Arts Group

ARTS OPTICAL INTERNATIONAL HOLDINGS LIMITED

雅視光學集團有限公司*

(Incorporated in Bermuda with limited liability)

(Stock Code: 1120)

INTERIM RESULTS
FOR THE SIX MONTHS ENDED 30TH JUNE, 2007

INTERIM RESULTS

The board of directors (the "Board") of Arts Optical International Holdings Limited (the "Company") is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (together, the "Group") for the six months ended 30th June, 2007 together with comparative figures for the corresponding period in 2006.

CONDENSED CONSOLIDATED INCOME STATEMENT

		Six months ended	
		30.6.2007	30.6.2006
	Notes	***HK$'000***	*HK$'000*
		(unaudited)	(unaudited)
Revenue	3	**609,420**	509,242
Cost of sales		**(435,573)**	(354,682)
Gross profit		**173,847**	154,560
Other income		**11,639**	9,671
Distribution costs		**(19,805)**	(24,183)
Administrative expenses		**(74,477)**	(56,793)
Other expenses		**(753)**	(8,168)
Finance costs	4	**(124)**	–
Profit before taxation		**90,327**	75,087
Taxation	5	**(8,706)**	(9,280)
Profit for the period	6	**81,621**	65,807
Attributable to:			
Equity holders of the parent		**81,893**	67,441
Minority interests		**(272)**	(1,634)
		81,621	65,807
Dividend paid	7	**26,856**	26,856
Earnings per share	8		
– Basic		**21.3 HK cents**	17.6 HK cents

CONDENSED CONSOLIDATED BALANCE SHEET

	As at	
	30.6.2007	31.12.2006
	HK$'000	*HK$'000*
	(unaudited)	(audited)
		(restated)
Non-current Assets		
Investment property	**4,800**	4,800
Property, plant and equipment	**402,877**	350,373
Prepaid lease payments	**28,197**	26,145
Deposit paid for property, plant and equipment	**31,382**	9,064
Intangible assets	**4,680**	4,680
Loan receivable	**14,196**	15,229
Available-for-sale investments	**5,858**	5,858
Deferred tax assets	**53**	53
	492,043	416,202
Current Assets		
Inventories	**190,558**	184,621
Debtors, deposits and prepayments	**323,265**	339,720
Loan receivable	**2,262**	2,247
Prepaid lease payments	**695**	652
Tax recoverable	**51**	265
Bank balances and cash	**107,320**	69,134
	624,151	596,639
Current Liabilities		
Creditors and accrued charges	**262,524**	234,442
Tax liabilities	**20,226**	10,381
	282,750	244,823
Net Current Assets	**341,401**	351,816
Total Assets less Current Liabilities	**833,444**	768,018
Capital and Reserves		
Share capital	**38,365**	38,365
Reserves	**782,253**	715,843
Equity attributable to equity holders of the parent	**820,618**	754,208
Minority interests	**–**	142
Total Equity	**820,618**	754,350
Non-current Liabilities		
Deferred tax liabilities	**11,914**	13,054
Loan from a minority shareholder of a subsidiary	**912**	614
	12,826	13,668
	833,444	768,018

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PREPARATION

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

2. PRINCIPAL ACCOUNTING POLICIES

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

The accounting policies used in the condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual financial statements for the year ended 31st December, 2006.

In the current interim period, the Group has applied, for the first time, the following new standard, amendment and interpretations ("new HKFRSs") issued by the HKICPA, which are effective for the Group's financial year beginning 1st January, 2007.

HKAS 1 (Amendment)	Capital Disclosures[1]
HKFRS 7	Financial Instruments: Disclosures[1]
HK(IFRIC) – INT 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies[2]
HK(IFRIC) – INT 8	Scope of HKFRS 2[3]
HK(IFRIC) – INT 9	Reassessment of Embedded Derivatives[4]
HK(IFRIC) – INT 10	Interim Financial Reporting and Impairment[5]

[1] Effective for annual periods beginning on or after 1st January, 2007.
[2] Effective for annual periods beginning on or after 1st March, 2006.
[3] Effective for annual periods beginning on or after 1st May, 2006.
[4] Effective for annual periods beginning on or after 1st June, 2006.
[5] Effective for annual periods beginning on or after 1st November, 2006.

