benefit from the Indian government's "Make-in-India" initiatives, which can address both the domestic Indian market and export demands. In addition, as the Group acquired a manufacturing facility in Vietnam on 18 May 2016, various customers are seeking manufacturing services in Vietnam with the goal to avoid potential tariff impact and the Group is now expanding capacity and capability there to better serve the customers.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Outlook** *(Continued)*

From product perspective, with the popularity of innovation and technology, the smart phone industry has become commoditised and highly homogenised products with standardised specifications have increased market competition as it is more fragmented and the modular industry structure has lowered the entry barriers. The smart phone matures as an application, driving innovation in design and features and appearances. IDC announced a feature prediction towards China's smart phone products in the next few years, including a larger amount of RAM, higher penetration of OLED screen, under screen fingerprint, artificial intelligence (AI), facial recognition, AR/VR/3D modeling and 5G functionalities, and in 2022, the average unit price of the overall smart phone will reach US\$416, an increase of 28% compared with 2018, yet the replacement cycle will be lengthened. In anticipation of 5G technology, innovations in the smart phone glass surface and casing are key to success. Smart phone casing manufacturing is the core competence of the Group, and we are demanding to continue to invest in the future and be committed to developing engineering capabilities and new technologies and solutions (such as new innovative materials). However, the gross margins of casing sales will inevitably deteriorate due to overcapacity in the machinery business sector caused by industry participants' excessive investment in machinery capacity in previous years and the shift in casing design from being dominated by unibody metal casing to middle frame with IMT. The Group has devoted non-stop effort to satisfy customers' demand in product innovation and cost competitiveness with the expectation to increase the utilisation of manufacturing equipment and facilities of the Group which ultimately will benefit the gross profit.

As the smart phone industry is dynamic and competitive, a slowdown in growth leads to industry consolidation, which results in larger and more geographically diverse competitors having significant combined resources to compete against the Group and may put pressure on the supply chain. As competition remains fierce, competition from EMS/ODM/OEM peers is deemed to intensify to create pressure on the Group's business and there may be slower new customer gain with rapidly growing smart phone vendors. The Group also faces competition from the manufacturing operations of its current and potential customers (including the Group's strategic partner, HMD), whom are constantly evaluating the advantages of manufacturing products in-house against outsourcing, OEM against ODM. All of these developments could potentially cause pressure on the Group's sales and the sales mix and margins, loss of market acceptance of its services, compression of its profits or losses, and loss of its market share. To address the above challenges and uncertainties and to alleviate the impact of price erosion on gross margins, the Group must remain lean and make business and operational decisions promptly. The cycle time of new product development must be shortened to align with the product launch schedule of customers and shorten the time to market. Despite the increase in revenue due to increase in system assembly business, there has been pressure on gross margins.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Outlook** *(Continued)*

To meet its customers' increasingly sophisticated needs, the Group has continuously engaged in product research and design activities to manufacture its customers' products in the most cost-effective and consistent manner, and focused on assisting its customers with product creation, development and manufacturing solutions and further strengthened IDM competence. The Group has dedicated PD (Product Development)/PM (Product Manufacturing) and R&D team whom have developed a full range of smart phones and feature phone products with innovations in industrial design, camera and audio applications to differentiate the Group's products from market competition and enable the Group to penetrate global mobile market share. The Group has fully utilised the strength of the Hon Hai Group in vertical integration for product creation. The one-stop shopping service and abundant resource of the Group (with support from the Hon Hai Group, providing scale, solid experience and control in key components) are especially attractive for Chinese brands. The R&D team will continue to innovate on industrial design, image and audio quality and user experience and AI technology and innovate existing and new mobile products and to focus on user experience in social media and establishment of ecosystem. The R&D team leverages on the entire product portfolio of mobile and wearable devices to address the opportunity for consumer IoT market and differentiate the IoT products with advanced voice user interfaces, better audio and video features. The Group had made further investment in R&D of new technology to ensure future business momentum and identify and address the changing demands of customers, industry trends and competitiveness.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Outlook** *(Continued)*

