

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

CHINA DIGITAL WIRELESS INC
Form 10QSB
August 12, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended June 30, 2005

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from _____ to _____
Commission File Number 000-12536

CHINA DIGITAL WIRELESS, INC.

=====
(Exact name of small business issuer as specified in its charter)

NEVADA
(State or other jurisdiction of
incorporation or organization)

90-0093373
(IRS Employer Identification No.)

429 Guangdong Road
Shanghai, People's Republic of China 200001
(Address of principal executive offices)

(86 21) 6336-8686
(Issuer's telephone number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

As of August 10, 2005, 17,018,692 of the issuer's \$.001 par value common stock were outstanding.

Transitional Small Business Issuer Format Yes No

=====

FORM 10-QSB

For the Quarter Ended June 30, 2005

Table of Contents

	Page
PART I - FINANCIAL INFORMATION	
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS	
Consolidated Balance Sheets as of June 30, 2005 and 2004 (unaudited)....	3
Consolidated Statements of Income and Comprehensive Income for the	
Six Months Ended June 30, 2005 and 2004 (unaudited).....	4

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

Consolidated Statements of Shareholders' Equity (unaudited).....	5
Consolidated Statements of Cash Flows for the Six Months Ended	
June 30, 2005 and 2004 (unaudited).....	6
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS.....	19
ITEM 3. CONTROLS AND PROCEDURES.....	26
PART II - OTHER INFORMATION	
ITEM 6. EXHIBITS.....	27
SIGNATURES.....	28

2

PART I - FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

CHINA DIGITAL WIRELESS INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	December 31, 2004	June 30, 2005
	-----	-----
		(Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 75,511	\$ 1,719,41
Accounts receivable, net of allowance for doubtful accounts of \$47,922 and \$22,705	4,619,809	3,169,88
Inventories	101,696	582,84
Deferred tax assets	28,772	10,65
VAT recoverable	--	4,10
Common stock proceeds held in escrow	1,500,000	--
Prepaid consulting fee	--	175,00
Amounts due from related parties	4,987,956	3,642,07

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

Advances & deposits to suppliers	150,412	2,872,94
Total current assets	11,464,156	12,176,91
Property and equipment, net	1,198,509	1,308,71
Deposit for equipment purchase	--	153,35
Total assets	\$ 12,662,665	\$ 13,638,98
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 55,839	\$ 696,75
Deferred revenue	617,694	18,12
VAT payable	213,535	--
Income tax payable	312,763	308,97
Due to related parties	100,260	--
Other liabilities	287,025	271,63
Total current liabilities	1,587,116	1,295,48
Shareholders' equity:		
Common stock - \$0.001 par value, 100,000000 shares authorized, 17,018,692 shares issued and outstanding	17,019	17,01
Additional paid-in capital	4,229,974	4,229,97
Retained earnings	6,828,281	8,096,23
Accumulated other comprehensive income	275	27
Total shareholder's equity	11,075,549	12,343,49
Total liabilities and shareholders' equity	\$ 12,662,665	\$ 13,638,98

See accompanying notes to consolidated financial statements.

3

CHINA DIGITAL WIRELESS INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME

	Three Months ended June 30		Six Months en
	2004	2005	2004
	(unaudited)	(unaudited)	(unaudited)
Revenues:			
Products sales	\$ 2,815,589	\$ 803,693	\$ 4,914,465
Products sales to related parties	2,498,019	3,748,031	4,273,019
Information service revenue, net	790,201	301,987	1,659,031

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

Advertising service revenue, net	--	736,787	--
	-----	-----	-----
Total revenues	6,103,809	5,590,498	10,846,515
Cost of goods sold	2,586,342	815,660	4,526,396
Cost of goods sold to related parties	2,266,305	3,613,279	4,005,730
Cost of service	250,422	158,381	504,246
	-----	-----	-----
	5,103,069	4,587,320	9,036,372
Gross profit	1,000,740	1,003,178	1,810,143
Operating expenses:			
Selling	48,849	51,736	85,085
General and administrative	1,089,071	210,328	1,215,252
	-----	-----	-----
Total operating expenses	1,137,920	262,064	1,300,337
	-----	-----	-----
(Loss) Income from operations	(137,180)	741,114	509,806
Other revenue	--	127	--
Interest income (expense)	13,592	(4,130)	13,592
	-----	-----	-----
(Loss) Income before income taxes	(123,588)	737,111	523,398
Income tax provision	66,813	135,570	115,337
	-----	-----	-----
Net (loss) income	\$ (190,401)	\$ 601,541	\$ 408,061
	=====	=====	=====
Other comprehensive income (loss):			
Translation adjustments	\$ 482	\$ (2)	\$ 152
Comprehensive (loss) income	\$ (189,919)	\$ 601,539	\$ 408,213
	=====	=====	=====
Basic (loss) earnings per share	\$ (0.01)	\$ 0.04	\$ 0.03
Weighted average common shares outstanding	13,959,267	17,018,692	13,871,440

See accompanying notes to consolidated financial statements.

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

	Common Stock Shares	Amount	Paid-in Capital	Retained Earnings	Com Inc
	-----	-----	-----	-----	-----
Balance at December 31, 2003	13,782,636	\$ 13,783	\$ 1,436,217	\$ 5,233,652	\$
Recapitalization and reorganization	1,585,705	1,586	308,465	--	
Shares issued for consulting services	167,895	168	604,254	--	
Shares issued for proceeds of \$190,000 and consulting services	166,667	167	599,834	--	
Shares issued for net proceeds of \$1.5 million	1,315,789	1,315	1,498,685	--	
Offset by issuing cost	--	--	(217,481)	--	
Net income	--	--	--	1,594,629	
Translation adjustment	--	--	--	--	
	-----	-----	-----	-----	-----
Balance at December 31, 2004	17,018,692	\$ 17,019	\$ 4,229,974	\$ 6,828,281	\$
Net income (unaudited)	--	--	--	1,267,949	
Translation adjustment (unaudited)	--	--	--	--	
	-----	-----	-----	-----	-----
Balance at June 30, 2005	17,018,692	\$ 17,019	\$ 4,229,974	\$ 8,096,230	\$
	=====	=====	=====	=====	=====

See accompanying notes to consolidated financial statements.

