

**FIH<sup>®</sup>** 富智康<sup>™</sup>

**FIH Mobile Limited**

(Incorporated in the Cayman Islands with limited liability)

Stock Code: 2038

**2018**

**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

#### NON-EXECUTIVE DIRECTOR

LUO Zhongsheng

#### 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

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802 West Bay Road

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Cayman Islands

#### HEAD OFFICE

No. 18 Youyi Road

Langfang Economic and Technological  
Development Zone

Hebei Province

People’s Republic of China

#### PRINCIPAL PLACE OF BUSINESS IN HONG KONG

8th Floor, Peninsula Tower

538 Castle Peak Road

Cheung Sha Wan

Kowloon

Hong Kong

#### LEGAL ADVISORS

Clifford Chance, Hong Kong

Freshfields Bruckhaus Deringer,  
Hong Kong

Mayer Brown, Hong Kong

#### AUDITORS

Deloitte Touche Tohmatsu

#### 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

Grand Cayman, KY1-1110

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 48, which comprise the condensed consolidated statement of financial position as of 30 June 2018 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

10 August 2018

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

	NOTES	Six months ended	
		30.6.2018 US\$'000 (unaudited)	30.6.2017 US\$'000 (unaudited)
Revenue	3	<b>6,563,291</b>	4,374,104
Cost of sales		<b>(6,598,202)</b>	(4,260,576)
Gross (loss) profit		<b>(34,911)</b>	113,528
Other income, gains and losses		<b>7,331</b>	119,733
Impairment loss recognised for available-for-sale investments		–	(162,499)
Selling expenses		<b>(60,851)</b>	(17,522)
General and administrative expenses		<b>(134,004)</b>	(155,093)
Research and development expenses		<b>(118,425)</b>	(72,265)
Interest expense on bank borrowings		<b>(9,422)</b>	(5,472)
Share of profit (loss) of associates		<b>1,110</b>	(2,301)
Share of loss of joint ventures		<b>(73)</b>	(640)
Loss before tax		<b>(349,245)</b>	(182,531)
Income tax credit (expense)	4	<b>678</b>	(16,545)
Loss for the period	5	<b>(348,567)</b>	(199,076)
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>6,073</b>	–
<i>Items that may be reclassified subsequently to profit or loss:</i>			
Exchange differences arising on translation of foreign operations		<b>(70,527)</b>	97,763
Fair value gain on available-for-sale financial assets		–	1,102
Share of translation reserve of associates		<b>(489)</b>	1,759
Share of translation reserve of joint ventures		<b>(70)</b>	200
Other comprehensive (expense) income for the period		<b>(65,013)</b>	100,824
Total comprehensive expense for the period		<b>(413,580)</b>	(98,252)

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

	<b>Six months ended</b>	
NOTE	<b>30.6.2018</b>	30.6.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Loss for the period attributable to:		
Owners of the Company	<b>(348,061)</b>	(196,556)
Non-controlling interests	<b>(506)</b>	(2,520)
	<b><u>(348,567)</u></b>	<u>(199,076)</u>
Total comprehensive expense attributable to:		
Owners of the Company	<b>(412,914)</b>	(96,099)
Non-controlling interests	<b>(666)</b>	(2,153)
	<b><u>(413,580)</u></b>	<u>(98,252)</u>
Loss per share	7	
Basic	<b><u>(US4.3 cents)</u></b>	(US2.5 cents)

# CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AT 30 JUNE 2018

	NOTES	30.6.2018 US\$'000 (unaudited)	31.12.2017 US\$'000 (audited)
<b>Non-current assets</b>			
Property, plant and equipment	8	994,997	974,236
Investment properties		5,103	6,149
Prepaid lease payments		50,255	51,625
Goodwill		79,435	79,435
Intangible assets		5,468	10,158
Available-for-sale investments		–	190,187
Financial assets at fair value through profit or loss			
– Equity instruments		81,670	–
– Convertible notes	10	44,209	60,000
Financial assets at fair value through other comprehensive income			
– Equity instruments		151,806	–
Interests in associates		100,889	100,348
Interests in joint ventures		2,656	2,799
Deferred tax assets	9	58,460	43,932
Deposit for acquisition of prepaid lease payments		28,815	29,177
		<b>1,603,763</b>	<b>1,548,046</b>
<b>Current assets</b>			
Inventories		1,285,877	1,024,611
Trade and other receivables	11	3,147,297	3,776,603
Financial assets at fair value through profit or loss			
– Short-term investments		400,421	426,554
Bank deposits		21,269	31,964
Bank balances and cash		1,991,765	1,979,905
		<b>6,846,629</b>	<b>7,239,637</b>
<b>Current liabilities</b>			
Trade and other payables	12	4,127,318	4,644,463
Contract liabilities		54,320	–
Bank borrowings	13	1,244,170	712,600
Provision	14	119,425	96,896
Tax payable		109,470	125,036
		<b>5,654,703</b>	<b>5,578,995</b>
Net current assets		<b>1,191,926</b>	<b>1,660,642</b>
Total assets less current liabilities		<b>2,795,689</b>	<b>3,208,688</b>

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

AT 30 JUNE 2018

	NOTES	30.6.2018 US\$'000 (unaudited)	31.12.2017 US\$'000 (audited)
Capital and reserves			
Share capital	15	<b>323,739</b>	323,739
Reserves		<b>2,437,361</b>	2,849,370
Equity attributable to owners of the Company		<b>2,761,100</b>	3,173,109
Non-controlling interests		<b>5,944</b>	6,610
Total equity		<b>2,767,044</b>	3,179,719
Non-current liabilities			
Deferred tax liabilities	9	<b>6,180</b>	5,362
Deferred income	16	<b>22,465</b>	23,607
		<b>28,645</b>	28,969
		<b>2,795,689</b>	3,208,688



# CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE SIX MONTHS ENDED 30 JUNE 2018

Attributable to owners of the Company

	Share capital	Share premium	Special reserve	Revaluation reserve	Other reserve	Legal reserve	Translation reserve	Share compensation	Retained profits	Total	Non-controlling interests	Total equity
	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000	US\$'000
Balance at 1 January 2017 (audited)	319,410	1,166,951	15,514	47,433	(1,198)	168,670	(2,952)	(21,537)	1,872,342	3,564,633	6,123	3,570,756
Loss for the period	-	-	-	-	-	-	-	-	(196,556)	(196,556)	(2,520)	(199,076)
Other comprehensive income for the period	-	-	-	1,102	-	-	99,355	-	-	100,457	367	100,824
Total comprehensive income (expense) for the period	-	-	-	1,102	-	-	99,355	-	(196,556)	(96,099)	(2,153)	(88,252)
Recognition of equity-settled share-based payments	-	-	-	-	-	-	-	16,125	-	16,125	-	16,125
Dividends recognised as distribution (note 6)	-	-	-	-	-	-	-	-	(142,000)	(142,000)	-	(142,000)
Balance at 30 June 2017 (unaudited)	319,410	1,166,951	15,514	48,535	(1,198)	168,670	96,403	(5,412)	1,533,786	3,342,659	3,970	3,346,629
Balance at 31 December 2017 (audited)	323,739	1,195,623	15,514	86,388	(1,302)	168,899	179,622	-	1,204,626	3,173,109	6,610	3,179,719
Adjustments (see note 2)	-	-	-	(102,497)	-	-	-	-	103,402	905	-	905
At 1 January 2018 (restated)	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

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE SIX MONTHS ENDED 30 JUNE 2018

	<b>Six months ended</b>	
	<b>30.6.2018</b>	30.6.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Net cash (used in) from operating activities	<b>(342,375)</b>	269,155
Investing activities		
Purchase of short-term investments	<b>(1,368,214)</b>	(1,860,589)
Purchase of property, plant and equipment	<b>(125,830)</b>	(75,538)
Purchase of equity instruments at fair value through other comprehensive income	<b>(63,982)</b>	-
Purchase of available-for-sale investments	-	(3,998)
Capital injection in an associate	-	(1,341)
Purchase of equity interest in a subsidiary	-	(189)
Dividend income from an associate	<b>80</b>	-
Proceeds from disposal of property, plant and equipment	<b>5,962</b>	5,922
Withdrawal of bank deposits for investing purpose	<b>9,196</b>	13,992
Proceeds on settlements of short-term investments	<b>1,399,107</b>	2,237,175
Net cash (used in) from investing activities	<b>(143,681)</b>	315,434
Financing activities		
Bank borrowings repaid	<b>(2,955,312)</b>	(516,255)
Interest paid	<b>(11,322)</b>	(11,694)
Bank borrowings raised	<b>3,498,419</b>	443,202
Dividends paid	-	(142,000)
Net cash from (used in) financing activities	<b>531,785</b>	(226,747)
Net increase in cash and cash equivalents	<b>45,729</b>	357,842
Cash and cash equivalents at 1 January	<b>1,979,905</b>	1,373,550
Effect of foreign exchange rate changes	<b>(33,869)</b>	49,360
Cash and cash equivalents as at 30 June, representing bank balances and cash	<b>1,991,765</b>	1,780,752

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 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”).

## 2. PRINCIPAL ACCOUNTING POLICIES

The condensed consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments including equity instruments at fair value through profit or loss/other comprehensive income, convertible notes, derivatives and short-term investments, which are measured at fair values.

Other than changes in accounting policies resulting from application of new and amendments to International Financial Reporting Standards (“IFRSs”), the accounting policies, key sources of estimation uncertainty and methods of computation used in the condensed consolidated financial statements for the six months ended 30 June 2018 are the same as those followed in the preparation of the Group’s annual financial statements for the year ended 31 December 2017.

### 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 for the preparation of the Group’s condensed consolidated financial statements:

IFRS 9	Financial Instruments
IFRS 15	Revenue from Contracts with Customers and the related Amendments
IFRIC 22	Foreign Currency Transactions and Advance Consideration
Amendments to IFRS 2	Classification and Measurement of Share-based Payment Transactions
Amendments to IFRS 4	Applying IFRS 9 “Financial Instruments” with IFRS 4 “Insurance Contracts”
Amendments to IAS 28	As part of the Annual Improvements to IFRSs 2014–2016 Cycle
Amendments to IAS 40	Transfers of Investment Property

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

*FOR THE SIX MONTHS ENDED 30 JUNE 2018*

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

#### **Application of new and amendments to IFRSs** *(Continued)*

The new and amendments to IFRSs have been applied in accordance with the relevant transition provisions in the respective standards and amendments which result in changes in accounting policies, amounts reported and/or disclosures as described below.

#### **2.1 Impacts and changes in accounting policies of application on IFRS 15 “Revenue from Contracts with Customers”**

The Group has applied IFRS 15 for the first time in the current interim period. IFRS 15 superseded IAS 18 “Revenue” (“IAS 18”), IAS 11 “Construction Contracts” (“IAS 11”) and the related interpretations.

The Group recognises revenue from the manufacturing services (including sales of goods, delivery service and processing service) and distribution income to its customers in connection with the production of handsets.

The Group has applied IFRS 15 retrospectively with the cumulative effect of initially applying this standard recognised at the date of initial application, 1 January 2018. Any difference at the date of initial application is recognised in the opening retained profits and comparative information has not been restated. Furthermore, in accordance with the transition provisions in IFRS 15, the Group has elected to apply the standard retrospectively only to contracts that are not completed at 1 January 2018. Accordingly, certain comparative information may not be comparable as comparative information was prepared under IAS 18 and IAS 11 and the related interpretations.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

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

### Application of new and amendments to IFRSs *(Continued)*

#### 2.1 **Impacts and changes in accounting policies of application on IFRS 15 “Revenue from Contracts with Customers”** *(Continued)*

##### 2.1.1 *Key changes in accounting policies resulting from application of IFRS 15*

IFRS 15 introduces a 5-step approach when recognising revenue:

- Step 1: Identify the contract(s) with a customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognise revenue when (or as) the Group satisfies a performance obligation.

Under IFRS 15, the Group recognises revenue when (or as) a performance obligation is satisfied, i.e. when “control” of the goods or services underlying the particular performance obligation is transferred to the customer.

A performance obligation represents a good and service (or a bundle of goods or services) that is distinct or a series of distinct goods or services that are substantially the same.

Control is transferred over time and revenue is recognised over time by reference to the progress towards complete satisfaction of the relevant performance obligation if one of the following criteria is met

- the customer simultaneously receives and consumes the benefits provided by the Group’s performance as the Group performs;
- the Group’s performance creates and enhances an asset that the customer controls as the Group performs; or
- the Group’s performance does not create an asset with an alternative use to the Group and the Group has an enforceable right to payment for performance completed to date.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

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

### Application of new and amendments to IFRSs *(Continued)*

#### 2.1 Impacts and changes in accounting policies of application on IFRS 15 "Revenue from Contracts with Customers" *(Continued)*

##### 2.1.1 Key changes in accounting policies resulting from application of IFRS 15 *(Continued)*

Otherwise, revenue is recognised at a point in time when the customer obtains control of the distinct good or service.

A contract liability represents the Group's obligation to transfer goods or services to a customer for which the Group has received consideration (or an amount of consideration is due) from the customer.

#### **A point in time revenue recognition**

The revenue of the Group is recognised at a point in time. Under the transfer-of-control approach in IFRS 15, revenue from manufacturing services and distribution income to the Group's customers in connection with the production of handsets are recognised when the goods are passed to the customers, which is the point of time when the customer has the ability to direct the use of the goods and obtain substantially all of the remaining benefits of the goods. The Group has assessed those manufactured goods with no alternative use to the Group and considered that no material impact on the timing and amounts of revenue recognised in the current interim period since the production cycle of its products is short.

#### **Contracts with multiple performance obligations (including allocation of transaction price)**

For contracts that contain more than one performance obligations (including sales of goods, delivery service and processing service), the Group allocates the transaction price to each performance obligation on a relative stand-alone selling price basis.

The stand-alone selling price of the distinct good or service underlying each performance obligation is determined at contract inception. It represents the price at which the Group would sell a promised good or service separately to a customer. If a stand-alone selling price is not directly observable, the Group estimates it using appropriate techniques such that the transaction price ultimately allocated to any performance obligation reflects the amount of consideration to which the Group expects to be entitled in exchange for transferring the promised goods or services to the customer.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

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

### Application of new and amendments to IFRSs *(Continued)*

#### 2.1 **Impacts and changes in accounting policies of application on IFRS 15 “Revenue from Contracts with Customers”** *(Continued)*

##### 2.1.1 *Key changes in accounting policies resulting from application of IFRS 15* *(Continued)*

#### **Principal versus agent**

When another party is involved in providing goods or services to a customer, the Group determines whether the nature of its promise is a performance obligation to provide the specified goods or services itself (i.e. the Group is a principal) or to arrange for those goods or services to be provided by the other party (i.e. the Group is an agent).