In light of the poor performance of the Group in the past two years and the difficulties ahead in 2019 and the need to maintain a healthy cash flow, the Group implemented a loss cutting initiative and a cost down exercise to cut its overheads and operating expenses in order to build a long-term sustainability in the highly competitive mobile phone market. The Group's partner, HMD (which also recorded poor performance) came to a strategic decision that HMD will not only seek for the Group's support but also contracts with other ODMs to enhance its supply chain flexibility and cost and price competitiveness at the end of 2018. In the second half of 2019, the Group will continue to manufacture HMD's second and third generation/wave smart phone products, which have been introduced in the market for a period of time, until the end of the product lifecycle and design and manufacture Nokia-branded feature phone programs and smart phone programs of satisfactory margin. The Group expects the change in the collaboration model will gradually decrease the sales to HMD but at the same time it would steadily improve its gross margin and the sale drop to HMD can be partially offset by sale to the new U.S. internet company. Regarding the Group's cessation of its logistics and distribution business from 1 January 2019, such cessation has worsen the Group's gross profit as the Group lost distribution income (grouped under revenue) that would otherwise be generated from that business (sales income from logistics and distribution business for the year ended 31 December 2018 totalled around US\$61.77 million whilst 2018 total Group annual sales was US\$14.93 billion), on the flip side, those selling expenses which were incurred to generate distribution income reduced. Also as mentioned above, margin erosion pressure of system assembly and casing businesses are always there and the Group has attempted and implemented various measures and put efforts to mitigate the impact and foster long term relationships with customers. As a whole, it is anticipated that pressure on the Group's gross margins generally ought to ease, over the course of 2019 and it also expects that operating expenses should reduce year-on-year, and for the time being, it expects that the Group's operating loss in the second half of 2019 and full year of 2019, if any, will be reduced when compared year-on-year.

In addition, as mentioned in the "Investments" section, the Group has taken necessary actions to control future impact from the change in the total fair value of the Group's investment in listed companies. The Company has evaluated the possible alternatives to maximise the benefits (financial, operational and otherwise) from the Group's investment in Ways. The Groups has disposed all holding in Ways ordinary shares in 2019 and thus the Company currently expects no substantial loss arising from the change in the total fair value of the Group's investments in other listed companies in 2019.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Outlook** *(Continued)*

The mobile phone manufacturing business is facing various new challenges (both external and internal) which have not been encountered before. The saturation of the smart phone market has also exerted tremendous pressure (margin erosion) on the entire handset industry. The Group has been doing OEM and ODM and IDM for mobile phone manufacturers for years. The growth rate of China's smart phone market has been declining and China's smart phone market has continued its shrinking situation with shipment since the fourth quarter in 2017. On the other hand, the decline in the OEM industry is also driven by the trend of China's capacity transformation. The rise of China's OEM mainly benefited from the low labour costs, which have been difficult to sustain since 2014. China domestic labour costs have risen sharply yet the efficiency of assembly line workers has not increased correspondingly and the cost advantage of China is no longer comparable with other countries in Southeast Asia. The recent trade war of China with the U.S. especially highlighted the need of changing the mix of China's GDP. In 15 July 2019, China published a disappointing 6.2% year-on-year GDP growth in the second quarter of 2019 which is less than the 6.4% of the previous quarter. 6.2% was the lowest GDP growth rate in 27 years since the first quarter of 1992 as to the on-going trade war with U.S. and the sluggish global demand.

China's traditional OEM and manufacturing industry is facing huge challenges and the support from the government is declining and the industry has to transform in order to survive and has to upgrade from an existing "world factory" to the "artificial intelligent leader" and doing automation is a must. That is the reason why the Company is introducing the "Industry 4.0" smart manufacturing paradigm to reduce manufacturing costs. But of course, it needs time to implement Industry 4.0 and the Group is now making effort on this.

Looking ahead, the Company understands the tremendous challenges happened before and will continue in 2019 and new factors might emerge during the remainder of 2019. The Group has implemented and maintained sound and effective systems of internal control and enterprise risk management to cope with all these challenges and uncertainties from time to time as well as to maintain and enhance its performance. For details, please refer to the "Accountability and Audit" section of the Company's 2018 corporate governance report which forms part of the 2018 annual report as issued and published on 9 April 2019.