5

CHINA DIGITAL WIRELESS INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months ended June	
	2004	2005
	-----	-----
	(unaudited)	(unaudited)
Cash flows from operating activities:		
Net income	\$ 408,061	\$ 1,267,
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	138,845	121,
Bad debt expenses	4,257	(25,

5

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

Issuance of common stock to consultants for services	1,014,423	
Deferred tax assets	(3,453)	18,
Changes in assets and liabilities:		
Accounts receivable	48,348	1,475,
Inventories	1,058,427	(481,
Other current assets	(216,235)	(3,050,
Accounts payable	(105,043)	640,
Deferred revenue	(16,242)	(599,
VAT recoverable and payable	83,414	(217,
Income tax payable	--	(3,
Due to related parties	--	(100,
Due from a related company	--	(1,234,
Other liabilities	206,190	(15,
	-----	-----
Net cash flows provided by (used in) operating activities	2,620,992	(2,204,
	-----	-----
Cash flows from investing activities:		
Purchase of property and equipment	(42,333)	(231,
Amounts due from related parties	(1,449,871)	2,580,
	-----	-----
Net cash flows (used in) provided by investing activities	(1,492,204)	2,348,
	-----	-----
Cash flows from financing activities:		
Recapitalization and reorganization	310,051	-
Proceeds from issuing redeemable common stock	1,690,000	-
Issuing cost	(217,481)	-
Escrow receivable	(1,500,000)	1,500,
	-----	-----
Net cash flows provided by financing activities	282,570	1,500,
	-----	-----
Foreign currency translation	162	
	-----	-----
Net increase in cash and cash equivalents	1,411,520	1,643,
Cash and cash equivalents, beginning of the period	1,713,748	75,
	-----	-----
Cash and cash equivalents, end of the period	\$ 3,125,268	\$ 1,719,
	=====	=====
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$ --	\$ -
Income taxes	118,790	254,

See accompanying notes to consolidated financial statements.

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

China Digital Wireless, Inc. ("CDW"), formerly known as Boulder Acquisitions, Inc., sells mobile phones to retailers, distributors, and related parties and provides information services to users of mobile phones and pagers. Substantially all of CDW's operations are in Shanghai, People's Republic of China (the "PRC").

In order to meet ownership requirements under Chinese law that restrict a foreign company from operating in certain industries such as value-added telecommunication and Internet services, CDW's subsidiaries have entered into information service and cooperation agreements with two of CDW's affiliates that are incorporated in the PRC, Shanghai Sifang Information Technology Co. ("Sifang Information") and Shanghai Tianci Industrial Group Co., Ltd. ("Tianci"). CDW holds no ownership interest in Sifang Information or Tianci. Sifang Information and Tianci contract with China Mobile Communications Corporation ("China Mobile") and China United Telecommunications Corporation ("China Unicom"), respectively, to provide wireless value-added information services to wireless receiver customers in China via China Mobile and China Unicom. Sifang Information transmits those services to customers of China Mobile and China Unicom on behalf of itself and Tianci pursuant to a signed agreement between Sifang Information and Tianci.

Recapitalization and Reorganization

On June 23, 2004, Boulder Acquisitions, Inc. ("Boulder Acquisitions") entered into a stock exchange agreement with Sifang Holdings Co. Ltd. ("Sifang Holdings") and certain shareholders. Pursuant to the stock exchange agreement, Boulder Acquisitions issued 13,782,636 shares of its common stock in exchange for a 100% equity interest in Sifang Holdings, making Sifang Holdings a wholly owned subsidiary of Boulder Acquisitions.

Boulder Acquisitions was incorporated under the laws of the State of Colorado on May 8, 1980 as Boulder Brewing Company ("Boulder Brewing"). Boulder Brewing was the successor to a general partnership formed in 1979. From the initial inception of the original partnership through 1990, Boulder Brewing was in the business of operating a microbrewery in Boulder, Colorado. During 1990, as a result of various debt defaults, Boulder Brewing's assets were foreclosed upon and all business operations were ceased. Boulder Brewing has effectively had no operations, assets or liabilities since its fiscal year ended December 31, 1990.

In September 2001, Boulder Brewing changed its state of incorporation from Colorado to Nevada by means of a merger with and into Boulder Acquisitions, a Nevada corporation formed on September 6, 2001 solely for the purpose of effecting the reincorporation. The Articles of Incorporation and Bylaws of the Nevada corporation are the Articles of Incorporation and Bylaws of the surviving corporation. Such Articles of Incorporation eliminated the provision for Boulder Acquisitions to issue preferred stock.

The above stock exchange transaction resulted in those shareholders of Sifang Holdings obtaining a majority voting interest in Boulder Acquisitions. Generally accepted accounting principles in the United States of America require that the company whose shareholders retain the majority interest in a combined business be treated as the acquirer for accounting purposes. Consequently, the stock exchange transaction has been accounted for as a recapitalization of Sifang Holdings as Sifang Holdings acquired a controlling equity interest in Boulder Acquisitions, as of June 23, 2004. The reverse acquisition process utilizes the capital structure of Boulder Acquisitions and the assets and liabilities of Sifang Holdings recorded at historical cost.

Sifang Holdings is the continuing operating entity for financial reporting purposes, and the financial statements prior to June 23, 2004 represent Sifang Holdings' financial position and results of operations. As of June 23, 2004, Boulder Acquisitions had only cash of \$310,051, and shareholders' equity of

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

\$310,051 with 1,585,705 shares of common stock outstanding, all of which were included in the consolidated financial statements of Sifang Holdings. Please see the shareholders' equity statement for the period from January 1, 2004 to March 31, 2005. Although Sifang Holdings is deemed to be the acquiring corporation for financial accounting and reporting purposes, the legal status of Boulder Acquisitions as the surviving corporation did not change. Subsequent to June 30, 2004, Boulder Acquisitions changed its name to China Digital Wireless, Inc.