The Group is a principal if it controls the specified good or service before that good or service is transferred to a customer.

The Group is an agent if its performance obligation is to arrange for the provision of the specified good or service by another party. In this case, the Group does not control the specified good or service provided by another party before that good or service is transferred to the customer. When the Group acts as an agent, it recognises revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the other party.

#### **Warranties**

The Group accounts for the warranty in accordance with IAS 37 “Provisions, Contingent Liabilities and Contingent Assets” unless the warranty provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications (i.e. service-type warranties).

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 2. PRINCIPAL ACCOUNTING POLICIES (Continued)

### Application of new and amendments to IFRSs (Continued)

#### 2.1 Impacts and changes in accounting policies of application on IFRS 15 "Revenue from Contracts with Customers" (Continued)

##### 2.1.2 Summary of effects arising from initial application of IFRS 15

There are no material impact of transition to IFRS 15 on retained profits at 1 January 2018. The following adjustments were made to the amounts recognised in the condensed consolidated statement of financial position at 1 January 2018. Line items that were not affected by the changes have not been included.

#### Impacts on liabilities as at 1 January 2018

		Carrying amount previously reported at 31 December 2017	Impacts of adopting IFRS 15	Carrying amount under IFRS 15 at 1 January 2018
	Notes	US\$'000 (audited)	US\$'000	US\$'000 (unaudited)
Trade and other payables	a, b	(4,644,463)	84,517	(4,559,946)
Contract liabilities	a, b	-	(84,517)	(84,517)

Notes:

- (a) As at 1 January 2018, advances from customers of US\$65,397,000 in respect of manufacturing and distribution contracts previously included in trade and other payables were reclassified to contract liabilities as the Group has obligation to transfer goods or services to its customers for which the Group has received consideration from the customer.
- (b) As at 1 January 2018, deferred consideration of US\$19,120,000 in relation to the investment in convertible notes of Mango International (as defined in note 10) previously included in trade and other payables were reclassified to contract liabilities as the Group has obligation to transfer goods to Mango International.



# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 2. PRINCIPAL ACCOUNTING POLICIES (Continued)

### Application of new and amendments to IFRSs (Continued)

#### 2.1 Impacts and changes in accounting policies of application on IFRS 15 "Revenue from Contracts with Customers" (Continued)

##### 2.1.2 Summary of effects arising from initial application of IFRS 15 (Continued)

There are no material impact of applying IFRS 15 on the Group's condensed consolidated statement of profit or loss and other comprehensive income for the current interim period. The following tables summarise the impact of applying IFRS 15 on the Group's condensed consolidated statement of financial position as at 30 June 2018 for each of the line items affected. Line items that were not affected by the changes have not been included.

#### Impacts on liabilities as at 30 June 2018

	As reported	Adjustments	Amounts without application of IFRS 15
	US\$'000	US\$'000	US\$'000
	(unaudited)		(unaudited)
Trade and other payables	(4,127,318)	(54,320)	(4,181,638)
Contract liabilities	(54,320)	54,320	-

#### 2.2 Impacts and changes in accounting policies of application on IFRS 9 "Financial Instruments" and the related amendments

In the current period, the Group has applied IFRS 9 "Financial Instruments" and the related consequential amendments to other IFRSs. IFRS 9 introduces new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) expected credit losses ("ECL") for financial assets and 3) general hedge accounting.

The Group has applied IFRS 9 in accordance with the transition provisions set out in IFRS 9. i.e. applied the classification and measurement requirements (including impairment) retrospectively to instruments that have not been derecognised as at 1 January 2018 (date of initial application) and has not applied the requirements to instruments that have already been derecognised as at 1 January 2018. The difference between carrying amounts as at 31 December 2017 and the carrying amounts as at 1 January 2018 are recognised in the opening retained profits and other components of equity, without restating comparative information.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

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

### **Application of new and amendments to IFRSs** *(Continued)*

#### **2.2 Impacts and changes in accounting policies of application on IFRS 9 “Financial Instruments” and the related amendments** *(Continued)*

Accordingly, certain comparative information may not be comparable as comparative information was prepared under IAS 39 “Financial Instruments: Recognition and Measurement” (“IAS 39”).

##### *2.2.1 Key changes in accounting policies resulting from application of IFRS 9*

#### **Classification and measurement of financial assets**

Trade receivables arising from contracts with customers are initially measured in accordance with IFRS 15.

All recognised financial assets that are within the scope of IFRS 9 are subsequently measured at amortised cost or fair value, including unquoted equity investments measured at cost less impairment under IAS 39.

Debt instruments that meet the following conditions are subsequently measured at amortised cost:

- the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All other financial assets are subsequently measured at fair value through profit or loss (“FVTPL”), except that at the date of initial application/initial recognition of a financial asset the Group may irrevocably elect to present subsequent changes in fair value of an equity investment in other comprehensive income (“OCI”) if that equity investment is not held for trading.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 2. PRINCIPAL ACCOUNTING POLICIES (Continued)

### Application of new and amendments to IFRSs (Continued)

#### 2.2 Impacts and changes in accounting policies of application on IFRS 9 “Financial Instruments” and the related amendments (Continued)

##### 2.2.1 Key changes in accounting policies resulting from application of IFRS 9 (Continued)

###### Classification and measurement of financial assets (Continued)

###### Equity instruments designated as at fair value through other comprehensive income (“FVTOCI”)

At the date of initial application/initial recognition, the Group may make an irrevocable election (on an instrument-by-instrument basis) to designate investments in equity instruments as at FVTOCI.

Investments in equity instruments at FVTOCI are initially measured at fair value plus transaction costs. Subsequently, they are measured at fair value with gains and losses arising from changes in fair value recognised in OCI and accumulated in the revaluation reserve; and are not subject to impairment assessment. The cumulative gain or loss will not be reclassified to profit or loss on disposal of the equity investments, and will be transferred to retained profits.

Dividends on these investments in equity instruments are recognised in profit or loss when the Group’s right to receive the dividends is established in accordance with IFRS 9, unless the dividends clearly represent a recovery of part of the cost of the investment. Dividends are included in the “other income, gains and losses” line item in profit or loss.

###### Financial assets at FVTPL

Financial assets that do not meet the criteria for being measured at amortised cost or FVTOCI or designated as FVTOCI are measured at FVTPL.

Financial assets at FVTPL are measured at fair value at the end of each reporting period, with any fair value gains or losses recognised in profit or loss. The net gain or loss recognised in profit or loss includes any dividend or interest earned on the financial asset and is included in the “other income, other gains and losses” line item.

The directors of the Company reviewed and assessed the Group’s financial assets as at 1 January 2018 based on the facts and circumstances that existed at that date. Changes in classification and measurement on the Group’s financial assets and the impacts thereof are detailed in note 2.2.2.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

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

### Application of new and amendments to IFRSs *(Continued)*

#### 2.2 Impacts and changes in accounting policies of application on IFRS 9 “Financial Instruments” and the related amendments *(Continued)*

##### 2.2.1 Key changes in accounting policies resulting from application of IFRS 9 *(Continued)*

###### **Impairment under ECL model**

The Group recognises a loss allowance for ECL on financial assets which are subject to impairment under IFRS 9 (including trade receivables, bank deposits and bank balances). The amount of ECL is updated at each reporting date to reflect changes in credit risk since initial recognition.

Lifetime ECL represents the ECL that will result from all possible default events over the expected life of the relevant instrument. In contrast, 12-month ECL (“12m ECL”) represents the portion of lifetime ECL that is expected to result from default events that are possible within 12 months after the reporting date. Assessment are done based on the Group’s historical credit loss experience, adjusted for factors that are specific to the debtors, general economic conditions and an assessment of both the current conditions at the reporting date as well as the forecast of future conditions.

The Group always recognises lifetime ECL for trade receivables. The ECL on these assets are assessed individually for debtors with significant balances and/or collectively using a provision matrix with appropriate groupings.

For all other instruments, the Group measures the loss allowance equal to 12m ECL, unless when there has been a significant increase in credit risk since initial recognition, the Group recognises lifetime ECL. The assessment of whether lifetime ECL should be recognised is based on significant increases in the likelihood or risk of a default occurring since initial recognition.

###### Significant increase in credit risk

In assessing whether the credit risk has increased significantly since initial recognition, the Group compares the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition. In making this assessment, the Group considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 2. PRINCIPAL ACCOUNTING POLICIES (Continued)

### Application of new and amendments to IFRSs (Continued)

#### 2.2 Impacts and changes in accounting policies of application on IFRS 9 “Financial Instruments” and the related amendments (Continued)

##### 2.2.1 Key changes in accounting policies resulting from application of IFRS 9 (Continued)

##### **Impairment under ECL model (Continued)**

##### Significant increase in credit risk (Continued)

In particular, the following information is taken into account when assessing whether credit risk has increased significantly:

- an actual or expected significant deterioration in the financial instrument’s external (if available) or internal credit rating;
- significant deterioration in external market indicators of credit risk, e.g. a significant increase in the credit spread, the credit default swap prices for the debtor;
- existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant decrease in the debtor’s ability to meet its debt obligations;
- an actual or expected significant deterioration in the operating results of the debtor;
- an actual or expected significant adverse change in the regulatory, economic, or technological environment of the debtor that results in a significant decrease in the debtor’s ability to meet its debt obligations.

Irrespective of the outcome of the above assessment, the Group presumes that the credit risk of financial assets except trade receivables has increased significantly since initial recognition when contractual payments are more than 30 days past due, unless the Group has reasonable and supportable information that demonstrates otherwise.

The Group considers that default has occurred when the instrument except trade receivables is more than 90 days past due unless the Group has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

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

### Application of new and amendments to IFRSs *(Continued)*

#### 2.2 Impacts and changes in accounting policies of application on IFRS 9 “Financial Instruments” and the related amendments *(Continued)*

##### 2.2.1 Key changes in accounting policies resulting from application of IFRS 9 *(Continued)*

##### **Impairment under ECL model *(Continued)***

##### Measurement and recognition of ECL

The measurement of ECL is a function of the probability of default, loss given default (i.e. the magnitude of the loss if there is a default) and the exposure at default. The assessment of the probability of default and loss given default is based on historical data adjusted by forward-looking information.

Generally, the ECL is estimated as the difference between all contractual cash flows that are due to the Group in accordance with the contract and all the cash flows that the Group expects to receive, discounted at the effective interest rate determined at initial recognition.

Interest income is calculated based on the gross carrying amount of the financial asset unless the financial asset is credit impaired, in which case interest income is calculated based on amortised cost of the financial asset.

The Group recognises an impairment gain or loss in profit or loss for all financial instruments by adjusting their carrying amount with the exception of trade receivables where the corresponding adjustment is recognised through a loss allowance account.

As at 1 January 2018, the directors of the Company reviewed and assessed the Group’s existing financial assets for impairment using reasonable and supportable information that is available without undue cost or effort in accordance with the requirements of IFRS 9. The results of the assessment and the impact thereof are detailed in note 2.2.2.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 2. PRINCIPAL ACCOUNTING POLICIES (Continued)

### Application of new and amendments to IFRSs (Continued)

#### 2.2 Impacts and changes in accounting policies of application on IFRS 9 “Financial Instruments” and the related amendments (Continued)

##### 2.2.2 Summary of effects arising from initial application of IFRS 9

The table below illustrates the classification and measurement (including impairment) of financial assets subject to ECL under IFRS 9 and IAS 39 at the date of initial application, 1 January 2018.

	Notes	Available-for-sale investments US\$'000	Financial assets* designated at FVTPL US\$'000	Financial assets at FVTPL required by IFRS 9 US\$'000	Equity instruments at FVTOCI US\$'000	Amortised cost (previously classified as loans and receivables) US\$'000	Revaluation reserve US\$'000	Retained profits US\$'000
Closing balance at								
31 December 2017 (audited)								
		190,187	486,554	-	-	5,591,980	86,388	1,204,626
Effect arising from initial application of IFRS 9:								
Reclassification								
	a	(190,187)	-	107,273	82,914	-	(103,402)	103,402
	b	-	(486,554)	486,554	-	-	-	-
Remeasurement								
	a	-	-	-	905	-	905	-
Opening balance at 1 January 2018 (unaudited)								
		-	-	593,827	83,819	5,591,980	(16,109)	1,308,028

\* Amounts represent convertible notes and short-term investments.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

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

### Application of new and amendments to IFRSs *(Continued)*

#### 2.2 Impacts and changes in accounting policies of application on IFRS 9 “Financial Instruments” and the related amendments *(Continued)*

##### 2.2.2 Summary of effects arising from initial application of IFRS 9 *(Continued)*

- (a) Available-for-sale (“AFS”) investments

##### From AFS equity investments to FVTOCI

The Group elected to present in OCI for the fair value changes of certain equity investments previously classified as available-for-sale investments, of which US\$73,334,000 related to unquoted equity investments previously measured at cost less impairment and US\$9,580,000 related to listed equity investments previously measured at fair value under IAS 39. These investments are not held for trading and not expected to be sold in the foreseeable future. This results in US\$82,914,000 included in AFS investments was reclassified to equity instruments at FVTOCI at the date of initial application of IFRS 9. The fair value gain of US\$905,000 relating to those unquoted equity investments previously carried at cost less impairment were adjusted to equity instruments at FVTOCI and revaluation reserve as at 1 January 2018. The fair value gains of US\$4,705,000 relating to those listed equity investments previously carried at fair value continued to accumulate in revaluation reserve. In addition, impairment losses previously recognised of US\$26,593,000 were transferred from retained profits to revaluation reserve as at 1 January 2018.

##### From AFS equity investments to FVTPL

At the date of initial application of IFRS 9, the Group’s remaining equity investments of US\$107,273,000 were reclassified from available-for-sale investments to financial assets at FVTPL. The fair value gains of US\$76,809,000 relating to those investments previously carried at fair value were transferred from revaluation reserve to retained profits.



# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 2. PRINCIPAL ACCOUNTING POLICIES (Continued)

### Application of new and amendments to IFRSs (Continued)

#### 2.2 Impacts and changes in accounting policies of application on IFRS 9 "Financial Instruments" and the related amendments (Continued)

##### 2.2.2 Summary of effects arising from initial application of IFRS 9 (Continued)

- (b) From financial assets designated at FVTPL to financial assets at FVTPL

At the date of initial application, the Group no longer applied designation as measured at FVTPL for the convertible notes and short-term investments as these financial assets do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding and so are measured at FVTPL under IFRS 9. As a result, the fair value of the convertible notes and short-term investments of US\$60,000,000 and US\$426,554,000, respectively, were reclassified from financial assets designated at FVTPL to financial assets at FVTPL.

- (c) Impairment under ECL model

The Group has applied the IFRS 9 simplified approach to measure ECL using lifetime ECL for all trade receivables. To measure the ECL, trade receivables have been grouped based on shared credit risk characteristics.

Loss allowances for other financial assets at amortised cost mainly comprise of bank deposits and bank balances, and are measured on 12m ECL basis and there had been no significant increase in credit risk since initial recognition.

As at 1 January 2018, no additional credit loss allowance has been recognised against retained profits as the directors of the Company consider that the amount is not material.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

### 2. PRINCIPAL ACCOUNTING POLICIES (Continued)

#### Application of new and amendments to IFRSs (Continued)

#### 2.3 Impacts on opening condensed consolidated statement of financial position arising from the application of all new standards

As a result of the changes in the entity's accounting policies above, the opening condensed consolidated statement of financial position had to be restated. The following table shows the adjustments recognised for each individual line item.

	31 December			1 January
	2017	IFRS 15	IFRS 9	2018
	US\$'000	US\$'000	US\$'000	US\$'000
	(audited)			(restated)
Available-for-sale investments	190,187	-	(190,187)	-
Equity instruments at FVTPL	-	-	107,273	107,273
Equity instruments at FVTOCI	-	-	83,819	83,819
Trade and other payables	(4,644,463)	84,517	-	(4,559,946)
Contract liabilities	-	(84,517)	-	(84,517)
Revaluation reserve	(86,388)	-	102,497	16,109
Retained profits	(1,204,626)	-	(103,402)	(1,308,028)

#### 2.4 Critical accounting judgement

Except as described below, the critical accounting judgement made by the directors of the Company in applying accounting policies are the same as those disclosed in the preparation of the Group's annual financial statements for the year ended 31 December 2017.

##### *Timing of revenue recognition*

In determining the timing of revenue recognised for those manufactured goods with no alternative use to the Group, the directors of the Company has considered the Group's right to payment for performance completed to date based on its legal advisor's opinion. In cases where the Group's right has changed, the timing of such revenue may vary.

### 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.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 3. REVENUE AND SEGMENT INFORMATION (Continued)

The Group's revenue is mainly arising from the manufacturing services and distribution income amounting to US\$6,512,335,000 and US\$50,956,000 (2017: US\$4,297,532,000 and US\$76,572,000), respectively, to its customers in connection with the production of handsets.

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

	<b>Six months ended</b>	
	<b>30.6.2018</b>	30.6.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Segment revenue (external sales)		
Asia	<b>5,567,823</b>	3,850,136
Europe	<b>925,458</b>	471,176
America	<b>70,010</b>	52,792
	<hr/>	<hr/>
Total	<b>6,563,291</b>	4,374,104
	<hr/>	<hr/>
Segment profit (loss)		
Asia	<b>42,672</b>	99,211
Europe	<b>(126,527)</b>	4,861
America	<b>4,695</b>	3,926
	<hr/>	<hr/>
Unallocated other income, gains and losses	<b>(79,160)</b>	107,998
Impairment loss recognised for AFS investments	<b>(9,261)</b>	107,741
General and administrative expenses	<b>–</b>	(162,499)
Research and development expenses	<b>(134,004)</b>	(155,093)
Interest expense on bank borrowings	<b>(118,425)</b>	(72,265)
Share of profit (loss) of associates	<b>(9,422)</b>	(5,472)
Share of profit (loss) of associates	<b>1,100</b>	(2,301)
Share of loss of joint ventures	<b>(73)</b>	(640)
	<hr/>	<hr/>
Loss before tax	<b>(349,245)</b>	(182,531)

Majority of the Group's sales to Asian and European customers are attributed to the People's Republic of China (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 2018

### 4. INCOME TAX (CREDIT) EXPENSE

The charge comprises:

	<b>Six months ended</b>	
	<b>30.6.2018</b>	30.6.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Current tax:		
– Hong Kong	–	–
– Other jurisdictions	<b>14,137</b>	29,318
	<b>14,137</b>	29,318
Under(over)provision in prior periods:		
– Hong Kong	–	–
– Other jurisdictions	<b>83</b>	(6,110)
	<b>83</b>	(6,110)
Deferred tax (note 9)		
Current period	<b>(15,299)</b>	(6,663)
Change in tax rate	<b>401</b>	–
	<b>(14,898)</b>	(6,663)
	<b>(678)</b>	16,545

On 21 March 2018, the Hong Kong Legislative Council passed The Inland Revenue (Amendment) (No. 7) Bill 2017 (the “Bill”) which introduces the two-tiered profits tax rates regime. The Bill was signed into law on 28 March 2018 and was gazetted on the following day.

Under the two-tiered profits tax rates regime, the first HK\$2 million of profits of qualifying corporation will be taxed at 8.25%, and profits above HK\$2 million will be taxed at 16.5%. For the period ended 30 June 2018, Hong Kong Profits Tax of the qualified entity is calculated in accordance with the two-tiered profits tax rates regime. The profits of other group entities in Hong Kong not qualifying for the two-tiered profits tax rates regime will continue to be taxed at the flat rate of 16.5%.

For the period ended 30 June 2017, Hong Kong Profits Tax was calculated at a flat rate of 16.5% of the estimated assessable profits.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

### **4. INCOME TAX (CREDIT) EXPENSE** *(Continued)*

No provision for Hong Kong Profits Tax has been made as the Group does not have assessable profit 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% (2017: 25%). Three 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% (2017: 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 2018

### 5. LOSS FOR THE PERIOD

	<b>Six months ended</b>	
	<b>30.6.2018</b>	30.6.2017
	<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	<b>4,750</b>	3,904
Amortisation of prepaid lease payments (included in general and administrative expenses)	<b>665</b>	493
Depreciation of property, plant and equipment	<b>84,505</b>	77,755
Depreciation of investment properties	<b>561</b>	305
	<hr/>	<hr/>
Total depreciation and amortisation	<b>90,481</b>	82,457
Less: Depreciation and amortisation capitalised in inventories	<b>(70,406)</b>	(54,055)
Less: Depreciation and amortisation included in research and development expenses	<b>(2,534)</b>	(2,166)
	<hr/>	<hr/>
	<b>17,541</b>	26,236
	<hr/>	<hr/>
Cost of inventories recognised as expense	<b>6,453,844</b>	4,188,270
Gain from changes in fair value of financial assets designated as at FVTPL	-	(9,996)
(Gain) loss on disposal of and write-off of property, plant and equipment	<b>(544)</b>	22,425
Provision for warranty	<b>48,644</b>	13,916
Write down of inventories to net realisable value	<b>95,714</b>	58,390
Impairment loss recognised (reversed) in respect of trade receivables	<b>57</b>	(6)
Net gain arising on short-term investments at FVTPL	<b>(9,299)</b>	-
Net loss arising on equity instruments at FVTPL	<b>25,591</b>	-
Interest income from bank deposits	<b>(16,421)</b>	(18,822)
	<hr/>	<hr/>

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 6. DIVIDENDS

<b>Six months ended</b>	
<b>30.6.2018</b>	30.6.2017
<b>US\$'000</b>	US\$'000
<b>(unaudited)</b>	(unaudited)

Dividends recognised as distribution during the period

2016 final — US\$0.00526 per share	–	42,000
Special — US\$0.01252 per share	–	100,000
	–	142,000

The directors did not recommend the payment of an interim dividend for the six months ended 30 June 2018 and 30 June 2017.

## 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>30.6.2018</b>	30.6.2017
<b>US\$'000</b>	US\$'000
<b>(unaudited)</b>	(unaudited)

### Loss attributable to the owners of the Company

Loss for the purposes of basic loss per share	<b>(348,061)</b>	(196,556)
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<b>Six months ended</b>	
<b>30.6.2018</b>	30.6.2017

### Number of shares

Weighted average number of ordinary shares for the purpose of basic loss per share

<b>8,093,480,291</b>	7,924,810,443
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The computation of diluted loss per share for the period ended 30 June 2017 did not assume the exercise of the Company's share awards as the assumed exercise of the outstanding share awards would result in a decrease in the loss per share. As at 30 June 2018, there was no outstanding share awards.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

### 8. MOVEMENTS IN PROPERTY, PLANT AND EQUIPMENT

During the current period, the Group acquired property, plant and equipment of approximately US\$125,830,000 (for the six months ended 30 June 2017: US\$75,538,000).

In addition, the Group disposed of and wrote off certain property, plant and equipment with an aggregate carrying amount of US\$5,418,000 (for the six months ended 30 June 2017: US\$28,347,000) for proceeds of US\$5,962,000 (for the six months ended 30 June 2017: US\$5,922,000), resulting in a gain on disposal and write-off of US\$544,000 (for the six months ended 30 June 2017: loss of US\$22,425,000 which mainly represented one-off write-off of idle computer equipment).

### 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 US\$'000	Warranty provision US\$'000	Accelerated tax depreciation US\$'000	Tax losses US\$'000	Deferred income US\$'000	Others US\$'000 (Note)	Total US\$'000
At 1 January 2017 (audited)	(7,131)	(4,202)	7,100	(1,037)	(5,004)	(18,362)	(28,636)
(Credit) charge to profit or loss for the period	(4,480)	767	3,593	(2,776)	181	(3,948)	(6,663)
Exchange adjustments	(275)	(100)	567	(313)	(116)	(1,418)	(1,655)
At 30 June 2017 (unaudited)	(11,886)	(3,535)	11,260	(4,126)	(4,939)	(23,728)	(36,954)
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)

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 2018

## 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>30.6.2018</b>	31.12.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
Deferred tax assets	<b>(58,460)</b>	(43,932)
Deferred tax liabilities	<b>6,180</b>	5,362
	<b>(52,280)</b>	(38,570)

At 30 June 2018, 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\$125,975,000 (31.12.2017: US\$71,855,000) as it is not probable that taxable profit will be available against which the deductible temporary difference can be utilised.

At 30 June 2018, the Group has unused tax losses of approximately US\$1,398,032,000 (31.12.2017: US\$1,215,147,000) available for offset against future profits. A deferred tax asset had been recognised in respect of approximately US\$8,968,000 (31.12.2017: US\$8,379,000) of such losses. No deferred tax asset has been recognised in respect of the remaining tax losses of approximately US\$1,389,064,000 (31.12.2017: US\$1,206,768,000) 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 before 2022.

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\$1,274,429,000 (31.12.2017: US\$1,318,638,000) 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 2018

### **10. CONVERTIBLE NOTES**

During the year ended 31 December 2016, the Group invested in an unlisted convertible notes with principal amount of US\$60,000,000, non-interest bearing with a maturity date of 14 April 2018, issued by Mango International Group Limited ("Mango International") (the "Original CN"). In exchange for the Original CN, the Group shall deliver inventories with an aggregate value of US\$60,000,000 to Mango International upon request by Mango International.

On 1 March 2018, an addendum (the "Addendum") was signed by the Group and Mango International to extend the maturity date of the Original CN to 1 March 2019 (the "Maturity Date") and to revise certain terms of the Original CN. Pursuant to the Addendum, the principal amount of the Original CN changed to be lesser of (i) US\$60,000,000 and (ii) the aggregate value of the inventories that the Group has delivered plus any additional inventories to Mango International (the "CN"). As a result, contract liabilities of US\$17,802,000, which was included in "trade and other payables", and the Original CN were derecognised and the CN with principal amount of US\$42,198,000 was recognised as at 1 March 2018. Subsequent to 1 March 2018, inventories with an aggregate value of US\$2,011,000 were delivered to Mango International, and thus the principal amount of CN has further increased to US\$44,209,000 as at 30 June 2018.

The Group and Mango International are entitled at any time after the date of issue up to the Maturity Date to request to convert in whole or in part the outstanding principal amount of the Original CN into ordinary shares of Mango International, provided that such conversion(s) shall not be effected unless Mango International or the Group gives prior written consent. However, pursuant to the Addendum, to the extent there is any principal amount of the CN remains outstanding at the Maturity Date, all of outstanding principal amount of the CN would no longer be automatically converted into ordinary shares of Mango International unless mutually agreed in writing by the Group and Mango International. Instead, upon the Maturity Date, the Group shall have the right to elect (i) to require Mango International to repay the outstanding principal amount and redeem the CN in its entirety; or (ii) to convert into ordinary shares. However, prior to the conversion, Mango International shall have the overwriting right to elect (i) to still repay the outstanding principal amount and redeem the CN in its entirety together with a premium accrued on the portion of the outstanding principal amount being repaid at a simple interest of 7% per annum calculated from the date of issuance of the CN to the repayment date (the "Premium"); or (ii) to effect the conversion of all or a portion of the outstanding principal amount into ordinary shares of Mango International and repay the remaining outstanding principal amount (if any) that Mango International elects not be converted together with the Premium.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 11. TRADE AND OTHER RECEIVABLES

	<b>30.6.2018</b>	31.12.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
Trade receivables	<b>2,621,490</b>	3,462,072
Less: Allowance for doubtful debts	<b>(890)</b>	(903)
	<b>2,620,600</b>	3,461,169
Other taxes recoverables	<b>383,794</b>	169,564
Other receivables, deposits and prepayments	<b>142,903</b>	145,870
Total trade and other receivables	<b>3,147,297</b>	3,776,603

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 doubtful debts as presented based on the invoice dates at the end of the reporting period, which approximated the respective revenue recognition dates:

	<b>30.6.2018</b>	31.12.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
0–90 days	<b>2,594,716</b>	3,404,202
91–180 days	<b>13,662</b>	41,405
181–360 days	<b>9,341</b>	9,776
Over 360 days	<b>2,881</b>	5,786
	<b>2,620,600</b>	3,461,169

During the current interim period, the Group provided impairment allowance of 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 2018

### 11. TRADE AND OTHER RECEIVABLES (Continued)

#### Allowance for impairment

The movement in the allowance for impairment in respect of trade receivables during the current interim period was as follows.