Regarding key risks faced in the first half of 2019, please refer to the major risk items below.



## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Outlook** *(Continued)*

##### *Risks Pertaining to the Handset Business*

As mentioned above, there is a year-on-year decline in handset shipment and the market is saturated and the pricing pressure has been higher than expectation. As a result, the general state of the global economy, trade war, protectionism, custom duty hikes, market conditions and consumer behaviour and the risk that our customers are not successful in marketing their products or that their products do not gain widespread commercial acceptance may have a significant impact on customers and the Group's operating results and financial conditions. To tackle this, the Group has to control BOM costs and manufacturing costs and improve gross margins performance and monitor impact of factors affecting business of customers and its financial health. For the Nokia-branded smart phone business, the Group has become selective when receiving orders from HMD and HMD can engage external ODMs. Handset market is highly dynamic and competitive and there are negative factors such as unfavourable product mix, increasing pricing pressure and price hikes in components and it is extremely challenging to maintain market share and at the same time defending margin erosion pressure and remaining cost competitive and lean and agile and technologically advanced.

##### *Risk Associated with U.S.-China Trade War*

Although the direct impact of tariff increase on smart phone supply chain is limited, the unpredictability of U.S. President Trump's future act adds to the uncertainty and will hurt market sentiment. The Trump administration is taking a different approach to put Chinese smart phone brand to its entity list which prohibits U.S. hardware and software companies doing business with Chinese smart phone brand. By doing so, it adversely weakens Chinese smart phone brands' ability to compete in the fierce smart phone market. The Group will continue monitoring the impact and devise counter measures if necessary.

##### *Reliance on Key Customers*

The Group's five largest customers account for 89.6% of the Group's total revenue. The Group has strong established relationships with these major customers and it is a big challenge to maintain bargaining power with these customers. Please refer to section headed "Key Relationships with Customers, Suppliers and Employees" for the details of our assessment of the risk presented to the Group and our actions to manage such risk. The majority of the Group's trade receivables are from the key established customers whom the Group has strong established working relationships. The credit terms granted to them are in the range of 60 to 90 days and are in line with those granted to other customers. As part of the audit procedures, subsequent settlements of trade receivables after the year-end have been reviewed and are satisfactory, requiring no provision. As market is volatile and general economy may deteriorate, the Group will keep monitoring credit position of customers and assess default risks. HMD is now raising funds and the Group will monitor its progress and the implication to cash position and credit position of HMD and the risk that huge account receivables cannot be collected or collected in a timely manner. Regarding the U.S. Government's blacklisting, export controls and bans against one of the Group's major customers, as things keep changing, the Group will continue to monitor and assess the impact and take necessary steps to mitigate the risks and the Group will dedicate resources to serve all customers and foster long term business relationship.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Outlook** *(Continued)*

##### *Reliance on Key Suppliers*

Please refer to section “Key Relationships with Customers, Suppliers and Employees” for the details of our assessment of the risk presented to the Group and how to mitigate such risk.

##### *Foreign Exchange Risks*

Please refer to the section of “Financial Performance” for the details on how to mitigate such risks.

##### *Cyber Risk Controls*

Regarding cyber risk, the Group has in place an information security policy which provides adequate security controls and protection of the financial data and business information. IT department has published a handbook which requires employees to follow so that the cybersecurity risks can be managed and controlled across the organisation (particular for the network control). Besides, IT department has a procedure and guideline in place enabling them to respond immediately when a cyber-attack is detected. For the network control, all the computer servers are located in a Local Network Area (Intranet) using redundant firewall design. Besides, there is a Global Security Operation Centre (GSOC) which helps manufacturing and functional units monitor their network to ensure any attack to the computer system can be detected immediately and IT department prepares a monthly report to report if any incidence of cyber-attack has been detected. In addition, IT department has a disaster recovery plan and procedure in place to ensure immediate and effective responses/actions can be initiated when there is an attack to minimise potential harmful impact/losses and operation can be restored rapidly to avoid any business interruption and enable continuing running of business operations of the Group.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Outlook** *(Continued)*