7

Business History

CDW's business is primarily conducted through its wholly-owned subsidiary Sifang Holdings Co., Ltd., ("Sifang Holdings") and its wholly-owned subsidiary TCH Data Technology Co., Ltd. ("TCH"). Sifang Holdings was established under the laws of the Cayman Islands on February 9, 2004 for the purpose of acquiring a 100% equity interest in TCH. TCH was established as a foreign investment enterprise in Shanghai under the laws of the PRC on May 25, 2004, with registered capital of \$7.2 million.

CDW's current operations were originally a business division of Sifang Information. Sifang Information is a Shanghai-based privately owned enterprise established under the laws of the PRC on August 14, 1998. Sifang Information is engaged in the business of pager and mobile phone distribution and provides value-added information services to the customers in the Shanghai metropolitan area. In March 2004, Sifang Information spun off its mobile phone distribution business and the majority of its value added information services business to TCH. As the acquiring entity under common control, TCH initially recognized all the assets and liabilities transferred at their carrying amounts in the accounts of Sifang Information at the date of transfer under the guidance of SFAS No. 141, Appendix D.

On May 26, 2004, Sifang Information exchanged 100% of the equity interest in TCH for 100% of the equity interest in Sifang Holdings. Since the ultimate owners of the three entities were the same owners and the three entities remained under common control, the ownership exchange transaction was accounted for at historical costs under the guidance of SFAS No. 141, Appendix D. Prior to May 26, 2004, there were no activities in Sifang Holdings. As a result of the exchange of ownership between TCH and Sifang Holdings, TCH's historical financial statements became the historical financial statements of Sifang Holdings.

As a result of the spin-off, TCH engages in the business of mobile phone distribution and provides pager and mobile phone users with access to certain value-added information reformatted by TCH. TCH purchases mobile phones from first tier distributors and sells them to retailers and distributors with a mark-up. In the process of providing value-added information services through entering into monthly subscription agreements with various users, TCH purchases trading activity information from stock exchanges, comments and analysis on PRC stock markets provided by certain reputable security and investment companies, lottery information, weather forecast, and other value-added products and reformats the aforementioned information through decoding and recoding and then has the reformatted information transmitted by Sifang Information, via service contracts, to pager users. The value-added information is constantly saved on TCH's server in order for mobile phone users to dial in via China Mobile or China Unicom. By signing a monthly subscription agreement, wireless receiver users agree to make advance payments for our services for either three or six-month subscription periods.

In the spin-off process, the cost of sales included in the Company's financial

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

statements is directly related to the product revenue and the cost of services is directly related to different types of service. The business taxes (similar to sales taxes in the U.S.) are related only to service revenue at a tax rate of approximately 3.3%. The selling expenses are allocated based on the relationship between expense and revenue (such as commission) and payroll records. The general and administrative expenses are allocated based on management hours spent and payroll records. The income tax provision has been calculated on a separate company basis and is in line with the historical actual income tax provision at the Sifang Information level assuming that all income taxes had been paid by Sifang Information and no income tax liability was in existence in the periods reported in the accompanying financial statements. Management believes that the costs, operating expenses, interest expense, and income tax provision included in the Company's financial statements are a reasonable representation of the costs and expenses that would have been incurred if the Company had performed these functions as a stand-alone company.

8

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

These unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and the instructions to Form 10-QSB and Regulation S-B. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the Company's financial condition and results of operations for the interim periods presented in this Form 10-Q have been included. Operating results for the interim periods are not necessarily indicative of financial results for the full year. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

The Company's consolidated financial statements for the six months ended June 30, 2004 have been derived from the historical financial statements and accounting records of Sifang Information using the historical operating results and the historical basis of the assets and liabilities transferred to the Company in accordance with accounting principles generally accepted in the United States of America. Management believes that the assumptions underlying the accompanying financial statements are reasonable. However, the financial statements that are derived from Sifang Information's financial records may not necessarily reflect the Company's results of operations and cash flows had the Company been a stand-alone company.

Principles of Consolidation:

The consolidated financial statements for the six months ended June 30, 2005 include the accounts of CDW, its wholly owned subsidiary Sifang Holdings, and its wholly owned subsidiary TCH (collectively "the Company"). Substantially all of CDW's revenues are derived from the operations of TCH, which represents substantially all of CDW's consolidated assets and liabilities as of June 30, 2005. All significant intercompany accounts and transactions have been eliminated.

Foreign Currency Translations and Transactions

The Renminbi ("RMB"), the national currency of the PRC, is the primary currency

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

of the economic environment in which the operations of TCH are conducted. The Company uses the United States dollar ("U.S. dollars") for financial reporting purposes.

The Company translates TCH's assets and liabilities into U.S. dollars using the rate of exchange prevailing at the balance sheet date (at June 30, 2005, the prevailing exchange rate of the US dollar against the RMB was 8.2765), and the statement of income is translated at an average rate during the reporting period (the average rate of the US dollar against the RMB, during the reporting period, was 8.2765). Adjustments resulting from the translation of TCH's financial statements from RMB into U.S. dollars are recorded in shareholders' equity as part of accumulated comprehensive income. Gains or losses resulting from transactions in currencies other than RMB are reflected in the statement of income for the reporting periods.

Revenue Recognition

The Company derives revenues from the sale of mobile phones, advertisement designing service and the provision of wireless information services that are used on cell phones, pagers and prepaid phone cards. The Company additionally earns commission income ("Agency Income") from the sale of CDMA mobile phones on the behalf of a related party. The Company recognizes its revenues net of related business taxes and value added taxes.