	<i>US\$'000</i>
Balance at 1 January 2018*	903
Exchange adjustments	(9)
Amounts written off	(61)
Net remeasurement of loss allowance	57
	<hr/>
Balance at 30 June 2018	890
	<hr/>

\* The Group has initially applied IFRS 9 at 1 January 2018. Under the transition method chosen, comparative information is not restated.

### 12. TRADE AND OTHER PAYABLES

	<b>30.6.2018</b>	31.12.2017
	<b><i>US\$'000</i></b>	<i>US\$'000</i>
	<b>(unaudited)</b>	(audited)
Trade payables	<b>3,288,344</b>	3,693,693
Accruals and other payables	<b>838,974</b>	931,650
Deferred consideration ( <i>note</i> )	-	19,120
	<hr/>	<hr/>
	<b>4,127,318</b>	4,644,463
	<hr/>	<hr/>

*Note:* The amount represented the aggregate value of the inventories to be delivered by the Group to Mango International in the consideration for Original CN, details of which are set out in note 10.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

### 12. TRADE AND OTHER PAYABLES (Continued)

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

	<b>30.6.2018</b>	31.12.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
0–90 days	<b>3,067,626</b>	3,616,960
91–180 days	<b>149,989</b>	47,979
181–360 days	<b>46,438</b>	19,900
Over 360 days	<b>24,291</b>	8,854
	<b>3,288,344</b>	3,693,693

### 13. BANK BORROWINGS

	<b>30.6.2018</b>	31.12.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
Bank loans	<b>1,244,170</b>	712,600
Analysis of bank borrowings by currency:		
US\$	<b>1,244,170</b>	712,600

The bank borrowings as at the end of the reporting period are unsecured, with original maturity of one to three months (31.12.2017: one to six months), repayable within one year and carry interest at fixed interest rates ranging from 2.43% to 2.79% (31.12.2017: 1.72% to 2.40%) per annum.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

### 14. PROVISION

	<b>Warranty provision</b>
	<i>US\$'000</i>
At 1 January 2017	21,172
Exchange adjustments	1,022
Provision for the year	87,680
Utilisation of provision	(12,978)
	<hr/>
At 31 December 2017	96,896
Exchange adjustments	(248)
Provision for the period	48,644
Utilisation of provision	(25,867)
	<hr/>
At 30 June 2018	<hr/> <b>119,425</b>

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.

### 15. SHARE CAPITAL

	<b>Number of shares</b>	<b>Amount</b>
		<i>US\$'000</i>
Ordinary shares of US\$0.04 each, authorised:		
Balance at 1 January 2017, 31 December 2017 and 30 June 2018	20,000,000,000	800,000
	<hr/>	<hr/>
Ordinary shares of US\$0.04 each, issued and fully paid:		
Balance at 1 January 2017	7,985,254,691	319,410
Issue pursuant to the share scheme (note 18(b))	108,225,600	4,329
	<hr/>	<hr/>
Balance at 31 December 2017 and 30 June 2018	<hr/> <b>8,093,480,291</b>	<hr/> <b>323,739</b>

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 16. DEFERRED INCOME

	<b>30.6.2018</b>	31.12.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
Government subsidies	<b>22,465</b>	23,607

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

## 17. CAPITAL COMMITMENTS

	<b>30.6.2018</b>	31.12.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(audited)
Commitments for the acquisition of property, plant and equipment contracted but not provided for	<b>9,729</b>	4,335

## 18. 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 2018 and 31 December 2017.

No expense in relation to the share options granted by the Company was recognised by the Group for the six months ended 30 June 2018 and 30 June 2017.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

### **18. SHARE-BASED PAYMENT TRANSACTIONS** *(Continued)*

#### **(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 new 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 Company's officers/delegates (as duly authorised by the board of directors of the Company) on 22 November 2017, the Company offered 118,595,820 ordinary shares to certain beneficiaries pursuant to the Share Scheme, of which 114,343,918 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. 106,053,805 ordinary shares were issued on 22 November 2017 and 12,542,015 ordinary shares were purchased by the trustee of the Share Scheme from the stock market in November 2017.

Pursuant to the approval of the Company's officers/delegates (as duly authorised by the board of directors of the Company) on 28 November 2017, the Company offered 2,171,795 ordinary shares to certain beneficiaries pursuant to the Share Scheme without lock-up periods. No consideration was payable on the grant of the shares. 2,171,795 ordinary shares were issued on 28 November 2017.

No expense in relation to the shares granted under the Share Scheme was recognised by the Group for the six months ended 30 June 2018 (for the six months ended 30 June 2017: US\$16,125,000).



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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 19. 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**

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 those derived from 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 2018

## 19. 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/ financial liabilities	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
	30.6.2018 US\$'000	31.12.2017 US\$'000				
Equity instruments at FVTPL	<b>Listed equity instruments – 81,670 (Assets)</b>	N/A	Level 1	Quoted bid prices in an active market	N/A	N/A
CN (defined in note 10) classified (31.12.2017: designated) as financial assets at FVTPL	<b>44,209 (Assets)</b>	60,000 (Assets)	Level 2	Fair value derived from market value of the shares of Mango International in recent investment transactions	N/A	N/A
Equity instruments at FVTOCI	<b>Listed equity investments – 6,803 (Assets)</b>	N/A	Level 1	Quoted bid prices in an active market	N/A	N/A
Equity instruments at FVTOCI	<b>Unlisted equity instruments – 113,898 (Assets)</b>	N/A	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 – 31,105 (Assets)</b>	N/A	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 4.28% to 21.18% and 20% to 23% respectively	The lower the WACC or discount for lack of control, the higher the fair value, and vice versa
Listed equity instruments classified as AFS investments	<b>N/A</b>	Listed equity instruments – 116,853 (Assets)	Level 1	Quoted bid prices in an active market	N/A	N/A

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 19. 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/ financial liabilities	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
	30.6.2018 US\$'000	31.12.2017 US\$'000				
Investment in interest bearing instruments classified as short-term investments classified (31.12.2017: designated) as financial assets at FVTPL	400,421 (Assets)	426,554 (Assets)	Level 3	Income approach – discounted cash flow method was used to capture the present value of the expected return, assumed to approximate the minimum 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 ranged from 3.90% to 4.70% (31.12.2017: 3.60% to 4.70%) per annum	The higher the expected guaranteed interest rate, the higher the fair value, and vice versa
Forward foreign exchange contracts classified as other receivables	Nil	1,902 (Assets)	Level 2	Fair value derived from observable forward exchange rates at the end of the reporting period	N/A	N/A

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

### 19. FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS (Continued) Reconciliation of Level 3 fair value measurements of financial assets

	Unlisted equity instruments <i>US\$'000</i>	Short-term investments <i>US\$'000</i>
At 1 January 2017 (audited)	N/A	929,627
Net fair value gain recognised in profit or loss	N/A	9,996
Purchases	N/A	1,860,589
Settlements	N/A	(2,237,175)
Exchange adjustments	N/A	<u>17,138</u>
At 30 June 2017 (unaudited)	N/A	<u>580,175</u>
At 1 January 2018 (unaudited)	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	<u>(99)</u>	<u>(4,538)</u>
At 30 June 2018 (unaudited)	<u>31,105</u>	<u>400,421</u>

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.

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

**19. 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 2018		
		Gross amounts of recognised financial (liabilities) assets set off in the condensed consolidated statement of financial position	Net amounts of financial assets (liabilities) presented in the condensed consolidated statement of financial position
	Gross amount of recognised financial assets (liabilities) US\$'000	US\$'000	US\$'000
Bank balances	1,041,707	(1,041,707)	-
Bank borrowings	(1,041,707)	1,041,707	-
Interest receivables	9,384	(7,828)	1,556
Interest payables	(7,828)	7,828	-

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

### 19. FAIR VALUE MEASUREMENTS OF FINANCIAL INSTRUMENTS (Continued) Financial assets and financial liabilities subject to offsetting (Continued)

	As at 31 December 2017		
	Gross amounts of recognised financial assets (liabilities) US\$'000	Gross amounts of recognised financial liabilities 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	755,327	(755,327)	-
Bank borrowings	(755,327)	755,327	-
Interest receivables	8,372	(7,060)	1,312
Interest payables	(7,060)	7,060	-

During the period, net interest income of US\$1,430,000 (for the six months ended 30 June 2017: US\$1,860,000) was included in interest income under the above arrangement.

# NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE SIX MONTHS ENDED 30 JUNE 2018

## 20. 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:

	<b>Six months ended</b>	
	<b>30.6.2018</b>	30.6.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Hon Hai:		
Sales of goods	<b>3,663</b>	–
Purchase of goods	<b>1,885</b>	33,736
Purchase of property, plant and equipment	–	5,400
Sales of property, plant and equipment	–	5
Lease expense — real properties	<b>345</b>	349
Sub-contracting income	<b>1,223</b>	16,551
Consolidated services and sub-contracting expense	<b>1,558</b>	446
General services income	–	402
General services expense	<b>18</b>	12
<hr/>		
Subsidiaries of Hon Hai:		
Sales of goods	<b>69,559</b>	206,654
Purchase of goods	<b>189,077</b>	266,857
Purchase of property, plant and equipment	<b>19,998</b>	29,849
Sales of property, plant and equipment	<b>1,415</b>	3,682
Lease income — real properties	<b>1,896</b>	1,774
Lease income — non-real properties	<b>174</b>	353
Lease expense — real properties	<b>2,190</b>	1,174
Lease expense — non-real properties	<b>3,772</b>	2,298
Sub-contracting income	<b>6,760</b>	9,778
Consolidated services and sub-contracting expense	<b>115,825</b>	88,915
General services income	<b>136</b>	539
General services expense	<b>11,493</b>	15,627
<hr/>		
Associates of Hon Hai:		
Sales of goods	<b>598,589</b>	437,832
Purchase of goods	<b>317,432</b>	253,802
Purchase of property, plant and equipment	<b>250</b>	1,074
Sales of property, plant and equipment	–	609
Lease income — real properties	<b>71</b>	131
Lease income — non-real properties	–	13
Lease expense — real properties	<b>6</b>	6
Sub-contracting income	<b>3,780</b>	4,786
Consolidated services and sub-contracting expense	<b>2,409</b>	7,710
General services income	<b>60</b>	756
General services expense	<b>229</b>	8
<hr/>		

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

FOR THE SIX MONTHS ENDED 30 JUNE 2018

### 20. 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>30.6.2018</b> <b>US\$'000</b> <b>(unaudited)</b>	31.12.2017 <i>US\$'000</i> (audited)
Trade receivables:		
Hon Hai	<b>4,815</b>	46,222
Subsidiaries of Hon Hai	<b>79,303</b>	194,215
Associates of Hon Hai	<b>118,384</b>	286,934
	<b>202,502</b>	527,371
Other receivables:		
Subsidiaries of Hon Hai	<b>395</b>	258
Associates of Hon Hai	<b>158</b>	691
	<b>553</b>	949
	<b>203,055</b>	528,320
Trade payables:		
Hon Hai	<b>1,634</b>	2,960
Subsidiaries of Hon Hai	<b>334,406</b>	372,786
Associates of Hon Hai	<b>148,190</b>	274,454
	<b>484,230</b>	650,200
Other payables:		
Hon Hai	<b>138</b>	144
Subsidiaries of Hon Hai	<b>19,655</b>	38,496
Associates of Hon Hai	<b>43</b>	1,355
	<b>19,836</b>	39,995
	<b>504,066</b>	690,195

Balances due from/to related parties 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 2018

## 20. 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>30.6.2018</b>	30.6.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Short-term benefits	<b>2,483</b>	2,212
Share-based payments	<b>7,902</b>	748
	<b>10,385</b>	2,960

(d) During the period, the Group entered into the following transactions with associates (2017: associates and a joint venture):

	<b>Six months ended</b>	
	<b>30.6.2018</b>	30.6.2017
	<b>US\$'000</b>	US\$'000
	<b>(unaudited)</b>	(unaudited)
Sales of goods	<b>17,525</b>	2,764
Purchase of goods	<b>126,083</b>	98,563
Other income	<b>18,947</b>	7,741
Other expense	<b>2,780</b>	-

The amounts due to associates were US\$3,823,000 (31.12.2017: The amounts due to associates and a joint venture were US\$83,967,000), which were included in other payables, as at 30 June 2018.

## 21. APPROVAL

The condensed consolidated financial statements on pages 4 to 48 were approved and authorised for issue by the board of directors of the Company on 10 August 2018.

## **BUSINESS REVIEW**

### **IMPORTANT**

The Group's consolidated interim results for the six-month period ended 30 June 2018 (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.

In the profit warning published on 4 May 2018 and the subsequent additional inside information relating to last profit warning published on 29 June 2018, it was mentioned that those unfavourable factors including those challenging conditions that the Group had faced in the second half of 2017 would continue in the remainder of 2018. In the "Outlook" section below, it is also mentioned that on the basis of a preliminary review of the Group's latest unaudited management accounts and other information currently available, the Company understands that the Group is likely to record a consolidated net loss for the second half of 2018 and accordingly throughout 2018. The Group had recorded a consolidated net loss of US\$525,394,000 for 2017.

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 conditions (such as intensifying trade wars and political conditions), changes in monetary market (such as interest rate hikes and volatility in foreign exchange rates), changes in capital market, competition, shifts in customer demands and preferences, seasonal demands, changes in sales and product mix, changes in commodity price, shortage of components, technology advancement, and changes in market/legal/regulatory/government/tax policy. In addition, new risks emerge from time to time and it is not possible for management to predict all such risk factors or to assess the impact of such risk factors on our 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 Rules (the "Listing Rules") Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") and the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) (the "SFO").

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

### **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 purposes 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., logistics and distribution 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 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, logistics and distribution services 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.

Our 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 a range of consumers and price points, and sales to HMD are grouped under Europe segment. 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 brand and intellectual property (IP) right management, product development, and marketing strategy for the phones. For details, please see “Investments” section below.

### **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 operations, Research and Development (“R&D”) centres and manufacturing 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, on 18 May 2016, the Group entered into collaboration with Nokia Technologies Ltd. (“Nokia”) and HMD with a view to building a globally successful business in the field of Nokia-branded mobile phones and tablets. Since 2017, the Group has been manufacturing and distributing Nokia-branded feature phones and smart phones to customers and consumers worldwide with the roll-out of logistics and distribution business (via “TNS” named entities and related entities altogether belonging to the Group (collectively, “TNS”), which is a distributor of HMD and manages retail relations of the supply chain and executes regional marketing campaigns developed by HMD) ancillary to such devices, particularly through its operations in China, Vietnam, India, Taiwan and Finland, and HMD now becomes one of the Group’s top five customers. 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.