On the basis of a preliminary review of the Group's latest unaudited management accounts and other information currently available, the Company expects the Group to record a loss, if any, for the year ending 31 December 2019 which is likely to be materially smaller than the Group's consolidated net loss of US\$857,115,000 for the year ended 31 December 2018. Various factors are relevant to the above, including those highlighted in the Company's profit warning announcement dated 3 May 2019. Those factors are expected to continue into, and new factors might emerge during, the remainder of 2019. For more details, please refer to the aforesaid announcement and the Company's announcement dated 18 July 2019 on additional inside information relating to last profit warning. At this stage, on the basis of a preliminary review of currently available information, apart from the aforesaid, the Company is unable to reasonably and meaningfully estimate a more precise likely magnitude of loss, if any, for the year ending 31 December 2019. The Company will make further announcement(s) in compliance with the Listing Rules and/or the SFO, as appropriate.

The shareholders of the Company and potential investors should note that the Company has been in the process of reviewing the Group's consolidated final results to date (as updated from time to time) for the year ending 31 December 2019. The information in this interim report is the result of a preliminary assessment by the Company's management based on the Group's latest unaudited management accounts and other information currently available. That information is subject to possible adjustments following further internal review, and is not based on any figure(s) or information which has/have been reviewed by the Company's auditor or audit committee. The Group's 2019 audited consolidated final results and other related details will be disclosed in the Company's 2019 final results announcement, which is tentatively scheduled to be published in March 2020.

In the meantime, pursuant to applicable disclosure requirements laid down by the Taiwan Stock Exchange Corporation, Hon Hai is required to disclose in due course (which is expected to be in or about November 2019) certain unaudited consolidated financial information of the Group for the nine months ending 30 September 2019, and simultaneously upon such disclosure in Taiwan, the Company will announce the same financial information in order to facilitate timely dissemination of information to investors and potential investors in Hong Kong and Taiwan.

## **BUSINESS REVIEW** *(Continued)*

### **DISCUSSION AND ANALYSIS** *(Continued)*

#### **Outlook** *(Continued)*

The Company wishes to take this opportunity to reiterate that the Group's quarterly performance may fluctuate (possibly significantly) as a result of a number of factors. For example, performance over certain periods may vary as a result of a combination of changes in the macro-economic environment (e.g. intensifying trade wars and political conditions) and industry generally and related changes in consumer demand, price wars, seasonality of sales, factors relating to the supply chain (e.g. component costs, sourcing and shortage) and to inventory (e.g. accumulated inventory may take time to clear and may have to be written-off), and customers' credit risks, product launch or product recalibration strategies and possible cancellation or delay of customer orders or change of production quantities and certain customers' products having short product life time volume, market competitiveness and shifts in customers' demand and preferences (e.g. in-house manufacturing instead of outsourcing), changes in money markets (e.g. fluctuation of interest rates and foreign exchange rates) and capital markets, sales and product mix changes, commodity price changes, technology advancement, and legal/regulatory/tax/government policy changes (e.g. government's blacklisting, export controls and bans against the Group's major customer). Other factors can also give rise to uncertainty. For example, the Group's financial exposure to market volatility (e.g. RMB and INR and other currency volatility, stock market volatility) can result in gains or losses; likewise with respect to any future impairments of property, plant and equipment, goodwill or intangible assets and equity investments, and the timing of dispositions of equity investments and resulting profits/losses, and the performance of the Group's associates and its share of those associates' profits/losses, renewing or meeting the conditions of any tax incentives and credits, and the timing of receipt of incentive income, can all (individually and collectively) affect quarterly performance.