Mobile Phone Sales

Revenues generated from the sale of mobile phones are recognized when the products are shipped to the distributor or retailer and when persuasive evidence of an arrangement exists, delivery of the products has occurred, customer

9

acceptance has been obtained, which means the significant risks and rewards of ownership have been transferred to the customer, the price is fixed or determinable, and collectibility is reasonably assured.

Advertising Service Revenue, Net

Advertising revenues are derived from advertisement designing, masterminding and producing services. The Company recognizes service revenues over the term of the noted agreement and/or when the services have been provided to the end user. The Company records the revenue from Shanghai Sifang Media Co. Ltd on a net basis in compliance with EITF 99-19, "Reporting Revenue Gross as a Principle versus Net as an Agent" because the Company is not the primary obligor in the arrangement, they receive a fixed fee from Shanghai Sifang Media Co., Ltd and they have no latitude in determining prices.

Information Services

The Company recognizes service revenues over the term of the noted agreement and/or when the services have been provided to the end user.

i) Information Services - TCH

By signing a subscription agreement, wireless receiver users agree to make payments for three to six-month subscriptions in advance. TCH records the proceeds as deferred revenue and amortizes the deferred revenue over the subscriptions period. When customers buy a pre-charged service card, the Company records the proceeds as deferred revenue. When a customer starts to use this

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

card to access the Company's server and starts to use a pager to access the aforementioned information, the Company identifies the subscription period and amortizes the deferred revenue over the subscription period.

ii) Information Services - Installing Agent

In response to a retailer's request, the Company has an installing agent install the Company's software on mobile phones, which are owned by the retailer. The retailer sells these phones for a premium covering a fee to be paid to the installing agent and pre-charged six-month subscription fee to be paid to the Company. After a customer using such a phone dials into the server to access the desired information, the server records a unique identification number installed on the mobile phone, which indicates that a specific phone user starts his or her subscription period. After the Company receives a detailed list from the installing agent regarding the number of phones that have been installed with the Company's software, the Company matches this information with a detailed list from the retailer setting forth how many of such phones have been sold. Based on the number of such phones sold, the Company records accounts receivable and deferred revenue correspondingly. At the date on which a customer starts to dial into the server, the six-month subscription period begins and the Company amortizes deferred revenue accordingly.

iii) Information Services - China Mobile and / or Unicom

Since April 2004, the revenue generated from selling pre-charged cards has gradually decreased while the revenue generated through monthly subscriptions with China Mobile and/or China Unicom (collectively, "Mobile Operators") has gradually increased as the Mobile Operators' billing systems have been enhanced. The Company's affiliates, Sifang Information and Tianci, contract with the Mobile Operators for the transmission of the Company's value-added information services. The Mobile Operators bill and collect from customers and then pass those fees (net of billing and collection service fees charged by the Mobile Operators) to Sifang Information and Tianci who in turn pass those fees to the Company. The Company recognizes net revenues based on the total amount paid by its customers, for which the Mobile Operators bill and collect on behalf of the Company. There is a time lag ranging from 10 days to 45 days between the end of the service period and the date the Mobile Operators send out their billing statements due to the segregated billing systems of each of the provincial subsidiaries of the Mobile Operators. The Company has not recognized service revenue based on the records provided by its own server but has performed a reconciliation on a monthly basis of the revenues recognized by the Company's server to the Mobile Operator's billing statement. In addition, the Mobile Operators charge a network usage fee based on a fixed per message fee multiplied by the excess of messages sent over messages received. (This type of service is

10

not covered by a monthly service subscription and the Company has no control whether it will occur or not.) Network usage fees charged by the Mobile Operators are reduced for messages received by the Company because the Mobile Operators separately charge the sender a fee for these transmissions.

The Company records the revenue from China Mobile / China Unicom on a net basis in compliance with EITF 99-19, "Reporting Revenues Gross as a Principle versus Net as an Agent" because the Company:

- o Is not the primary obligor in the arrangement, as it relies on Sifang Information to transmit the information services to the end user,
- o Has limited ability to adjust the cost of services by adjusting the

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

- design or marketing of the service,
- o Has limited ability to determine prices because the Company must follow the price policy within ranges prescribed by Mobile Operators, and
- o Has limited ability to assume risk of non-payment by customers.

The Company's dependence on the substance and timing of the billing systems of the Mobile Operators may require us to estimate portions of our reported revenue for wireless Internet services from time to time. As a result, subsequent adjustments may have to be made to our wireless Internet service revenue in our financial statements. As we do not bill our wireless Internet services users directly, we depend on the billing systems and records of the Mobile Operators to record the volume of our wireless Internet services provided, charge our users through mobile telephone bills and collect payments from our users and pay us.

Cash and Cash Equivalents

The Company considers all highly liquid investments with maturities of three months or less to be cash equivalents. The Company maintains its cash accounts at credit worthy financial institutions.

Accounts Receivable and Concentration of Credit Risk

During the normal course of business, the Company extends unsecured credit to retailers and distributors who are mainly located in the Shanghai metropolitan area. Typically, for mobile phone distributors, credit terms require payment to be made within 30 days of the sale. The Company does not require collateral from its customers. The Company's policy is to provide for an allowance for doubtful accounts that is based on 5% of total trade accounts receivable less amounts due from related parties and from the installing agent.

The Company regularly evaluates and monitors the creditworthiness of each customer on a case-by-case basis. The Company includes any account balances that are determined to be uncollectible in the overall allowance for doubtful accounts. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. The Company believes that its allowance for doubtful accounts was adequate as of June 30, 2004 and 2005. However, actual write-offs might exceed the recorded allowance.

The following table presents activities in the allowance for doubtful accounts.

	December 31, ----- 2004 -----	June 30, ----- 2005 ----- (Unaudited)
Beginning balance	\$ 28,158	\$ 47,922
Additions charged to expense	19,764	--
Recovered	--	(25,217)
Ending balance	\$ 47,922 =====	\$ 22,705 =====

Inventories

Inventories consist principally of mobile phones manufactured by name brand manufacturers with various features and are stated at the lower of cost (weighted-average) or market.