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

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

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

Amongst the Group's five largest customers (including HMD) during the current period which accounted for approximately 90.2% 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 2017 but there has been a change in the ranking as HMD's sales grew in the second half of 2017. 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. Further, it takes time for us to gear up our production facilities to produce products and provide services that are customised for new customers. It typically takes us approximately 2 months to customise our production facilities 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, 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. 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. The Group believes that the efforts and results in the previous years on customer diversification are testimony of its ability to achieve this balance in the rapidly changing industry landscape to date. Year-on-year change in sales is one of the financial key performance indicators (KPIs) as this will reflect the effectiveness of the efforts invested by the Group on the above and achieve economies of scale and scalability in the competitive handset market and increase the bargaining power of component and material sourcing and procurement for ODM and IDM and IIDM (Integration, Innovation, Design, Manufacture) businesses.

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 a close 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 7.7% of the Group's total revenue from the sales of goods and rendering of services for the current period.

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

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

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

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 doubtful debt made for the current period was US\$0.057 million (when compared to the reversal of allowance for doubtful debt of US\$0.006 million for the same period in 2017), 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 additional provision for the current period.

The Group's procurement team deals with over 3,000 suppliers whom 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 in 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 for raw materials, electronic components and parts, display module, camera module, battery, enclosure and packaging materials, which are generally selected by the Group 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 63.1% 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 over three years. 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 seemingly concentration of procurements from these major suppliers, we do not expose to 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 Hon Hai, the ultimate controlling shareholder of the Company and hence a connected person of the Company pursuant to the Listing Rules. The purchases attributable to Hon Hai accounted for approximately 9.2% 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 2017 environmental, social and governance report.

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

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

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

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 2017 corporate governance report, which forms part of the 2017 annual report.

Employees are valuable assets to the Group. Therefore, the Group has been working diligently 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, coupled with better career prospect across various products and business lines. The Group places great emphasis on career planning and talent development for employees by encouraging employees to attend internal and external training programs. Internal training programs include courses for core competency and professional competency 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. The Group has built up and will continue to expand a large and 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. 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, logistics and distribution competence. As at 30 June 2018, the Group had a total of 93,408 (31 December 2017: 92,779) employees. Total staff costs incurred during the current period amounted to US\$270 million (US\$213 million for the first half of 2017 and US\$357 million for the second half of 2017), and the year-on-year increase was mainly due to the recruitment, development, rewards and retention of talents for the business relating to the Nokia-branded products. Please refer to the "Investments" and "Outlook" sections below for details. 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 ("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 2017 environmental, social and governance report.

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

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

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

##### **Financial Performance**

The financial KPIs 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 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 casing and system assembly business.

For the six-month period ended 30 June 2018, the Group recognised a consolidated revenue of US\$6,563 million, representing an increase of US\$2,189 million or 50% when compared to US\$4,374 million for the same period last year. Net loss for the current period was US\$349 million, when compared to a net loss of US\$199 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 faced by the Group in the second half of 2017 (when the Group recorded a gross profit of US\$16.8 million and gross margins of 0.22% and consolidated net loss of US\$326.3 million including an impairment loss provision of US\$40 million for one of the Group's investments in India) persisted in 2018; (2) pressure on the Group's gross margins continued; (3) increase in the expenses relating to the continuous growth of the Group's IIDM business (including ancillary logistics and distribution services) as more particularly described in the "Discussion and Analysis" section of the 2017 annual report; (4) increase in the Group's foreign exchange loss (the Group's foreign exchange loss was US\$88.2 million for the first half of 2018, when compared with the Group's foreign exchange gain of US\$11.5 million for the first half of 2017); and (5) the Group's investment portfolio includes investments in certain listed companies which are classified as equity instruments at fair value through profit or loss under IFRS 9, where the fair value of certain investments is measured through the prevailing quoted share prices of the relevant shares, and the fair value gains or losses are booked to the Group's statement of profit or loss in accordance with IFRS 9. The Group recorded a fair value loss of US\$25.6 million for those investments for the first six months of 2018. Factors (1), (2) and (3) above may continue into the remainder of 2018.

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 details 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 loss for the current period was US\$34.9 million, represented an increase of US\$148.4 million loss from that for the same

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

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

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

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

period last year, mainly as a result of the decrease in gross margins. Gross margins for the current period was a loss of 0.53% and was less than the gain of 2.6% for the same period last year. Gross margins of Nokia-branded phone manufacturing business in 2017 was subject to extremely huge pressure since the start of mass production of Nokia-branded smart phone (in June 2017) and decreased as HMD was in the early stage of Nokia-branded phones re-entering into the market (especially the smart phone market) with the first generation/wave products. HMD, the Group's strategic partner may need to promote, develop and prove itself in the competitive handset market (especially for smart phones) and to build up the product line and it is a process where it needs time to accumulate demand with marketing and public relations positioning against competition. HMD is targeting a range of consumers with phones of different price points and is highly committed to innovation and quality and offer unique values to consumers therefore brand value can be increased and help sustain customer stickiness. It has to achieve product quality, differentiated and diversified products portfolio, effective marketing initiatives and increasing brand awareness among mass-market consumers, all of which will increase costs of HMD running the Nokia-branded phone business in order to remain competitive in the market. In order to penetrate the market and capture market share in the beginning years (namely in 2017 and 2018), the pricing of the early generations/waves of smart phones has to be competitive, aggressive, and close to those adopted by its competitors (who already have strong foothold and well-established customer brand loyalty in the competitive handset market) in respect of similar products and correspondingly, the Group has to sell the products at aggressive and competitive prices to HMD to maintain the long-term sustainability of the collaboration with HMD which the Group has started to invest in December 2016 and secure the long-term success of the IIDM business. Penetration pricing is a pricing strategy where the price of a product is initially set low to rapidly reach a wide fraction of the market of early adopters segment and initiate word of mouth. The strategy works on the expectation that customers will switch to a new brand due to the lower price. Penetration pricing is most commonly associated with marketing objectives of enlarging market share and exploiting economies of scale or experience. Nokia-branded phones are also required to have better hardware and specifications than competitors' products of similar selling prices so as to induce consumers to switch to the Nokia-branded phones and this will inevitably increase the material costs of phones which resulted in Cost of Goods Sold of smart phones being above selling prices as there was no scalability yet and the Group was in a weak bargaining position of component and material sourcing in the first year of operation of this part of new IIDM business and it takes time for the Group to develop and manufacture phones and run the new business under the IIDM business model and the majority of the poor performance of this part of business was reflected in the loss-making Europe segment (as disclosed in note 5 of 2017 annual report on page 96) as HMD is a European company.



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

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

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

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

In the first half of 2018, after operating for one and a half year (since the acquisition of assets from Microsoft Mobile Oy (“Microsoft”) in December 2016), the challenging conditions faced by the Group in the second half of 2017 continued into 2018 and BOM costs of smart phones remained higher than selling prices. The volume of manufacturing of Nokia-branded smart phone business will hinge on the success of HMD. However, the volume is still not large enough to drive economies of scale so that the Group’s sourcing can carry out supplier consolidation and allocate procurements to only limited number of qualified suppliers to enable the Group to have stronger bargaining power to buy at bulk and at more competitive prices and drive BOM costs down step by step. It is anticipated that it may take time to reach scalability for future generations of products as HMD is now operating in a handset market which is close to saturation. Once our annual smart phone shipment volume crosses over a certain huge enough threshold level, there will be no gap between BOM cost of market leaders and ours. For the Nokia-branded phone business, the Group now has to do the commodity and program sourcing work itself. To relieve its pricing and gross margins erosion pressure in the stiff competitive handset market, BOM control is of critical importance. Key drivers in handset BOM cost include platform chipset, memory, display, camera module, enclosure/housing and battery which are the top 6 in dollar value. The rising price of memory started from the fourth quarter in 2016 and continued in 2017 till now, yet, increase percentage has tapered off in 2018 while the rising price of battery started from the beginning of 2017. The increase in key components costs has affected profit margins as the rise in BOM cost cannot be readily transferred to customer as demand of phones is price-sensitive and retail selling prices of phones sold by TNS are required to be competitive in order to penetrate the market and continue to gain more market share and increase the phone shipment volume and achieve better bargaining power for the sourcing function of the Group. Unfavourable factors including 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 is extremely high in order to foster the strategic collaboration. Internally, the Group will continue to devote adequate resources to program sourcing and commodity sourcing and find more new competent suppliers and maintain executive level vendor relationship to obtain best technology, supply and price support and gradually obtain improved position with suppliers. Other initiatives on BOM cost reduction include the design of key parts based on best cost performance, collaborating together with vendors and achieve narrow gap (2–3%) with industry cost leader continuously. The engineering team is putting effort to optimise product design (including BOM design) and address BOM cost competitiveness by leveraging off 2017 experience and drive product innovations. Of course, there is also need to drive for better internal operational efficiency of assembly, testing processes, inventory and supply chain management and quality management and to improve yields to lower manufacturing costs and conduct the benchmarking of cost leaders’ processes and costs of external EMS (electronic manufacturing services) so as to measure the competitiveness of the Group’s manufacturing costs and yield and efficiency. On the other hand, as phones are distributed worldwide, there is need of handling order fulfilment of many different countries and this will

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

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

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

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

inevitably have high impact on our conventional flow line manufacturing process and results in higher operational cost. As a whole, good vendor management, supply chain management, manufacturing management, quality management, order fulfilment and inventory management are critical to efficiency enhancement and cost control. All challenges above and factors 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").

For TNS, in the second operation year, it continued to expand portfolio and strengthen channel partnerships and increased investments into channel for driving transition from previous generation models into new generation and reducing channel inventory levels and driving smart phone volume. As part of the measures taken for improving operational efficiency, operating expense of TNS has declined and the streamlined operational structure made TNS more competitive and allowed more resources to be devoted to the channel while marketing expense increased.

Apart from the IIDM business, the Group's casing and system assembly business also faced a lot of challenges in 2018. There was surplus capacity for 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 price and margin erosion pressure for both casing (and mechanical) and system assembly businesses was 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 the large year-on-year increase in the sales in the first half of 2018 was attributable to the increase in system assembly business (on top of Nokia-branded phone business) of comparatively low gross margins. For our peers of casing business, they are Mainland listed or Hong Kong or Taiwan listed companies and they have been vendors of our customers for a long time with well-established business relationships with our customers and they also have customers which are not customers of the Group. They have strong cost-competitiveness and they are innovative (like having glass casing capabilities) and become growingly strong and competitive in all areas in a fast pace and their margins are in general better than the Group. A research in analyst reports and quarterly reports (in 2018 first quarterly results) and annual reports of 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 half of 2018. These peers' core businesses are diversified and apart from mechanical business, they also engage in other businesses. For the 5 peers, their core and other businesses and 2018 first quarterly performance are listed as follow: (i) Peer 1 is a Hong Kong-listed company whose core businesses are acoustics, haptics optical applications. Its mechanical business is comparatively small and thus in its 2018 first quarterly report there is no separate disclosure of its mechanical business but it stated that it will continue to provide metallic casing for more high-end and mid-range

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

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

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

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

Android models; (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 EMS/ODM service provider for handset OEMs and also provider for a wide range of metal, glass, and ceramic designs. Its 2018 first quarterly gross margins declined a bit year-on-year, which is in line with the concerns on the intensifying competition in the metal casing industry and margin pressure from the metal casings business and new business still in the infant stage with potential diluted margins; (iii) Peer 3 is a Shenzhen-listed company whose core business also includes IMT (In-Mould Transfer) casings and glass casings and water-proof components. In 2018 first quarterly report, it announced there was a year-on-year decline of 63% in revenue in the first quarter and 33% quarter-on-quarter in 2018. 2018 first quarterly gross margins was slightly higher than gross margins in the second half of 2017 with net profit downed 86% year-on-year and the gloomy 2018 first quarterly result was attributable to sluggish demand for smart phones during the quarter and the expected recognition of related costs and expenses from investing in new products and clients in the second half of 2018; (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. It issued a profit alert in June 2018 anticipating net profit growth in the first half of 2018 in the 40% to 50% year-on-year range on the back of higher sales and it indicated that the gross margins for metal/IMT casing/metal frame is 25%/25–30%/20–25% respectively. It expected the overall gross margins to increase continually, driven by improved product mix (more IMT and metal frame products); and (v) Peer 5 is a Taiwan-listed company which specialises in light metal casing industry and its products include computers, communication and other consumer electronics. Due to sluggish market, its 2018 first quarterly result was disappointing and recorded gross margins of 2% and a net loss of 8% (versus 2017 gross margins of 16% and net margin of 5%).

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. That is why the Group is now devoting itself to improving existing technologies and manufacture, as well as delivering innovation on both processes and materials and 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 optimise 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.

## **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 term of competition analysis, the Group only earns processing fee and manufacturing fee while yield, efficiency and quality differentiation are of critical importance to reduce customers' price sensitivity and develop long-term business relationship. 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 companies and US company. For a Taiwan peer who is also a direct competitor, it is a private company and there were no accessible financials for comparison. It began design manufacturing with small-scale handheld devices and step by step moved towards R&D in multimedia entertainment, broadband transmission and wireless communication to have our handheld products operate on various platforms. It also provided diversified product design service that consists of three main aspects, namely, product design service, testing & certification service and manufacturing consulting. Another peer is a Taiwan-listed company which offers a wide range of electronics products in computing, it also engages in development, design and manufacturing of peripherals and components of the above-mentioned products. Referring to its 2018 first quarterly published result, its gross margins was 3.3% and net margin was 0.7% (versus 2017 first quarter of gross margins of 5.0% and net margin of 1.6%). It mentioned in its 2017 annual report market competition and highlighted that in the process of market consolidation among computing, consumer electronics, and communication products, major assembly companies are gaining more market share from the smaller ones. Furthermore, Chinese vendors have also challenged the assembly industry, which was traditionally dominated by Taiwanese vendors, by penetrating downstream assembly business from upstream component business. It also mentioned the problem of declined gross margins due to severe pricing competition as the competition in the system assembly industry is intense due to the low entry barrier that attracted a large number of competitors. Product differentiation has also gradually diminished, which may also lead to a decline of gross margins. Another peer is a reputable US-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 tech and mobile OEMs. US GAAP ("US Generally Accepted Accounting Principles") net loss was US\$20 million and adjusted net income for 2018 first quarter was US\$150 million (i.e. net margin of 2.3%). In 2017 annual report, it mentioned that the market was extremely competitive and included many companies, several of which had achieved substantial market share. It competed against numerous domestic and foreign manufacturing service providers, as well as its current and prospective customers, who evaluated its capabilities in light of their own capabilities and cost structures. It faced particular competition from Asian-based competitors, including Taiwanese original design manufacturing ("ODM") suppliers who competed in a variety of its end markets and had a substantial share of global information technology hardware production. The above comparison of 3 peers showed that the market is really competitive and operating margin of system assembly business/industry is really low and lean.