**The shareholders of the Company and potential investors are advised to exercise caution when dealing in the shares of the Company.**

## OTHER INFORMATION

### DIRECTORS

Mr. LAU Siu Ki (“Mr. Lau”), an independent non-executive director of the Company, was appointed with effect from 21 June 2019 as an independent non-executive director of IVD Medical Holding Limited, whose shares are listed on the Main Board of the Stock Exchange commencing from 12 July 2019. It follows that Mr. Lau currently holds the position of independent non-executive director in six other companies whose shares are listed on the Stock Exchange. In this respect, the Board and the Company’s nomination committee have considered that Mr. Lau has throughout the six months ended 30 June 2019 demonstrated that he has been, and will continue to be, able to devote sufficient time to the matters relating to the Group from time to time handled by the Board and/or the Board committees chaired by Mr. Lau, taking into account (among other things) his full attendance at all meetings of the Board, and all meetings of the Board committees chaired by him, as held during such six months. For details, please refer to page 154 of the Company’s 2018 annual report as issued and published on 9 April 2019.

According to the Company’s articles of association (the “Articles”), one-third of the directors of the Company for the time being (or, if their number is not three or a multiple of three, then the number nearest to, but not exceeding, one-third) shall retire from office by rotation at each annual general meeting of the Company, provided that every director shall be subject to retirement by rotation at an annual general meeting at least once every three years, and the directors of the Company to retire in the relevant year will be those who have been longest in office since their last re-election. It follows that pursuant to the resolution passed by the Company’s shareholders at an annual general meeting of the Company in relation to the re-election of any one director of the Company, the current term of such director’s appointment with the Company will commence from the closing of such annual general meeting, ending upon the conclusion of the relevant annual general meeting of the Company at which (among other things) such director’s next re-election is considered in accordance with the Articles. For better understanding, the current appointment term of each director of the Company is as follows: (1) pursuant to the re-elections duly approved by the Company’s shareholders on 25 May 2017, the current appointment term of each of Mr. WANG Chien Ho (“Mr. Wang”) as an executive director of the Company and Mr. TAO Yun Chih as an independent non-executive director of the Company has commenced from 25 May 2017, ending upon the conclusion of the relevant annual general meeting of the Company at which (among other things) his next re-election is considered in accordance with the Articles; (2) pursuant to the re-elections duly approved by the Company’s shareholders on 18 May 2018, the current appointment term of each of Mr. Lau and Dr. Daniel Joseph MEHAN as an independent non-executive director of the Company has commenced from 18 May 2018, ending upon the conclusion of the relevant annual general meeting of the Company at which (among other things) his next re-election is considered in accordance with the Articles; and (3) pursuant to the re-elections duly approved by the Company’s shareholders on 17 May 2019, the current appointment term of each of Mr. CHIH Yu Yang (“Mr. Chih”) and Dr. KUO Wen-Yi as an executive director of the Company has commenced from 17 May 2019, ending upon the conclusion of the relevant annual general meeting of the Company at which (among other things) his next re-election is considered in accordance with the Articles.

## OTHER INFORMATION (Continued)

### DISCLOSURE OF INTERESTS

#### Directors' Interests and Short Positions in Shares, Underlying Shares and Debentures

As at 30 June 2019, the interests and short positions, if any, of each director and chief executive of the Company in the shares, underlying shares and debentures of the Company and any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which the directors and chief executive were taken or deemed to have under such provisions of the SFO), or which were required to be and were recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO, or which were otherwise required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 to the Listing Rules (the "Model Code") adopted by the Company were as follows:

Name of director	Name of corporation	Capacity/ Nature of interest	Total number of ordinary shares	Approximate percentage of interest in the Company/ associated corporation
CHIH Yu Yang	The Company	Personal Interest	20,731,661	0.2524%
	Hon Hai	Personal Interest	558,075	0.0040%
	Chiun Mai Communication Systems, Inc. (Note)	Personal Interest	1,000	0.0007%
KUO Wen-Yi	The Company	Interest of Spouse	700,000	0.0085%
	Hon Hai	Personal Interest	1,848	0.00001%
		Interest of Spouse	13	0.000001%

Note: The Company indirectly, through its wholly-owned subsidiaries, holds approximately 87.06% of the entire number of issued shares of Chiun Mai Communication Systems, Inc., a company incorporated in Taiwan.

## OTHER INFORMATION (Continued)

### DISCLOSURE OF INTERESTS (Continued)

#### Directors' Interests and Short Positions in Shares, Underlying Shares and Debentures (Continued)

Save as disclosed above, none of the directors or chief executive of the Company had, as at 30 June 2019, any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which would have to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which the directors and chief executive of the Company were taken or deemed to have under such provisions of the SFO), or which were required to be and were recorded in the register required to be kept by the Company under Section 352 of the SFO, or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code.