Prepaid Consulting Fee

Prepaid consulting fees consisted of the following at June 30, 2005 and December 31, 2004:

	December 31, ----- 2004 -----	June 30, ----- 2005 -----
(Unaudited)		
Fee for public relations and sourcing of financing	\$ --	\$ 175,000
	=====	=====

Rebates and Credits Receivable

In 2004, the Company's major vendor began providing rebates and credits if the Company meets certain sales volume levels prescribed by the vendor. As a result, the Company is entitled to receive certain rebates and credits for the inventory held and sold by the Company within the specified period of time as defined by its vendor through submitting the necessary application forms. In general, once the vendor approves these applications the amounts of these rebates and credits will be deducted from the Company's accounts payable to its vendor and decrease the cost of goods sold or inventory held correspondingly.

Capitalization of Software Costs

The Company's software is developed by an independent third party to enable pager users to accept certain recoded information which is transmitted, through affiliates, by the Company and enables mobile phone users to dial into the Company's server. The software is for internal use and gives the Company the ability to provide value added information services. In accordance with SOP 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," the Company capitalizes the external cost incurred to develop this internal-use software by an engineering company at the application development stage and amortizes that cost over the estimated economic life of the software (two or three years) which is consistent with the expected life of a particular type of mobile phone.

Property and equipment

Property and equipment are recorded at cost and are stated net of accumulated depreciation. Depreciation expense is determined using the straight-line method over the estimated useful lives of the assets as follows:

Buildings	20 years
Software	2-3 years
Vehicles and other equipment	2-5 years

Maintenance and repairs are charged directly to expense as incurred, whereas betterment and renewals are generally capitalized in their respective property accounts.

Impairment of Long-Lived Assets

The Company applies the provisions of Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), issued by the Financial Accounting Standards Board ("FASB"). SFAS No. 144 requires that long-lived assets be reviewed for impairment whenever events

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

or changes in circumstances indicate that the carrying amount of an asset may not be recoverable through the estimated undiscounted cash flows expected to result from the use and eventual disposition of the assets. Whenever any such impairment exists, an impairment loss will be recognized for the amount by which the carrying value exceeds the fair value. There was no impairment of long-lived assets in the six months ended June 30, 2004 and 2005.

Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents, accounts receivable, advances and deposits to supplier, accounts payable and other current liabilities are reasonable estimates of their fair value because of the short maturity of these items.

12

Stock Based Compensation

The Company utilizes FAS 123 "Accounting for Stock-Based Compensation," when accounting for stock based compensation and recognizes the fair value impact of the compensation granted to employees and consultants as a charge to net income in the period that the services associated with the compensation are incurred. The Company does not currently have a stock option plan.

Value Added Tax

TCH is subject to value added tax ("VAT") imposed by the PRC on TCH's domestic product sales. The output VAT is charged to customers who purchase mobile phones from TCH and the input VAT is paid when TCH purchases mobile phones from its vendors. The VAT rate ranges from 13% to 17%, depending on the types of products purchased and sold. The input VAT can be offset against the output VAT.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No 109, "Accounting for Income Taxes" ("SFAS No. 109"). SFAS No. 109 requires an entity to recognize deferred tax liabilities and assets. For the future tax consequence attributable to the difference between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are measured using the enacted tax rate expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company establishes a valuation when it is more likely than not that the assets will not be recovered.

The Company's Chinese subsidiary TCH is registered at Pudong District in Shanghai and subject to a favorable income tax rate of 15% compared to a normal income tax rate of 33% (30% for the central government and 3% for the local government) under current PRC tax laws. However, Sifang Information is registered in the Shanghai downtown and the area has been treated by the Shanghai Municipal Administration of Labor as an enterprise that provides unemployed and handicapped people with jobs. Accordingly, Sifang Information is entitled to a favorable income tax rate of 15% and qualifies for an income tax exemption for three years from January 1, 2000 to December 31, 2002, and a 50% income tax reduction for three years from January 1, 2003 to December 31, 2005. The income tax provisions presented in the Company's financial statements are based on the historical actual income tax rates of SFT at 7.5% for the six

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

months ended June 30, 2004. The income tax provision presented for the six months ended June 30, 2005 is based on 15%. The deferred tax assets are determined based on the historical income tax rates applicable at the TCH level.

There is no income tax for companies domiciled in the Cayman Islands. Accordingly, the Company's financial statements do not present any income tax provisions related to Cayman Islands tax jurisdiction.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Comprehensive (Loss) Income

The Company has adopted Statement of Financial Accounting Standard No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"), issued by the FASB. SFAS No. 130 establishes standards for reporting and presentation of comprehensive income (loss) and its components in a full set of general-purpose financial statements. The Company has chosen to report comprehensive income (loss) in the statements of income and comprehensive income. Comprehensive income (loss) is comprised of net income and all changes to stockholders' equity except those due to investments by owners and distributions to owners.

13

(Loss) Earnings Per Share

The Company presents earnings per share in accordance with the Statement of Financial Accounting Standards No. 128, "Earnings per Share" ("SFAS No. 128"). Basic earnings (loss) per share includes no dilution and is computed by dividing income (loss) available to common shareholders by the weighted average number of shares outstanding during the period. Diluted earnings (loss) per share reflects the potential dilution of securities that could share in the earnings of an entity if they were converted. The Company did not have any potentially dilutive common share equivalents as of June 30, 2004 and 2005.

NOTE 3 - EQUITY TRANSACTIONS

On June 23, 2004, the Company issued 167,895 shares of its common stock to a consultant for services relating to the reverse merger that was completed in fiscal 2004. The trading price of the Company's common stock on June 23, 2004 was \$3.60 per share, and accordingly, the fair value of 167,895 shares was \$604,422.