The adoption of these new HKFRSs had no material effect on the results or financial position of the Group for the current or prior accounting periods. Accordingly, no prior period adjustment has been recognised.

The Group has not early applied the following new or revised standards or interpretations that have been issued but are not yet effective.

HKAS 23 (Revised)	Borrowing Costs[1]
HKFRS 8	Operating Segments[1]
HK(IFRIC) – INT 11	HKFRS 2: Group and Treasury Share Transactions[2]
HK(IFRIC) – INT 12	Service Concession Arrangements[3]

[1] Effective for annual periods beginning on or after 1st January, 2009.
[2] Effective for annual periods beginning on or after 1st March, 2007.
[3] Effective for annual periods beginning on or after 1st January, 2008.

The directors of the Company anticipate that the application of these standards or interpretations will have no material impact on the results and financial position of the Group.

3. SEGMENT INFORMATION

Business Segments

The Group is principally engaged in the design, manufacture and sales of optical products. No business segment analysis is presented as management considers this as one single business segment.

Geographical Segments

The Group's operations and assets are located in Hong Kong and elsewhere in the People's Republic of China. Segment information of the Group by location of customers is presented as below:

	Six months ended			
	30.6.2007	**30.6.2007**	30.6.2006	30.6.2006
	Revenue	**Results**	Revenue	Results
	HK$'000	***HK$'000***	*HK$'000*	*HK$'000*
Europe	**377,116**	**58,794**	325,020	51,560
United States	**181,451**	**29,515**	134,185	22,966
Asia	**36,262**	**2,313**	38,437	862
Other regions	**14,591**	**1,882**	11,600	1,266
	609,420	**92,504**	509,242	76,654
Unallocated corporate income		**744**		2,249
Unallocated corporate expenses		**(2,797)**		(3,816)
Finance costs		**(124)**		–
Profit before taxation		**90,327**		75,087
Taxation		**(8,706)**		(9,280)
Profit for the period		**81,621**		65,807

4. FINANCE COSTS

	Six months ended	
	30.6.2007	30.6.2006
	HK$'000	*HK$'000*
Interest on bank borrowings wholly repayable within five years	**79**	–
Imputed interest on loan from a minority shareholder of a subsidiary	**45**	–
	124	–

5. TAXATION

	Six months ended	
	30.6.2007	30.6.2006
	HK$'000	*HK$'000*
The charge comprises:		
Current taxation		
Hong Kong Profits Tax	**9,846**	7,980
Deferred taxation		
Current year	**(1,140)**	1,300
	8,706	9,280

Hong Kong Profits Tax is calculated at 17.5% (six months ended 30th June, 2006: 17.5%) on the estimated assessable profit for the period.

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

6. PROFIT FOR THE PERIOD

	Six months ended	
	30.6.2007	30.6.2006
	HK$'000	*HK$'000*
Profit for the period has been arrived at after charging (crediting):		
Cost of inventories recognised as an expense	**435,573**	354,682
Depreciation of property, plant and equipment	**32,735**	26,026
(Gain) loss on disposal of property, plant and equipment	**(28)**	1,543
Net foreign exchange (gain) loss	**(3,836)**	5,472
Release of prepaid lease payments	**340**	431

7. DIVIDENDS

	Six months ended	
	30.6.2007	30.6.2006
	HK$'000	*HK$'000*
Final dividend paid in respect of 2006 of 7 HK cents (2006: 7 HK cents in respect of 2005) per share	**26,856**	26,856

The interim dividend in respect of 2007 of 8 HK cents (2006: 7 HK cents) per share amounting to a total of HK$30,692,000 (2006: HK$26,856,000) has been declared by the board of directors on 14th September, 2007.