#### Substantial Shareholders' Interests and Short Positions in Shares and Underlying Shares

So far as is known to any director of the Company, as at 30 June 2019, shareholders (other than the directors or chief executive of the Company) who had interests and short positions in the shares and underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO or which were required to be and were recorded in the register required to be kept by the Company under Section 336 of the SFO were as follows:

Name of substantial shareholder	Capacity/Nature of interest	Total number of ordinary shares	Approximate percentage of interest in the Company
Foxconn (Far East) Limited (Note 1)	Beneficial owner	5,081,034,525	61.86%
Hon Hai (Notes 1 & 2)	Interest of a controlled corporation	5,081,034,525	61.86%

#### Notes:

1. Foxconn (Far East) Limited is a direct wholly-owned subsidiary of Hon Hai, and therefore, Hon Hai is deemed or taken to be interested in the 5,081,034,525 shares which are beneficially owned by Foxconn (Far East) Limited for the purposes of the SFO.
2. Mr. Chih, the acting chairman and an executive director of the Company, is a director of certain subsidiaries of Hon Hai. Mr. Wang, an executive director of the Company, is an employee of the Hon Hai Group.

Save as disclosed above, as at 30 June 2019, the Company had not been notified by any persons (other than the directors or chief executive of the Company) who had interests or short positions in the shares or underlying shares of the Company which would be required to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or which were required to be and were recorded in the register required to be kept by the Company under Section 336 of the SFO.

## **OTHER INFORMATION** *(Continued)*

### **OPTION SCHEME AND SHARE SCHEME**

During the six months ended 30 June 2019, no option was granted under the Option Scheme and no share was awarded under the Share Scheme.

For details about the shares granted pursuant to the Share Scheme since 2015, please refer to pages 54 and 55 of the Company's 2018 annual report as issued and published on 9 April 2019.

Apart from the Option Scheme, the Share Scheme and potential entitlements pursuant to Hon Hai's articles of incorporation (pursuant to which, among other things, Hon Hai shares may be distributed as part of compensation to employees, including the Company's directors, upon and subject to the terms and conditions set out therein) and also potential entitlements to any and all scrip dividends (which any director of the Company may from time to time have as a shareholder of the Company and/or Hon Hai in respect of the relevant shares then held by him/her) pursuant to any scrip dividend scheme in respect of any dividend as may be announced by the Company and/or Hon Hai from time to time, at no time during the six months ended 30 June 2019 was the Company, any of its subsidiaries, its holding company or any subsidiary of the Company's holding company a party to any arrangement to enable the directors of the Company to acquire benefits by means of acquisitions of shares in, or debentures of, the Company or any other body corporate.

### **DIVIDEND**

On 9 August 2019, the Board resolved not to recommend the payment of an interim dividend for the six months ended 30 June 2019.

### **PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY**

Neither the Company nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the six months ended 30 June 2019.

### **RESERVES**

Movements in reserves of the Group during the six months ended 30 June 2019 are set out on page 8.

### **AUDIT COMMITTEE**

The Company has established and maintained an audit committee in accordance with the requirements of the Listing Rules, particularly the Corporate Governance Code and Corporate Governance Report as set out in Appendix 14 to the Listing Rules (the "CG Code"). Its primary duties are to review the Group's financial reporting process and internal control and enterprise risk management systems, nominate and monitor external auditor and provide advice and comments to the Board. The audit committee comprises three independent non-executive directors (among whom one of the independent non-executive directors has the appropriate professional qualifications or accounting or related financial management expertise as required under the Listing Rules).



## **OTHER INFORMATION** *(Continued)*

### **AUDIT COMMITTEE** *(Continued)*

The audit committee has reviewed the unaudited condensed consolidated financial statements of the Group for the six months ended 30 June 2019 and the Company's interim report for such six-month period and recommended the same to the Board for approval. In addition, the unaudited condensed consolidated financial statements of the Group for the six months ended 30 June 2019 have been reviewed by the Company's auditor, Deloitte Touche Tohmatsu, in accordance with Hong Kong Standard on Review Engagements 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Hong Kong Institute of Certified Public Accountants.