On June 23, 2004, the Company issued 166,667 shares of its common stock in exchange for services performed by an existing major shareholder of Boulder Acquisitions for his consulting services involved with the reverse merger. The common stock was issued at a price of \$1.14 per share in exchange for gross proceeds of \$190,000 based on a stock purchase agreement. The \$1.14 per share price was pre-negotiated between the Company and the shareholder before the reverse merger had been completed. Pursuant to the stock purchase agreement, the Company granted the existing shareholder an option which required the Company to

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

purchase up to the aforementioned 166,667 shares of common stock at a price of \$1.14 per share, such option being exercisable at any time after the date that is six months after the Company files a registration statement on Form SB-2 with the SEC, registering the shares purchased by the existing shareholder, up to and including the earlier of the date that such registration statement is declared effective by the SEC or the existing shareholder's shares are eligible for resale under Rule 144 under the Securities Act of 1933. According to Topic D-98 from the SEC, "Classification and Measurement of Redeemable Securities," these shares should be presented outside the permanent equity section. However, on November 12, 2004, the Company filed a Registration Statement on Form SB-2 with the SEC, for registration of these securities to be sold to the public by selling shareholders. On February 8, 2005, the SEC declared the registration statement effective and accordingly, the Company has recorded these shares in shareholders' equity as the contingency surrounding these shares expired as of February 8, 2005. On June 23, 2004, the trading price at the end of the day was \$3.60 per share. Due to the relationship between the parties, the difference between the price of \$1.14 per share and the price of \$3.60 per share was recorded as compensation by presenting \$410,001 in additional paid-in capital and in general and administrative expenses.

On June 28, 2004, the Company issued, in the aggregate, 1,315,789 shares of its common stock to three investors at a price of \$1.14 per share in exchange for gross proceeds of \$1,500,000 based on a stock purchase agreement. The \$1.14 per share price was pre-negotiated between the Company and the investors before the reverse merger had been completed. Pursuant to the signed stock purchase agreement, the Company granted to each of the three investors an option which requires the Company to purchase up to the aforementioned 1,315,789 shares, in the aggregate, of common stock at a price of \$1.14 per share, such option being exercisable at any time after the date that is six months after the Company files a Registration Statement on Form SB-2 with the SEC, registering the shares purchased by the existing stockholder, up to and including the earlier of the date that such registration statement is declared effective by the SEC or the existing shareholder's shares are eligible for resale under Rule 144 under the Securities Act of 1933. As of December 31, 2004, the proceeds of \$1.5 million were held in an escrow account with an agent who is related to a shareholder. As of December 31, 2004, the Company has treated the proceeds held in escrow as a current asset as the entire amount was released from escrow in March 2005 and paid to the Company. According to Topic D-98 from SEC, "Classification and Measurement of Redeemable Securities," these shares should be presented outside the permanent equity section. However, on November 12, 2004, the Company filed a Registration Statement on Form SB-2 with the SEC, for registration of these securities to be sold to the public by small business issuers. On February 8, 2005, the SEC declared the registration statement effective. Accordingly, the Company has recorded these shares in shareholders' equity as the contingency surrounding these shares expired as of February 8, 2005.

In connection with the June 28, 2004, issuance of common stock, the Company incurred share issuance costs of \$217,481 and accounted for it as a reduction of additional paid-in capital.

NOTE 4 - RELATED PARTY TRANSACTIONS

Related Party Relationships

The following parties are related through common ownership with the major shareholder of the Company.

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

Merchandise Sold to Related Parties

	Six months Ended June 30, 2004	2005
	-----	-----
	(Unaudited)	(Unaudited)
Shanghai Shantian Telecommunication Co. Ltd.	4,273,019	7,808,545
	-----	-----
	4,273,019	7,808,545
	=====	=====

During the six months ended June 30, 2005, TCH sold Samsung GSM mobile phones valued at \$7,808,545 (2004 - \$4,273,019) at a 3% (2004 - 6%) gross profit margin to Shantian. Accounts receivable include \$2,738,498 (2004 \$812,550) due from Shantian.

Advertising Services Rendered to Related Party

	Six months Ended June 30, 2004	2005
	-----	-----
	(Unaudited)	(Unaudited)
Shanghai Tianci Real Estate Co. Ltd.	--	1,124,742
	-----	-----
		1,124,742
	=====	=====

In January 2005, Shanghai Sifang Media Co., Ltd and TCH entered into the "Bank Digital TV's Cooperation Agreement", where TCH will assist in the promotion of TV ads for Shanghai Tianci Real Estate Co. Ltd. ("Tianci Real Estate"). TCH received a net fee of approximately \$1,125,000 for providing the service from January 2005 to June 30, 2005. There is an "Advertisement Agency Contract" between Tianci Real Estate and Shanghai Sifang Media Co., Ltd, which continues until November 2005 and it is expected that TCH will earn additional advertising service revenue during the term of the Advertising Agency Contract.

As of June 30, 2005 the accounts balance due from Tianci Real Estate was \$1,234,218. In early July 2005, TCH collected \$483,296 from Tianci Real Estate.

Service Provided by Related Party

	Six months Ended June 30, 2004	2005
	-----	-----
	(Unaudited)	(Unaudited)
Shanghai SFT Co., Ltd.	283,920	229,608
	-----	-----
	283,920	229,608
	=====	=====

In accordance with terms contained in signed service agreements between TCH and Sifang Information giving TCH the right to use Sifang Information's facility (which may not be owned by foreign investors at the present time) to transmit the reformatted information, the Company paid service fees of approximately \$283,920 and \$ 181,236 for the six months ended June 30, 2004 and 2005, respectively. The annual payments for the services have decline from

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

approximately \$567,000 to approximately \$362,472 from January 1, 2005.

During the six months ended June 30, 2005, Sifang Information also provided other management support and marketing services to TCH for \$48,372.