8. EARNINGS PER SHARE

The calculation of the basic earnings per share attributable to the ordinary equity holders of the Company is based on the following data:

	Six months ended	
	30.6.2007	30.6.2006
	HK$'000	*HK$'000*
Earnings for the purposes of basic earnings per share	**81,893**	67,441
	Number of shares	
Number of shares for the purpose of basic earnings per share	**383,650,000**	383,650,000

DIVIDEND

The Board has resolved to declare an interim dividend of 8 HK cents per share for the six months ended 30th June, 2007 (2006: 7 HK cents per share). The interim dividend will be payable on 16th October, 2007 to shareholders whose names appear on the register of members of the Company on 9th October, 2007.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from 8th October, 2007 to 9th October, 2007, both days inclusive, during which period no transfer of shares will be effected. All transfers, accompanied by the relevant share certificates, must be lodged with the Company's share registrar in Hong Kong, Tricor Secretaries Limited at 26/F., Tesbury Centre, 28 Queen's Road East, Hong Kong for registration not later than 4:30 p.m. on 5th October, 2007 in order to qualify for the interim dividend mentioned above.

BUSINESS REVIEW

Summary of results

The Group's consolidated revenue and profit attributable to the equity holders of the Company increased by 20% and 21% to HK$609.4 million and HK$81.9 million respectively (2006: HK$509.2 million and HK$67.4 million respectively) in the six months ended 30th June, 2007. Basic earnings per share increased by 21% to 21.3 HK cents (2006: 17.6 HK cents) in the period under review.

The movement of various cost components of the Group, including higher raw material costs, labour wages, record energy prices and gradual appreciation of renminbi, continued to have an adverse effect on the gross margin of the Group which declined by 1.9% to 28.5% in the first half of 2007 (2006: 30.4%). Due to the positive effect of economies of scale and the strict cost control measures implemented by the Group, the total expenses to revenue ratio decreased by 1.9% from 17.5% in the first 6 months of 2006 to 15.6% in the corresponding period of 2007. Net profit margin (ratio of profit attributable to the equity holders of the Company to revenue) increased slightly by 0.2% from 13.2% to 13.4%.

Original design manufacturing (ODM) division

After registering a robust sales growth of 38% in 2006, sales to ODM customers recorded a relatively modest growth rate of 21% from HK$458.3 million in the first 6 months of 2006 to HK$554.5 million in the period under review. Europe and the United States remained as the main export markets of the Group's ODM division. Sales to Europe and the United States increased by 16% and 36% to HK$350.1 million and HK$177.4 million respectively (2006: HK$302.9 million and HK$130.8 million respectively) in the first half of 2007. On a geographical basis, sales to Europe, the United States, Asia and other regions accounted for 63%, 32%, 3% and 2% respectively of the sales of this division in the first 6 months of 2007 (2006: 66%, 29%, 4% and 1% respectively). Market demand by fashion labels for quality and trendy sunglasses, particularly those made of acetate plastic materials, continued in 2007. Sales of sunglasses grew by 38% to HK$273.0 million (2006: HK$198.1 million) and surpassed the sales of prescription frames which grew by 8% to HK$271.3 million (2006: HK$250.9 million). This growth pattern was consistent with market trends and changes in sales mixes of the market leaders in this industry. Sales of plastic frames, metal frames and spare parts accounted for 54%, 44% and 2% respectively of the sales of this division during the period under review (2006: 48%, 50%, 2% respectively).

Distribution and retailing divisions

Sales of the Group's own-branded and licensed branded products (including both spectacles and lenses) increased by 7% to HK$45.0 million in the six months ended 30th June, 2007 (2006: HK$42.1 million). Sales of the German brand owned by the Group, Stepper eyewear, continued to perform well especially in the European markets. Sales of other brands including the licensed Italian fashion brand Fiorucci eyewear and the new house brand Oopz Eyewear, had limited sales contribution to the distribution division. Sales to Europe, Asia, North America and other regions accounted for 60%, 17%, 12% and 11% respectively of the Group's turnover of distribution division in the period under review (2006: 48%, 30%, 12% and 10% respectively).