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

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

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

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

The Group had experienced a foreign exchange loss of US\$88.2 million for the current period of which the depreciation in Indian Rupee (“INR”) has the largest exchange exposure to the Group. The INR has weakened sharply against USD (U.S. dollar) and is down by over 7% so far this year which resulted in exchange loss to the Group due to the settlement of account payable denominated in USD. For the second quarter in 2018, the INR further depreciated due to the high oil price and elections in India. To carry out forward hedge of INR comes with certain costs due to interest rate differences between INR/USD. If the depreciation becomes long-term trend, then the Group may need to go back to our customers to ask for foreign exchange compensation. For 2018 second half outlook, the INR will be relatively stabilizing at 68–69 versus the record high of INR is 69. Two major reasons which caused the depreciation of INR are high oil price and uncertainty of local elections in the first half of 2018. Now Russia and Saudi Arabia or maybe OPEC members will increase their oil output which can bring down the oil price and can help to push INR to appreciate. The local election in India has finished and there was no surprise. Another positive matter is not like US-China trade war, there are no major trade deficit issues between US-India. So the foreign exchange risk exposure should be lower in the second half this year.

Regarding operating expenses, for the current period was US\$313 million, when compared with US\$245 million for the same period last year. Because of the continuing investment in the IIDM business relating to the Nokia-branded phones, there was a year-on-year increase in selling expenses and R&D expenses. For selling expenses, the increase was mainly due to the increase 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 an increase in distribution volume of Nokia-branded phones. For General and Administrative (“G&A”) expenses, they mainly include spending on professional fee (legal & accounting firms), recruitment fees, IT services and license fee of application systems, depreciation and maintenance expenses for accounting system and travelling and rental expenses and salaries. But as some of the expenses like those professional fees and recruitment fees incurred in 2017 were non-recurring ones and there is no such expense in 2018, and there was also saving in payroll costs and overheads in 2018 and this explained why there has been a year-on-year decrease in G&A expenses. For R&D expenses, there is a continuous investment in product innovation in order to remain competitive and offer unique values to customers.

## **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 losses (such as equity investments fair value change losses) 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 losses (such as equity investments fair value change losses). 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\$348 million, as compared to a net loss attributable to the owners of the Company of US\$197 million for the corresponding period last year. The net loss margin for the current period was 5.3%, as compared to the net profit margin of 4.49% for the same period last year. The net loss increased by US\$22.2 million for the first half of 2018, as compared with that US\$326.3 million for the second half of 2017.

As at 30 June 2018, 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 12.61% negative, when compared with the ROE as at 31 December 2017 of 16.56% negative. The Group strived to achieve a better ROE during the current period.

Income tax credit during the current period was US\$0.7 million, when compared to income tax expenses of US\$16.5 million for the same period last year. The increase in income tax credit was mainly due to the decrease in profits, and increase in deferred tax assets provided during the current period.

During the period ended 30 June 2018 and 2017, no impairment was recognised for property, plant and equipment.

Basic loss per share for the current period was US4.3 cents.

##### **Dividends**

On 10 August 2018, the Board resolved not to recommend the payment of an interim dividend for the six months ended 30 June 2018.

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

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

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

##### **Sales**

Thanks to the Group's continuous development and penetration of the Chinese and international brand customers and efforts to expand production capacity in India and implementation and development of the new IIDM business relating to the Nokia-branded products. Since 2017, the Group started to generate sales revenue via manufacturing and selling phones to HMD and distribution service income from such collaboration, the Group also succeeded in increasing system assembly sales of low gross margins in the current period, though there was some decline in its casing business in the current period due to product mix changes. By the way, the Group will continue to provide system assembly service of consumer electronic products such as e-Readers and tablets and voice interaction products to an international brand. This brand now offers lower price products to penetrate the market. In 2017, there was a dramatic year-on-year and half-on-half growth in sales as the IIDM business started to grow dramatically from June 2017 and for one of the major customers, there has been changed of business model from pure processing to buy-sell. For the first half of 2018, there was a good year-on-year growth in sales as the sales in the first half of 2017 were not large yet. But for the second half of 2018, as the IIDM business started to grow rapidly in June 2017 and there may have a year-on-year decline in sales (like system assembly and casing business) to some other customers in the second half of 2018, it is anticipated that the year-on-year growth in sales in the second half of 2018 will slow down and as a result, the year-on-year growth in sales for the full year of 2018 will be lower than that of 2017 which amounted to US\$5,847 million.

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 has 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. For 2017 and 2018, 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 International Data Corporation (IDC) Worldwide Quarterly Mobile Phone Tracker, published on 30 May 2018, it is predicted that after the decline of 0.3% in 2017, the worldwide smart phone market is expected to contract again in 2018 before returning to growth in 2019 and beyond. Smart phone shipments are forecasted to drop by 0.2% in 2018 to 1.462 billion units, downed from 1.465 billion units in 2017 and 1.469 billion units in 2016. Reports mentioned that the declines were mainly attributable to the lack of further innovation in the current generation of handsets, especially in developed markets where replacement cycles were lengthening with overall smart phone features and design reaching its peak. The abundance of ultra-high-end flagships with big price tags released over the past 12 to 18 months have most likely halted the upgrade cycle in the near term.

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

With diffusion of innovation and technology, 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 just like the computer industry has been. 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 2018, the year-on-year increase of sales was mainly attributable to the corresponding expansion of system assembly business of low gross margins. In particular, as mentioned in the “Financial Performance” section above and “Outlook” section below, the biggest challenge continues to be the IIDM business relating to the manufacturing of Nokia-branded products and the manufacturing and distribution of Nokia-branded phones which are still in the difficult stage of increasing volume and margin performance is bad. Prices of some key components like memory and battery have been steadily rising for over a year. At the same time, there are rising competition 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 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 2018. The revenue of Asia segment in the current period was US\$5,568 million, representing an increase of 44.6% from that for the same period last year (30 June 2017: US\$3,850 million) and the growth was mainly due to the growth of OEM system assembly business of low margin of Chinese brand customers and an international brand. There are also sales generated by the IIDM business relating to the manufacturing and assembly of Nokia-branded products by the Group’s manufacturing entities to HMD in India. In the current period, Asia segment’s recorded earnings were US\$43 million which were lower than the recorded earnings of US\$99 million for the same period last year, mainly because of the poor gross margins. 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 for coming months will increase as Asia segment sales growth is driven by system assembly business which has a lower gross margins. Due to crowded competition and excess capacity in casing industry, gross margins of casing business will continue to face pressure this year (especially in the second half of 2018). 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 after the downsizing of European sites so as to further enhance the capacity, capability, competence and presence of the Group in Asia segment (especially in India) and develop more new businesses and customers. The Group has started to be active again in India and the expansion of capacity in India keeps on going. Apart from sales of manufactured phones, there was distribution service income earned by TNS (which is a distributor of HMD) on selling and distribution of Nokia-branded phones which are manufactured by the Group in Asia (China, India and Vietnam) to Asian and African emerging markets for HMD.

The Group has continued to review its global capacities to optimise resources and capacity in emerging markets like India and Vietnam and further align its manufacturing capacities with the geographic production demands of customers. The Company believed that outside Asia/Pacific, the biggest regions for growth will be the Middle East, Africa, 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 for years and has helped certain Chinese brand customers to develop business and grasp more market shares in India and overseas markets

## **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)

- Asia segment: (Continued)

outside of China in the past couple of years. Sales of the Group’s Indian operations in the current period were about 77% more than that of the same period in 2017 due to the dramatic growth of the business of a Chinese brand customer in India and the start of manufacturing of Nokia-branded phones. 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. TNS also operates in India as it is a market with good potential for both feature phones and smart phones.

- Europe segment:

The recorded revenue of Europe segment in the current period was US\$925 million when compared with the recorded revenue of US\$471 million for the same period last year. The revenue of Europe segment increased in the current period as the Group has continued to manufacture feature phones and smart phones in Asia (China, India and Vietnam) under the IIDM business relating to the Nokia-branded phones and sell the phones to HMD which is a Finnish company. But as the IIDM business started to grow a lot in the second half of 2017, comparatively speaking, this explains why YTD June 2017 sales were comparatively smaller. The recorded loss of this segment in the current period was US\$127 million, when compared with the recorded earnings of US\$5 million for the same period last year. As explained in above “Financial Performance” and “P&L” sections, it was mentioned that the gross margins performance for the IIDM business relating to the Nokia-branded phones was particularly bad and was making loss as there was fierce price competition and the selling price of the Nokia-branded phones to the end market had to be competitive upon its re-launching to the handset market and the Group’s as a partner to HMD, the selling price and gross margins of phones manufactured by the Group was under huge pressure as there was no economy of scale yet in terms of sourcing as the business was still at the stage of building up momentum and scale rendering the Group unable to buy at competitive prices from suppliers and the BOM cost was higher than selling price. At this stage, TNS sells and distributes some of the handsets throughout the European markets for HMD and earns distribution service income. The performance of Europe segment has deteriorated dramatically which has affected the performance of the Group adversely and the Group has to monitor more closely and then assess the impact of the loss-making 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, because of the loss of market shares and change of outsourcing strategies, certain key customers of the Group which previously shipped a lot of products to America segment have reduced their orders in the Group since 2016, thus leading to further shrinkage of sales of America segment in 2017, thereby further adversely affecting performance of this segment. In 2018, the recorded revenue of America segment in the current period was US\$70 million when compared with the recorded revenue of US\$53 million for the same period last year and the year-on-year increase came from the increase of sales to a US customer. Core businesses (both now and under development) of American segment entities 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 US customers. The recorded earnings for the current period were US\$5 million when compared with the recorded earnings of US\$4 million for the same period last year. The performance of America segment did not have a significant adverse impact on the Group’s overall performance as the focus of the Group has shifted to Asia segment and IIDM business of Europe segment. The sales and earnings of America segment have dropped since 2016 and now have become insignificant to the Group’s overall sales and bottom line.

#### ***Investments***

On the basis that the value of each of the investments mentioned below as at 30 June 2018 does not exceed 5% of the Company’s total assets as at 30 June 2018, 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) activities.

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

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

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

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

###### *Investments in New 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 feature phone business operated by Microsoft, 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). Goodwill of US\$79.4 million has arisen from the above acquisition. During the six months ended 30 June 2018, management determined that there was no impairment for goodwill by reviewing and comparing the recoverable amounts of the cash generating unit (CGU) and carrying amounts of the CGU. For the new business relating to the Nokia-branded products as operated through TNS, the collaboration among Nokia, HMD and TNS has provided for a framework among the parties with a view to building a globally successful business in the field of Nokia-branded mobile phones and tablets. Pursuant to such collaboration, while HMD has been engaging exclusively in the Nokia-branded products business, the Group has continued to develop business with HMD covering primarily the manufacture of feature phones and smart phones together with accessories in Asia (China, India and Vietnam) under the manufacturing agreement between HMD and the Group and the distribution arrangements between HMD and TNS, so that phones bought by HMD will be distributed by TNS and the Group could generate more revenue and distribution service income via TNS as well as enhance utilisation of its assets, capacities and capabilities in its handset manufacturing business and fulfilment services. The Company noted HMD's ambitious plans to become a globally recognised player in the handset and tablet markets. In the current period, the Group's strategic partnership with HMD has gradually taken shape and become much closer to enable the strategic partners to jointly tackle and resolve some teething problems through swift actions towards better achievement of its objectives. This demonstrated the strength of the Group, in particular, in its manufacturing operations and R&D capabilities.

For the manufacturing part of business with HMD, right now we are manufacturing feature phones in Vietnam and India whilst smart phones are manufactured in China and India. From P&L performance perspective, as explained above in the section headed "Geographical segment", there are a lot of challenges with price and margin pressure remaining extremely huge.

As at 30 June 2018, Nokia-branded phones are sold at over 250,000 retail outlets across the world and more than 600 direct partners are committed to this next chapter of Nokia-branded phones globally. Demonstrating incredible passion, engagement and enthusiasm for the new portfolio, the responses from fans around the world to the new Nokia range of Android smart phones have been overwhelming. The Company has been able to capture the hearts and minds of the next generation of Nokia-branded phone users with its portfolio of Android smart phones. Two-thirds of consumers buying a Nokia-branded phone today are below the age of 35 years. Four out of every five consumers are recommending a Nokia-branded smart phone to their friends and families. Over 150,000,000 visits have been welcomed to the Nokia.com/phones website since January 2017.

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

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

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

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

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

In the second quarter of 2018, HMD started shipping next generation portfolio Nokia 3.1, Nokia 6.1 and 8110 4G worldwide. HMD has received great consumer feedbacks about new generation products. Recently, the Company has introduced Nokia X6 in China as a smart phone specially catering to the new age Nokia-branded phone users. The first batch of Nokia X6 was sold out in 10 seconds in China.

New portfolio and increased investments into marketing were growing. Mix is shifting more towards smart phones driving average selling price up and doubling the revenue year-on-year. Market remains dynamic and changes in competition continues in accelerating speed. Few developed markets are already declining while consumers are waiting for further innovation and maintaining an ownership cycle. For the declining market, manufacturers are facing challenges of selling the right amount of devices, which further fuel the competition. Similar market dynamics can be expected to continue, regardless of the year-end peak seasons, which may ease the pressure slightly. Nokia-branded business is adapting into competitive environment having truly global distribution coverage and offering wide range covering lowest cost feature phones, affordable sub-US\$100 smart phone and up to highest price points with Nokia 8 Sirocco. In the second half of 2018, there will be more new products introduced worldwide with clear expectation of robust growth compared with the first half of the year, as amplified by key sell-out seasons.

In May 2018, the Group invested US\$62 million in HMD. For details, please see the Company's announcement dated 21 May 2018. As set out above, it generated further values for the Group and its investment in HMD from the synergies between HMD's business and the Group's handset manufacturing experience. The Group's total investment in HMD represented about 6.2% (calculated on as-converted and fully-diluted basis) of the total issued shares of HMD as at 30 June 2018. The Group has designated the investment in HMD as fair value through other comprehensive income ("FVTOCI").