15

Amounts Due from Related Parties

	December 31, 2004	June 30, 2005
		(unaudited)
Shanghai SFT Co., Ltd.	\$ 4,987,956	2,407,852
Shanghai Tianci Real Estate Co. Ltd.	--	1,234,218
	4,987,956	3,642,070
	4,987,956	3,642,070

In order to develop the Company's mobile phone distribution business, the Company has signed an agreement to become Nokia's distributor (provincial level) of mobile phones. On March 20, 2005 TCH signed agreement with Sifang Information for cooperation on Nokia mobile phone's distribution, as TCH will act as an agent to sell Nokia phones on Sifang Information's behalf. As of June 30, 2005, TCH advanced \$2,407,852 (RMB19,900,000) to Sifang Information in order to help Sifang Information maintain enough working capital to purchase Nokia mobile phones and to establish marketing for channel distribution.

Deposit for Business Acquisition

In March 2005, TCH signed an agreement with Tianci that appointed Tianci as an agent for assisting with TCH's proposal to acquire assets and a related business from Shanghai Oriental New Window Company Limited ("Shanghai ONW"), whose main business was digital mobile television and digital media services. To initiate the acquisition, TCH advanced Tianci RMB20,000,000 (approximately \$2,418,000). In June 2005, the acquisition was finalized, and the Tianci repaid the advance to TCH and all related assets and business were transferred from Tianci to TCH with no mark up.

Due to Related Parties

	December 31, 2004	June 30, 2005
(unaudited)		
Shanghai Tianci Real Estate Co. Ltd	\$ 51,350	--
Shanghai Tianci Industry Group Co. Ltd.	48,910	--
	100,260	--
	100,260	--

NOTE 5 - SEGMENT REPORTING

The Company currently operates in four principal business segments. Management believes that the following table presents useful information to decision makers for measuring the Company's business performance and financing needs. As most of the Company's customers are located in the Shanghai metropolitan area and the Company's revenues are generated in Shanghai, no geographical segment information is presented.

	Advertising Service Revenue	Phone Sales	Mobile Phone Service	Beep Pagers Service	Corpo
	-----	-----	-----	-----	-----
Six months ended June 30, 2004					
Revenue	\$ --	\$ 9,187,484	\$ 1,050,200	\$ 608,831	\$ --
Gross profit	--	655,358	832,562	322,223	--
Depreciation	--	--	110,220	--	--
Interest income	--	--	--	--	--
Net income	--	425,583	616,824	145,940	7,443
Expenditures for long-lived assets	--	--	42,333	--	--
Total Assets, as of December 31, 2004	--	2,721,741	2,443,657	--	7,443
Six months ended June 30, 2005					
Revenue	\$ 1,124,742	\$ 9,281,429	\$ 620,606	\$ 339,083	\$ --
Gross profit	1,124,742	282,697	405,470	225,030	--
Depreciation	--	--	93,065	--	--
Interest (expense)	--	--	--	--	--
Net income	927,851	160,548	261,829	152,171	(2,000)
Expenditures for long-lived assets	157,264	--	74,638	--	--
Total Assets, as of June 30, 2005	157,264	6,665,011	297,021	--	6,500

NOTE 6 -EMPLOYEE WELFARE AND RETIREMENT BENEFITS

The PRC has been undergoing significant reforms with regard to its employee welfare and fringe benefits administration. Any enterprise operating in the PRC is subject to government-mandated employee welfare and retirement benefit contributions. In accordance with PRC laws and regulations, TCH participates in a multi-employer defined contribution plan pursuant to which TCH is required to provide employees with certain retirement, medical and other fringe benefits. PRC regulations require TCH to pay the local labor administration bureau a monthly contribution at a stated contribution rate based on the monthly basic compensation of qualified employees. The local labor administration bureau, which manages various investment funds, will take care of employee retirement,

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

medical and other fringe benefits. TCH has no further commitments beyond its monthly contribution. TCH contributed a total of \$14,849 and \$ 12,782 to these funds as part of selling, general and administrative expenses for the six months ended June 30, 2004 and 2005, respectively.

17

NOTE 7 - CAPITAL COMMITMENT

In May 2005, TCH signed contracts with two main providers for purchase of liquid crystal displays (LCDs) for TCH's digital wireless media services; the value of the contracts was about \$469,000. By the end of June 30, 2005, these purchase contracts were still carried out in process; there were about \$208,192 of LCDs, which TCH committed to purchase in July 2005 according to the purchase contracts.

NOTE 8 - SUBSEQUENT EVENT

At 19:00 on July 21, 2005, the People's Bank of China (the "PBoC") announced a revaluation of the Chinese currency Renminbi (RMB) or yuan, which immediately jolted international finance markets. The PBoC said that the RMB yuan will no longer be pegged to the US dollar, and at the same time it will be traded at a rate of 8.11 for the US dollar. According to the RMB's revaluation, as of June 30, 2005, the net assets of the Company would increase by about \$220,000 using the exchange rate of 8.11.

18

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion should be read in conjunction with our

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

financial statements and the notes thereto and the other financial information appearing elsewhere in this document. In addition to historical information, the following discussion and other parts of this document contain certain forward-looking information. When used in this discussion, the words "believes," "anticipates," "expects," and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those projected due to a number of factors beyond our control. We do not undertake to publicly update or revise any of the forward-looking statements herein even if experience or future changes show that the indicated results or events will not be realized. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof.

Overview of Business Background

Sifang Holdings was formed under the laws of the Cayman Islands on February 9, 2004 for the purpose of holding a 100% equity interest in TCH. TCH was established as a foreign investment enterprise in Shanghai under the laws of the PRC on May 25, 2004, with registered capital of \$7.2 million.