Turnover of the retailing division increased by 13% to HK$9.9 million in the first half of 2007 (2006: HK$8.8 million) as a result of better sales performance in Shenzhen after the completion of the renovation works of the flagship shop in late 2006. The Group operated a total of 13 shops (Beijing: 8 shops; Shenzhen: 5 shops) as at both 30th June, 2007 and 31st December, 2006.

Financial position and liquidity

During the period under review, the Group's operating activities generated a net cash inflow of HK$161.6 million (2006: HK$114.7 million). Capital expenditure incurred during the period amounted to HK$77.4 million (2006: HK$67.8 million) and was wholly financed by the Group's internal resources. Dividend payment amounted to HK$26.9 million was also made during the period under review (2006: HK$26.9 million). The net cash position of the Group (bank and cash balance less bank borrowing, if any) increased from HK$69.1 million as at 31st December, 2006 to HK$107.3 million as at 30th June, 2007. The Group did not have any interest bearing borrowings as at both 30th June, 2007 and 31st December, 2006.

The current ratio of the Group as at 30th June, 2007 was 2.2 to 1 (31st December, 2006: 2.4:1) with HK$624.2 million of current assets (31st December, 2006: HK$596.6 million) and HK$282.8 million of current liabilities (31st December, 2006: HK$244.8 million). To maintain the competitive edge of the Group in this fast changing fashion industry, the management continued its efforts of cutting down the delivery lead time for production and inventory turnover period (ratio of inventory balance to cost of sales) decreased from 87 days in the first six months of 2006 (or 86 days for the full year of 2006) to 80 days in the corresponding period of 2007. Debtors turnover period (ratio of the total of debtor and discounted bills balances, if any, to sales) increased slightly from 93 days in the first six months of 2006 to 95 days in the corresponding period of 2007, but this was still substantially shorter than the debtors turnover period of 111 days recorded for the whole year of 2006.

The Group had 383,650,000 shares in issue as at both 30th June, 2007 and 31st December, 2006 with an equity attributable to equity holders of the Company amounting to HK$820.6 million and HK$754.2 million as at 30th June, 2007 and 31st December, 2006 respectively. Net asset value per share (equity attributable to equity holders of the Company divided by the total number of shares in issue) as at 30th June, 2007 was HK$2.14 (31st December, 2006: HK$1.97). Total long term liabilities and debt to equity ratio (expressed as a percentage of total long term liabilities over equity attributable to equity holders of the Company) were HK$12.8 million (31st December, 2006: HK$13.7 million) and 1.6% (31st December, 2006: 1.8%) respectively.

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

Contingent liabilities

	30.6.2007	31.12.2006
	HK$'000	*HK$'000*
Corporate guarantee to a financial institution in respect of banking facilities granted to a trade debtor	**9,750**	9,687

The directors consider that the fair value of the financial guarantee contract at its initial recognition is insignificant on the basis of short maturity periods and low applicable default rates. The financial guarantee contract has not been recognised in the condensed consolidated financial statements.

PROSPECTS

ODM Division

The management is closely monitoring the impact on the business of ODM division of the repercussions on consumer spending in the American and European markets arising from the subprime mortgage crisis in the United States. Although there are no significant adverse changes in the procurement pattern and behaviour exhibited by the major customers and the Group currently has three months sales orders on hand, the management maintains its vigilance of any potential market upheaval.

On the production side, change in government policies in mainland China especially tax and customs regulations is another major concern to the Group. The recent changes in customs regulations on processing trade will create both threats and opportunities to the Group. Although the regulations do not currently have a significant effect on the costs and operations of the Group, they are going to affect the Group in the long run especially the Group will eventually change from contract processing arrangement to import processing arrangement. On the other hand, this can be an opportunity to the Group to gain market share as smaller players may not have the resources to cope with the changes in regulations.

The pace of increase of various cost factors of production appears to have slowed down in recent months, but there are also no signs that they will be moving downward in the foreseeable future. The Group will continue to alleviate the margin pressure by moderate adjustments to the selling price of the products and internal streamlining of operations. Capacity expansion plan will be executed after critical analysis of market trend and availability of funds and capital investment will continue to be primarily funded by internal resources.