The Group previously invested US\$2.5 million in an exempted limited partnership registered in the Cayman Islands with sole activity to invest in HMD. The Group's total investment represented about 29.76% of the partnership as at 30 June 2018. After IFRS 9 became effective in 2018, the Group has designated the investment as FVTOCI, and due to series A financing of HMD in May 2018, the partnership recognised approximately US\$123 million fair value gain on investment, therefore the Group also recognised approximately US\$36.5 million fair value gain in other comprehensive income during 2018.

##### *Other Major Investments*

With 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.

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

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

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

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

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

As at 30 June 2018, the Group had its US\$20.8 million equity investment in Meitu Inc. (the shares of which are listed and traded on the Stock Exchange with stock code: 1357, “Meitu”), a leading mobile internet platform company specialising in photo and video applications, as well as selling self-branded smart phones for optimised selfie experience. Meitu is not only a photo-enhancement application but also turning itself into a photo-social platform, with plans to expand into games, online literature, even claw crane machines. The Group’s total investment in Meitu represented about 1.27% (calculated on as-converted and fully-diluted basis) of the total issued shares of Meitu as at 30 June 2018. After IFRS 9 became effective in 2018, the investment in Meitu is accounted for as fair value through profit or loss (“FVTPL”), there was US\$28 million fair value loss recognised in profit or loss during the current period. As at 30 June 2018, its fair value amounted to US\$48 million and represented 0.57% of the Group’s total assets.

The Group invested in Mango International Group Limited (“Mango”), a company which provides smart phones to help hotels better monetise and understand their guests through a customised system. Since the Group’s investment in 2015, Mango’s business expanded into certain major tourist destinations in the world and collaborated with various leading hotel groups and luxury hotel icons. Mango continued to increase the scale of participating hotels and successfully completed the series D fund raising in the first half of 2018, which timely solved the tight cash flow. The Group will closely monitor its operating performance, monetization and cash flow. The Group’s total investment in Mango represented about 18.23% (calculated on as-converted and fully-diluted basis) of the total issued shares of Mango as at 30 June 2018 and it was booked as interest in associate subject to impairment testing and was not within the scope of IFRS 9. The carrying value of the Group’s investment in Mango amounted to US\$70 million, and the fair value of the outstanding convertible note issued by Mango in favour of the Group amounted to US\$44 million, which principal amount was amended in March 2018 based on the shipping amount. They represented 0.83% and 0.52% of the Group’s total assets, respectively. There was no fair value change recognised in profit or loss during the current period. The fair value of the convertible note is measured using fair value model based on a valuation performed by an independent qualified professional valuer (the “Valuer”). In determining the fair value of the convertible note, the Valuer has considered the market value of the shares of Mango in recent transactions.

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 the first half of 2018, MAU/DAU (Monthly Active User/Daily Active User) of various functions and content did not meet Hike’s expectation. The Company tried to conduct more market research and users test to further improve user experience on core product so that it can compete with other

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

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

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

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

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

big players like WhatsApp with over 200 million MAU and Facebook Messenger with over 250 million MAU in India. Therefore, to focus on the core products and optimise resources, Hike also downsized parts of its teams and offices including payment and games. With sufficient capital, Hike would keep improving the core products especially the social and content, and try to develop more valuable products and services for the users in the future. While based on the performance in 2018 and the adjustment for the future cash flow, the Group decided to recognise appropriate fair value loss to its investment. The amount is measured using the fair value model based on a valuation performed by 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 discounted cash flow (DCF) 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. After IFRS 9 became effective in 2018, the Group has designated the investment in Hike as FVTOCI.

###### *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. Due to the large and growing gamer total addressable market and Razer’s unique combination of brand, ecosystem and global footprint, the Group believes that Razer will keep expanding its product lines and cooperate with the Group to create a comprehensive and seamless gaming experience for its global users. After IFRS 9 became effective in 2018, the investment in Razer is accounted for as FVTPL, there was US\$6 million fair value loss recognised in profit or loss during the current period. As at 30 June 2018, its fair value amounted to US\$6 million and represented about 0.25% of total issued shares of Razer.

The Group invested in CExchange, LLC (“CEX”), which engages in the business of consumer electronics trade-in and buy-back in the US since 2014, for a cumulated US\$11.8 million in the past few years. In the first half of 2018, CEX kept profitable and restarted the negotiation with key account customers and tried to provide more services including mobile repair. As at 30 June 2018, the Group’s investment represented 49% of the total membership interests in CEX. Its carrying value of US\$8.4 million represented 0.10% of the Group’s total assets as at 30 June 2018.

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

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

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

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

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

The Group also made certain investments in other companies designated as FVTOCI mainly in China, India and US in the past few years. In China, the Group's investments mainly include a distributor of mobile devices and accessories, which is listed and traded on the PRC's NEEQ (National Equities Exchange and Quotations) and an operator of cloud-based systems for intelligent robots since early 2015. In India, the Group's investments mainly include a data-driven advertising technology company. In US, 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 2018, the total fair value of the Group's equity investments designated as FVTOCI was US\$151.8 million represented 1.80% of the Group's total assets.

###### *Other Investment-Related Matters*

For the current period, except as disclosed above and based on the information currently available, the Group was not aware of any circumstances which involved any material change in respect of its major investments, and the Company believed that their long-term prospects were optimistic for the time being. In such a dynamic and volatile equity investment market, the Group's investment team is cautious always, and therefore they 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.

The Group has been maintaining healthy cash flows for years, which provides the Group with adequate financial resources to cope with unforeseen operational fluctuations. 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 the phone related hardware, software, sales and marketing service providers for building up the phone ecosystem portfolio including but not limited to IoT (Internet of Things) 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 in 2018.

There had been no material acquisitions and disposals of the Group's subsidiaries, associates and joint ventures for the current period.



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

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

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

##### **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, logistics and distribution, foreign exchange control and intellectual property, and (as the Company's shares have been listed and traded on the Stock Exchange) applicable requirements laid down by 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 multiple jurisdictions. In this respect, the Group's major operating subsidiaries fall under different tax regimes in the PRC, Taiwan, India, Vietnam, Finland, Mexico and USA where different tax laws and regulations as well as specific concessionary incentives apply. During the current period, the newly-promulgated local tax laws and regulations that have a significant impact on the Group are highlighted and summarised as follows:

##### *PRC*

For VAT (value-added tax), by way of background, in May 2016, VAT reforms were implemented nationwide replacing the previous business tax. VAT was extended to the sale and importation of goods and provision of services in or to the PRC, including construction, real estate, finance and consumer services. The unification of a single VAT system enabled businesses which were already VAT taxpayers to generally be able to claim input VAT credits for the goods and services they purchased or consumed from those sectors that were VAT taxpayers, and businesses, as general VAT taxpayers, became eligible to claim input VAT credits for the goods and services they purchased or consumed. 2018 began with a war on customs duties that shocked the world economy. To avoid kickbacks and further stimulate the economic growth via reducing tax burdens on enterprises, the PRC State Council decided to reduce the current VAT rate, and on 4 April 2018, the Ministry of Finance (MOF) and the State Administration of Taxation (SAT) jointly issued a new circular (Caishui [2018] No. 32, or Circular 32) to reduce the VAT tax rate for manufacturers from 17% to 16%. The reform also consists of switching the VAT system from a three-tiered to a two-tiered rate structure. Thus, the three VAT rates of 17% (now 16% for manufacturers), 11% and 6% (excluding the 3% applicable to small-scaled VAT taxpayers) will be consolidated into two. From an enterprise's perspective, this VAT reform is good news and is favourable to the Group as less cash will be needed for domestic purchases.

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

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

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

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

##### *PRC (Continued)*

There are also other tax cut measures. For example, on 7 May 2018, the MOF and SAT issued a regulation (Caishui [2018] No. 51) to increase the maximum tax-deductible employee education fee from 2.5% to 8% of total salaries. The excessive portion could be carried forward to next year(s) for tax deduction purposes. The new cap of yearly tax-deduction rate is applied from the year 2018 and onwards. Also, to encourage investments in R&D, during the period from 1 January 2018 to 31 December 2020, equipment or machinery, newly purchased for R&D activities, is eligible for a 100% immediate tax deduction for CIT (Corporate Income Tax) purposes, on the condition that the unit price of each item of equipment or machinery is individually less than RMB5 million (previously RMB1 million under SAT Announcement [2014] No. 64). From an enterprise's perspective, these tax cut measures have worked in the Group's favour at least to reduce the Group's PRC tax expenses to a certain extent.

##### *USA*

For US tax reform and tax cut, the Group considers that there will not be much impacts on the Group as the US tax exposure from the Group's operation is comparatively small.

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 Organisation for Economic Cooperation and Development (OECD). The Group is committed to duly comply with applicable laws and regulations introduced or updated due to the BEPS Action Plans, including the increased documentation requirements triggered by the local transfer pricing documentation and CbCR (Country-by-Country Reporting) obligations in the jurisdictions where the Group operates. The Group falls into the CbCR scope of the Company's ultimate controlling shareholder Hon Hai for such purposes.

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

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

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

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

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.

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, please refer to the Company's separate 2017 environmental, social and governance report as issued and published on 9 April 2018.

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

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

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

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

As at 30 June 2018, the Group had a cash balance of US\$1,992 million (31 December 2017: US\$1,980 million). Free cash flow, representing the net cash used in operating activities of US\$342 million (31 December 2017: US\$113 million) minus capital expenditure of US\$126 million (31 December 2017: capital expenditure and dividends of US\$362 million), was US\$468 million outflows (31 December 2017: US\$475 million outflows). Free cash flow slightly 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\$1,244 million (31 December 2017: US\$713 million) over total assets of US\$8,450 million (31 December 2017: US\$8,788 million), was 14.72% (31 December 2017: 8.11%). All of the external borrowings were denominated in USD (31 December 2017: 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 2.43% to 2.79% (31 December 2017: fixed rate ranging from 1.72% to 2.4%) per annum with an original maturity of one to three months (31 December 2017: one to six months).

As at 30 June 2018, the Group's cash and cash equivalents were mainly held in USD and RMB.

Net cash used in operating activities for the six months ended 30 June 2018 was US\$342 million.

Net cash used in investing activities for the six months ended 30 June 2018 was US\$144 million, of which, mainly, US\$126 million represented the expenditures on property, plant and equipment related to the facilities in the Group's major sites in the PRC, US\$9 million represented withdrawal of bank deposits, US\$1,368 million represented purchase of short-term investments, US\$64 million represented purchase of equity investments, US\$6 million represented proceeds from disposal of property, plant and equipment and US\$1,400 million represented proceeds from settlements of short-term investments.

Net cash from financing activities for the six months ended 30 June 2018 was US\$532 million, primarily due to net increase in bank borrowings of US\$543 million and interest paid of US\$11 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 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.

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

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

#### **Capital Commitment**

As at 30 June 2018, the capital commitment of the Group was US\$9.7 million (31 December 2017: US\$4.3 million). Usually, the capital commitment will be funded by cash generated from operations.

#### **Pledge of Assets**

There was no pledge of the Group's assets as at 30 June 2018 and 31 December 2017.

#### **Outlook**

Smart phone shipments growth hits the ceiling and has been continuously slowing down since 2017. Although there are still opportunities from consumption upgrades 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. US 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 largest economies into a full-blown trade conflict. Washington's 25% tariffs and China's immediate retaliation with tariffs on its US\$34 billion list of goods issued in June 2018, including soybeans, pork and electric vehicles; and Beijing calls it the "biggest trade war in economic history". The Group will closely monitor the resulting impact. It is good that the Group now has large set ups in India.

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 more mature growth pattern. For 2018, the handset market remains dynamic and strong, continuing last year's growth trend. As mentioned above, the Asia segment, with China as the focus, remains the Group's core performance contributor. For China, the world's largest smart phone market, the top five brands accounted for 82% of the market with other OEMs struggling to grow. 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. 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 and this is consistent with 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.

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

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

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

The decline in the Chinese market in the first quarter of 2018 led to the decline in the overall growth of some key Chinese brands. These brands are investing in countries and regions outside China to offset the weak demand in the domestic market. 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. The Group had injected approximately US\$100 million to cater for business expansion in the region and additional working capital needed as announced in January 2018.

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. Innovations in the smart phone glass surface and smart phone casing is fundamental to boost consumer demand for smart phones. Metal casing manufacturing is the core competence of the Group, and we have 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. It is expected that casing sales and gross profit will decline in the second half of 2018.

As smart phone industry is dynamic and competitive, a slowdown in growth may lead to industry consolidation, which may result 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, whom are constantly evaluating the advantages of manufacturing products in-house against outsourcing. 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 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. On 13 December 2017, the Group announced that it has proposed to incorporate a wholly foreign-owned enterprise known as 富智康(南京)智能科技有限公司 (FIH (Nanjing) Intelligent Technology Co., Ltd., for identification purposes only) with a total capital injection of approximately US\$120 million. The principal activities of FIH (Nanjing) Intelligent Technology Co., Ltd. are proposed to be the development, testing, system integration and provision of application services and related technological services for handset-related software and hardware. The investment project was approved by Taiwan Investment Commission on 25 April 2018 and we are in the process of setting up a new legal entity.

But the biggest challenge is still the phone manufacturing and distribution business relating to the Nokia-branded products and the difficulties encountered have been explained in detail in the "Financial Performance" section.