### **MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS**

The Company has adopted the Model Code. Following specific enquiry made by the Company, all the directors of the Company have confirmed that they have complied with the required standards set out in the Model Code in respect of the Company's securities throughout the six months ended 30 June 2019.

### **CORPORATE GOVERNANCE**

The Company has applied and complied with all the code provisions set out in the CG Code during the period from 1 January 2019 to 30 June 2019.

The code provision contained in Paragraph A.2.1 of the CG Code provides that the roles of the chairman and chief executive should be separate and should not be performed by the same individual.

However, Mr. TONG Wen-hsin ("Mr. Tong"), the Company's former chairman and former executive director, had resigned from his positions within the Company with effect from 1 January 2017. Upon Mr. Tong's resignation, the Company has not been able to comply with the code provision contained in Paragraph A.2.1 of the CG Code. The reasons for such deviation are set out below.

## **OTHER INFORMATION** *(Continued)*

### **CORPORATE GOVERNANCE** *(Continued)*

Since the resignation of Mr. Tong as the chairman of the Company, the Company has been searching for the right candidate to fill the position of chairman of the Company. However, given the importance of the role, the Board expects that it may take some time before the Company is able to find a suitable candidate to fulfil the role of chairman. In light of the tremendous market challenges and the current uncertainties relating to the vacancy of the chairman role, the Board considered that experienced leadership was of utmost importance and has resolved to adopt an arrangement by appointing Mr. Chih, the current chief executive officer, to act as the acting chairman with effect from 1 January 2017. Mr. Chih has been the Company's executive director and chief executive officer since 28 August 2009 and 26 July 2012, respectively. In these positions, Mr. Chih has accumulated extensive and in-depth knowledge and experience in both the Company and the industry. The Board believes that this arrangement not only is crucial to the continuation in the Group's implementation of business plans and formulation of business strategies, but also serves to avoid unnecessary speculation, confusion and instability that may be caused to the Group's shareholders, investors, customers, suppliers and business partners worldwide, thereby allowing the Company to have sufficient time for the selection and appointment of the replacement chairman of the Company. During the current period, the Company had continued its search for the right candidate to fill the position of chairman of the Company and had considered the suitability and appropriateness of certain distinguished candidates. However, the Company was not able to identify the right candidate and it will continue its search efforts. Although the arrangement deviates from the relevant code provision, the Board considers that the arrangement will not impair the balance of power and authority between the Board and the management of the Company as three out of the six Board members are the independent non-executive directors and the Board meets regularly to consider major matters affecting the operations of the Group and all directors of the Company are properly and promptly briefed on such matters with adequate, complete and reliable information.

In light of the above and other measures taken (including arrangements relating to delegation by the Board of certain authority as detailed in the "Other Information — Corporate Governance" section of the Company's 2018 interim report as issued and published on 19 September 2018), the Board believes that there have been adequate checks and balances at both the Board level and the Company's senior management level, and there has been sufficiently close supervision over the key operational matters of the Group, notwithstanding that the Company has not been able to comply with the code provision contained in Paragraph A.2.1 of the CG Code during the current period. The Board therefore considers that the circumstances justify the adoption of the arrangement for the chief executive officer to serve also as the acting chairman, and considers that this arrangement is currently in the best interests of the Company and its shareholders as a whole.



## **OTHER INFORMATION** *(Continued)*

### **CORPORATE GOVERNANCE** *(Continued)*

In the spirit of better corporate governance, the Board will periodically review the effectiveness of this arrangement (and introduce further measures, if necessary) and, through the Company's nomination committee, will continue to use its best endeavours to find a suitable candidate to assume the duties as the chairman of the Company as soon as reasonably practicable, thereby separating the roles of the chairman and chief executive as prescribed under the code provision contained in Paragraph A.2.1 of the CG Code.

On behalf of the Board

**CHIH Yu Yang**  
*Acting Chairman*

Hong Kong, 9 August 2019