Distribution and Retailing Divisions

The growth momentum of sales of the distribution division had slowed down in the first half of 2007 after achieving a compound annual growth rate of more than 40% in the previous three fiscal years. The management believes that the capability of the Group of producing quality products with innovative designs at competitive prices together with the well established distributor network provide the Group an excellent platform to further develop this business. More resources will be devoted to the identification of other brands acquisition or licensing opportunities, expansion of the distribution network and cross selling of different brands among the distributors. The management is determined to build up this division to become a significant long term recurrent income base of the Group.

Although the reporting of encouraging sales growth in the retailing division during the first half of 2007 demonstrated the success of the consolidation strategy adopted by the Group in recent years, the management expects that its contribution to the sales and profitability of the whole Group will remain relatively limited in view of its small scale of operations. The management will focus on maintaining the growth trend in sales on same-store basis and exploring the earning potential of the existing sales network.

Summary

Despite the increased uncertainty and volatility of the market conditions, the Group still manages to report a modest but satisfactory growth in both revenue and profitability in the first half of 2007. The management will continue to follow the guiding management principles of business diversification and financial prudence and is well prepared to meet the challenges and seize any new business opportunities.

EMPLOYEE AND REMUNERATION POLICIES

The Group employed approximately 12,300 full time staff as at 30th June, 2007 (31st December, 2006: 11,300). The Group remunerates its employees based on their performance, experience, qualifications and prevailing market price while performance bonuses are granted on a discretionary basis after considering individual performance and the operating results of the Group. Other employee benefits include insurance and medical cover, subsidised educational and training programmes, mandatory provident fund scheme as well as a share option scheme.

CORPORATE GOVERNANCE

The Company has complied with all of the code provisions in the Code on Corporate Governance Practices (the "CG Code") as set out in Appendix 14 to the Listing Rules throughout the six months ended 30th June, 2007, except for deviations from code provision A.2.1 of the CG Code only. Code provision A.2.1 of the CG Code stipulates that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. Mr. Ng Hoi Ying, Michael ("Mr. Ng") is the founder and chairman of the Group. Currently, the Company does not have any officer with the title "chief executive officer" and Mr. Ng has been carrying out the duties of both the chairman and chief executive officer since the establishment of the Group and the Company. The Board intends to maintain this structure in future as it believes that this structure can ensure efficient and effective formulation and implementation of business strategies without compromising the balance of power and authority between the Board and the management of the Company.

An Audit Committee has been established by the Company since 1998 to act in an advisory capacity and make recommendations to the Board. The Audit Committee currently comprises Messrs. Wong Chi Wai, Chung Hil Lan Eric and Francis George Martin, all of whom are independent non-executive directors of the Company. The duties of the Audit Committee include review of the interim and annual reports of the Company as well as various auditing, financial reporting and internal control matters with the management and/or external auditors of the Company. The Group's unaudited financial statements for the six months ended 30th June, 2007 have been reviewed by the Audit Committee and the Company's auditor, Deloitte Touche Tohmatsu.

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

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

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed shares during the six months ended 30th June, 2007.

INTERIM REPORT

The 2007 Interim Report will be despatched to the shareholders of the Company and published on the websites of Hong Kong Exchanges and Clearing Limited (www.hkex.com.hk) and the Company (www.artsgroup.com) in due course.

DIRECTORS

As at the date of this announcement, the Board comprises seven directors, four of which are executive directors, namely Mr. Ng Hoi Ying, Michael, Ms. Hui Pui Woon, Mr. Ng Kim Ying and Mr. Lee Wai Chung, and three are independent non-executive directors, namely Mr. Francis George Martin, Mr. Wong Chi Wai and Mr. Chung Hil Lan Eric.

By order of the Board
Ng Hoi Ying, Michael
Chairman

Hong Kong, 14th September, 2007

* *For identification purpose only*