The key driver for operating success of HMD is forecasting product ramp-ups and ramp-downs correctly. Resulting product launch road-map determines the underlying manufacturing volume commitments (linked to potential vendor liability costs), as well as sets the timing to market strategy (product launch compared to competitive product launches and peak demand around holidays, e.g. Christmas). This highlights the importance of HMD's ability to position the products successfully in the market and support the demand through timely and relevant marketing efforts. In consumer demand driven business with relatively short life-cycle of individual products, there is an inherent risk of missing the projected demand. This is partly mitigated by continuous cross-supply chain forecast process in co-operation with the Group and TNS and enabled by integrating upstream/

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

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

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

downstream partners and information in order to ensure prompt material and product delivery. HMD expects short-term success principally from frontier markets and affordable smart phone market segment whilst long-term success of the business is dependent on achieving market-leading position in the most competitive markets and high-end products. As the strategic partner and preferred supplier of HMD, the volume of the new business and the related margins will largely depend on the success of HMD in its Nokia-branded products business and the Group's gross margins of the new business is subject to extremely huge pressure at the early stage when the selling price of phones to HMD has to be very aggressive and before scale can be built up and components and parts can be purchased at better prices. When volumes go up, with the joint efforts of design engineers and sourcing teams, it is expected that the Group will have more bargaining power on procurement and pricing of some key components can be lowered gradually and the gross margins performance will gradually improve over time. It really takes time to achieve BOM cost reduction in a highly competitive market and HMD needs to persistently devote effort in order to gain market shares while commodity prices increase is to some extent beyond the Group's control. There are needs to continue to put effort into BOM costs control and operating expenses cut. Regarding BOM cost control, overall, we have achieved quarterly to quarterly cost reduction including feature phones as well as smart phones. Battery cost increase has been significant during this year mainly driven by key factors including cobalt global price increase and Congo political situations and currency impact (RMB vs USD). Looking forward to upcoming generation/wave products, more products will be meeting BOM targets at the beginning of programs and therefore comparing with previous year generation products, we will progressively improve margin performance as well as cost visibility in 2019. The increase of effort in sourcing capacity and capability as well as new way of working have resulted in great improvement of visibility of right cost, cost benchmarking as well as choosing right solutions and components for each product. We have also introduced new suppliers as well as made right allocation decision in order to make sure that we have best possible cost performance in each quarter. Supplier management cannot be singly dimensionally driven on cost, and clear quality criteria need to be set to develop a culture of quality and deepen supplier quality management process to cover key functional criteria, especially in all consumer experience impacting areas. Step forward, in tactical level, sourcing is moving for fixed volumes deal with the supplier in order to make sure that we will have the best pricing and cost in the most critical moment, i.e. in the product ramp-up phase. Last but not the least, establishing an obsolescence execution team, has been greatly supporting the Group to maximise obsolesces component spot market value and reduce the amount of write-downs due to material scrapping. There are also needs to improve OTD (On Time Delivery) and customer satisfaction and develop specifications for different markets and operators and focus on price to performance ratio and strengthen the time management and control on research & development in order to launch the new product to market on time. The Group will continue innovating feature phone business. But the feature phone shipment volume is expected to decrease over the following years together with the projected market decline of the feature phone. To remain



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

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

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

competitive, we are expanding feature phone offering to cover 4G radio technology and we aim for volume share leadership in the near future. For phone distribution business, we are starting the year 2018 from a good position as we now have larger distribution footprint and positive consumer reaction to smart phone introduced in 2017 and 2018 and we improve our offering based on consumer feedback.

Since 2017, the Group and TNS have put efforts and resources and recruited more talents to develop products and institute proper conception process with engineering competence to design cost down solutions and such activities lead to a year-on-year increase in R&D expenses. Resources were also spent on building up quality management capability and industrial engineering to run the production facility and distribution/fulfilment network in a cost-effective manner and all these initiatives need time before the savings and efficiency enhancement can be materialised. All these costs will continue to be incurred, and coupled with the factors mentioned above, the gross margins and net margin will continue to be subject to huge pressure in 2018.

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 and there is an immediate need for the Group to carry out strategic transformation and this is the overwhelming reason why the Group has to continue to devote resources in this business which the Group has invested US\$330 million upfront and to continue to invest in the Nokia-branded business aiming at developing a new customer with good potential. 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 OEM industry is also driven by the trend of China's capacity transformation. The rise of China's OEM was 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. China government has set a 6.5% target set for annual GDP growth and China's "new normal" of slower economic growth has been accepted and it is emphasising that the focus of China's economic growth would be less on speed but more on the quality. In order to achieve goals, the promotion of consumption plays a central role. In a longer term, China's goal is to get higher on the global value chain, since currently, the export-driven economic structure keeps the level of products with relatively low added values. It is a serious problem that only a fraction of the profit on countless products stays in the country because added value is low which is typical for the system assembly business. The model based on domestic demand works in a much more complex way than the mostly export-driven one. The recent trade war of China with the US especially highlighted the need of changing the mix of China's GDP. China's traditional OEM and manufacturing industry is facing huge

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

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

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

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 spending effort on this. On the whole, the Group has to invest in the future and continue to invest costs and devote resources into the Nokia-branded business and develop and enhance the Group’s overall capabilities (in terms of procurement, value and design engineering and product development, quality management, manufacturing footprint, production management, expansion of commercial network, product offerings, logistics and distribution competence and cultivation of talents needed to run the new business smoothly and successfully in the long run) to support the new business on a global basis and to find alternative ways of making competitive products. When the Nokia-branded business size increases and with the development of new generation/wave products with better performance to price ratio, this burden will gradually be reduced correspondingly. The Group can create consumer pull that enables it to start benefiting from the business incrementally. In addition, the Group will work on business synergy and process improvements to make the entire operations more efficient. As the OEM and ODM market is competitive and close to saturation, this is an opportunity for the Group to drive sales of phone manufacturing and distribution service income and volume and scale and develop a new area of competence which the Group aims to develop on top of its existing OEM and ODM businesses and is looking at a long-term prospect of the Nokia-branded business operated by TNS and the Nokia-branded phone manufacturing business. These investments together with the gross margins erosion pressure mentioned above will unfortunately continue to be a very heavy burden on the Group and hence its profitability and margins.

Apart from its existing business, the Group is dedicated to exploit new business by establishing strategic partnerships (such as the collaboration with Nokia and HMD as mentioned above) and making equity investments, which are expected to be funded by cash generated from the Group’s operations and the cash on hand. Currently, the Group draws down and repays short-term loan on regular basis based on operational needs and it is envisaged that there will be no fund-raising activities in the capital market for 2018.

Looking ahead, the Company understands the tremendous challenges in 2018. 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 corporate governance report as contained in the Company’s 2017 annual report.

Regarding key risks faced in the first half of 2018, 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. 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 their products do not gain widespread commercial acceptance may have a significant impact on the Group's operating results and financial conditions. Especially for the Nokia-branded business, it needs time and effort to secure long-term sustainability of the business. To tackle this, the Group has to control BOM costs and manufacturing costs and improve gross margins performance.

##### *Risk Associated with US-China Trade War*

Although the direct impact of tariff increase on smart phone supply chain is limited, the unpredictability of US President Trump's future act adds to the uncertainty and will hurt market sentiment. Regarding smart phone supply chain, since the assembly of smart phone of both overseas brands and Chinese brands are mostly done by ODMs in China, the increased tariff will only be applied to the part exporting to the US, while all the other parts like component suppliers' shipping to domestic ODMs or ODMs' shipping to regions outside the US will not be affected. While Chinese smart phone brands only have minimal shares in the US market, this is under very small impact. So the overall impact on smart phone supply chain is limited even if the tariff is increased. US mobile phone market is dominated by mobile operators, and most Chinese smart phone brands, so far have not yet built a relationship with the US mobile operators and their shipment to the US is minimal. The Group will continue monitoring the impact and devise counter measures if necessary.

##### *Reliance on Key Customers*

The Group's five largest customers, accounts for 90.2% of the Group's total revenue and has strong established relationships with these major customers. 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 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.

##### *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.

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

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

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

##### *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 organization (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.

On the basis of a preliminary review of the Group's latest unaudited management accounts and other information currently available, the Company understands that the Group is likely to record a consolidated net loss for the year ending 31 December 2018 (the Group recorded a consolidated net loss of US\$525,394,000 for the year ended 31 December 2017), primarily as a result of various factors, including those set out in the Company's announcements dated 4 May 2018 and 29 June 2018. In particular, the following unfavourable factors — (1) the challenging conditions that the Group has faced since the second half of 2017; (2) pressure on the Group's gross margins generally; and (3) increase in the expenses relating to the continuous growth of the Group's IIDM business — are expected to continue into the remainder of 2018. At this stage, on the basis of a preliminary review of currently available information, the Company expects the Group to record a consolidated net loss for the second half of 2018 and accordingly for the year ending 31 December 2018, but it is currently unable to reasonably and meaningfully estimate the likely magnitude of any such loss. The Company will make further announcement(s) in compliance with the Listing Rules and/or the SFO, as appropriate.

The Company's shareholders and potential investors should note that the Company is in the process of reviewing the Group's consolidated final results for the year ending 31 December 2018. 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 auditors or audit committee. The Group's audited 2018 consolidated final results and other related details will be disclosed in the Company's 2018 final results announcement, which is tentatively scheduled to be published in March 2019.

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

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

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

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 2018) certain unaudited consolidated financial information of the Group for the nine months ending 30 September 2018, 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.

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 demands, seasonality of sales, factors relating to the supply chain (e.g. components 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' 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 cycles, market competitiveness and shifts in customers' demands 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 market, sales and product mix changes, commodity price changes, technology advancement, and legal/regulatory/tax/government policy changes. 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.

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

## **OTHER INFORMATION**

### **DIRECTORS**

Pursuant to the approval of the Board on 29 June 2018, the letter of appointment in respect of Mr. CHIH Yu Yang as the chief executive officer and an executive director of the Company was renewed for a term of three years ending on 27 August 2021 subject to retirement and re-election under the articles of association of the Company. Mr. Chih is entitled to annual emoluments package of NT\$2,816,800 and a discretionary bonus to be determined by the Board from time to time with reference to the Company's performance, his duties and responsibilities with the Company, his contribution to the Company and the prevailing market practice.

Pursuant to the approval of the Board on 29 June 2018, Dr. KUO Wen-Yi was appointed as an executive director of the Company with effect from 29 June 2018. Dr. Kuo was appointed for a term of three years ending on 28 June 2021, and he would hold office until the conclusion of the first general meeting of the Company after his appointment and would then be eligible for re-election at that meeting in accordance with the articles of association of the Company. Dr. Kuo is entitled to annual emoluments package of US\$500,000 and a discretionary bonus to be determined by the Board from time to time with reference to the Company's performance, his duties and responsibilities with the Company, his contribution to the Company and the prevailing market practice. Dr. Kuo was also appointed as a member of the corporate governance committee of the Company with effect from 29 June 2018.

Dr. Kuo joined the Group in December 2014 and is currently the vice president of the Group. He is also a director of ICI Cayman Limited (the Company's indirect wholly-owned subsidiary incorporated in the Cayman Islands) and a supervisor of 深圳市富宏訊科技有限公司 (Shenzhen Fu Hong Xun Technology Co., Ltd., for identification purposes only) (the Company's indirect wholly-owned subsidiary incorporated in the PRC).

Mr. YU Mingjen resigned as an executive director of the Company and ceased to act as a member of the corporate governance committee of the Company and Mr. HUANG Chin Hsien was appointed as a member of the corporate governance committee of the Company as his replacement, all taking effect from 4 May 2018.

Mr. HUANG Chin Hsien resigned as an executive director of the Company and ceased to act as a member of the corporate governance committee of the Company with effect from 29 June 2018. However, Mr. Huang has remained as a director of certain subsidiaries of the Company until the effective dates on which the nominated replacement directors could take up such directorships.

## OTHER INFORMATION (Continued)

### DISCLOSURE OF INTERESTS

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

As at 30 June 2018, 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 (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	17,479,759	0.2160%
	Hon Hai	Personal Interest	1,272,594	0.0073%
	Chiun Mai Communication Systems, Inc. (Note)	Personal Interest	1,000	0.0007%
KUO Wen-Yi	Hon Hai	Personal Interest	2,310	0.00001%
		Interest of Spouse	17	0.0000001%

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.

Save as disclosed above, none of the directors or chief executive of the Company had, as at 30 June 2018, 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.

## OTHER INFORMATION (Continued)

### DISCLOSURE OF INTERESTS (Continued)

#### 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 2018, 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	62.78%
Hon Hai (Notes 1 & 2)	Interest of a controlled corporation	5,081,034,525	62.78%

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 Yu Yang, the acting chairman and an executive director of the Company, is a director of certain subsidiaries of Hon Hai. Mr. WANG Chien Ho, an executive director of the Company, is an employee of the Hon Hai Group (comprising of Hon Hai, its subsidiaries and associates).

Save as disclosed above, as at 30 June 2018, 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.

#### OPTION SCHEME AND SHARE SCHEME

During the six months ended 30 June 2018, 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 page 55 of the Company's 2017 annual report.

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 executive directors, upon and subject to the terms and conditions set out therein), at no time during the six months ended 30 June 2018 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.



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

### **DIVIDEND**

The directors of the Company did not recommend the payment of an interim dividend for the six months ended 30 June 2018.

### **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 2018.

### **RESERVES**

Movements in reserves of the Group during the six months ended 30 June 2018 are set out on page 8.

### **AUDIT COMMITTEE AND EXTERNAL AUDITORS**

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 risk management systems, nominate and monitor external auditors 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).

The audit committee has reviewed the unaudited condensed consolidated financial statements of the Group for the six months ended 30 June 2018 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 2018 have been reviewed by the Company's auditors, 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 as set out in Appendix 10 to the Listing Rules. 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 2018.

### **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 2018 to 30 June 2018.

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.

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

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

However, Mr. TONG Wen-hsin, 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.

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 Yu Yang, 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 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 seven 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. Furthermore, the Board believes that the circumstances justify the bases for adopting the arrangement which is in the best interest of the Company and its shareholders as a whole. 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 chairman of the Company as soon as reasonably practicable thereby separating the roles of chairman and chief executive as prescribed under the code provision contained in paragraph A.2.1 of the CG Code.

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

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

To facilitate a better and smoother operation in practice, on 29 June 2018, the Board revised its delegation of authority, pursuant to which (among other things) any two executive directors of the Company (or, alternatively, any one executive director of the Company and (as the case may be) any one senior management member designated by another executive director of the Company or the head of finance department of the Company) have been jointly authorised to approve, ratify and confirm any and all matters (including, without limitation, any and all financing activities of the Group) which have not been covered by the list of matters reserved for the Board (as amended from time to time) and also do not fall under the duties of any Board committee, in each case upon and subject to the terms and conditions set out therein.

For the sake of completeness, it should be noted that on 8 December 2017, the Board revised its delegation mechanism in respect of the grants of shares and share options under the Company's Share Scheme and Option Scheme respectively for better and smoother operation in practice, pursuant to which (among other things) the chairman/acting chairman and any one executive director of the Company (other than the chairman/acting chairman) have been jointly authorised to approve, in relation to a 12-month period, the grants of shares and share options under the Company's Share Scheme and Option Scheme respectively, together with the grantees and the corresponding number of grants and grant dates (subject to the groups of grantees and the maximum number of grants previously approved by the Board), in each case upon and subject to the terms and conditions set out therein.

On behalf of the Board

**CHIH Yu Yang**

*Acting Chairman*

Hong Kong, 10 August 2018