Sifang Information is a Shanghai-based privately owned enterprise established under the laws of the PRC on August 14, 1998. Sifang Information is engaged in the business of pager and mobile phone distribution and provides value added information services to customers in the Shanghai metropolitan area. In March 2004, Sifang Information spun off its mobile phone distribution business and the majority of its value added information services business by presenting a set of carve-out financial statements for the years ended December 31, 2002 and 2003 and six months ended June 30, 2004 as if the spun-off business had been a stand-alone company for two years and one quarter. On June 30, 2004, Sifang Information transferred the spun-off business into TCH. Being a receiving entity under common control, TCH initially recognized all the assets and liabilities transferred at their carrying amounts in the accounts of Sifang Information at the date of transfer under the guidance of SFAS No. 141, Appendix D. On May 26, 2004, Sifang Information exchanged 100% of its equity interest in TCH for a 100% equity interest in Sifang Holdings. Since the ultimate owners of the three entities were the same owners and the three entities remained under common control, the ownership exchange transaction was accounted for at historical costs under the guidance of SFAS No. 141, Appendix D. Prior to May 26, 2004, there were no activities in Sifang Holdings. As a result of exchanging the ownership between TCH and Sifang Holdings, TCH's historical financial statements become the historical financial statements of Sifang Holdings.

Sifang Information operates in a business segment that is subject to certain restrictions imposed by the government of the PRC. For example, paging facilities, radio transmitting stations and transmitting equipment owned by Sifang Information are not allowed to be owned by foreign investment enterprises in accordance with PRC government regulations. Therefore, Sifang Information still maintains a small part of its business and paging facilities in order to stay in compliance with relevant regulations and laws in PRC.

As a result of the spin-off, TCH engages in the business of mobile phone distribution and provides pager and mobile phone (collectively "wireless receiver") users with access to certain information reformatted by TCH. TCH purchases mobile phones from first tier distributors and sells them to retailers with a mark-up. In the process of providing value-added information services through entering into monthly subscription agreements with various users, TCH purchases trading activity information from stock exchanges, comments and analysis on PRC stock markets provided by certain reputable security and investment companies, lottery information, weather forecast, and other value-added products and reformats the aforementioned information through decoding and recoding and then has the reformatted information transmitted by Sifang Information, via service contracts, to pager users. The information is

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

constantly saved in TCH's server in order for mobile phone users to dial in via China Mobile or China Unicom. By signing a monthly subscription agreement, wireless users agree to make advance payments for either three or six-month subscription periods.

Discussion and Analysis of Operating Results

Six Months Ended June 30, 2005 Compared to Six Months Ended June 30, 2004

Revenue

Total Revenues

19

Total sales revenues for the six months ended June 30, 2005 increased by \$519,345, representing an approximately 4.8% increase, to \$11,365,860 as compared to \$10,846,515 for the same period of the prior year. The increase was mainly due to our marketing effort and further facilitated by Samsung's marketing promotion. Total sales revenues consist of product sale, product sales to related parties, and net of information and advertising service revenue. In the Chinese telecommunication market, mobile phones have rapidly replaced beepers and pagers, resulting in an increase in mobile phone distribution. In the six months ended June 30, 2005, Samsung's mobile phones accounted for about 97% of our total product sales and other name brands mobile phones accounted for the remaining 3%, compared to the same period of the prior year, in which Samsung's mobile phones accounted for 95% of our total product sales and other brands accounted for the balance. During 2005, market competition for mobile phone sales intensified, causing us to decrease our overall mark-up ratio to 3.0% in order to maintain our market position, in comparison with a mark-up ratio of 7.1% for the same period of the prior year.

Product Sales

Revenue for product sales in the six months ended June 30, 2005 decreased by approximately \$3,441,581, representing a material decrease to \$1,472,884 as compared to \$4,914,465 for the same period of the prior year. Since 2004, we have cultivated our related party, Shanghai Shantian, to be in a good position to distribute mobile phones by establishing its market channel and facility. In focusing our marketing efforts on Shanghai Shantian, there has been a decline in mobile phone sales directly to customers.

We entered an agreement to exclusively distribute select Nokia mobile phones in the Shanghai region of China in May 2005 and now have obtained the right to distribute two popular models of Nokia's mobile phones. We believe that this agreement will enhance both our market share and profitability. In June, we distributed approximately \$62,000 worth of Nokia mobile phones to our customers with a mark-up of approximately 8% compared to the other brands we have been selling. We continue to strengthen our relationship with Nokia and diversify the mobile phone portfolio to be responsive to market changes and product innovation. The relationship will allow us to benefit from Nokia's position as the leading manufacturer of mobile phones worldwide and Nokia's leadership in the rapidly growing mobile phone market in China.

Product sales to a related party

We distribute Samsung mobile phones to our related party, Shanghai Shantian, in which Sifang Information holds a 51% equity interest, for its retail market channel and facility. During the six month period ended June 30,

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

2005, we sold \$7,808,545 worth of mobile phones to Shantian, with an average mark-up of approximately 3.0%.

Information service revenue, net

Total information service revenue net of related business tax and surcharge for the six months ended June 30, 2005 increased by \$699,342, representing an approximately 42.1% decrease, to \$959,689 compared to \$1,659,031 for the same period of the prior year. Value-added service revenue from mobile phone users for the six months ended June 30, 2005 decreased by \$429,594 to \$620,606 compared to \$1,050,200 for the same period of the prior year, representing a 40.9% decrease. The decrease was mainly due to the decline of our financial value-added service. The sluggish Chinese stock market along with inactive stock exchanges hindered our growth in this segment of business. In addition, service revenue from pager users for the six months ended June 30, 2005 dropped by \$269,748 to \$339,083 compared to \$608,831 for the same period of the prior year, representing an approximately 44.3% decrease. We believe that service revenue from pager users will continue to decrease given the increased popularity of mobile phones over beepers and pagers. We project that the decrease in service revenue from pager users will likely plateau at a certain level as most lower income pager users still prefer to use pagers to access our information services.

Advertising service revenue, net

We launched a new digital media project to move into the media market in China in 2005. In conjunction with charitable organizations, we have installed donation boxes with digital TV incorporated on top of them and placed in the main lobbies of commercial banks, hotels, malls and other public locations to call the public's attention to the charity and broadcast commercial advertisements.

During the six months ended June 30, 2005, TCH rendered advertisement designing and producing services to Tianci Real Estate for publicity and promoting its apartment. Net service revenue of \$ 1,124,742 was derived from this service. We have placed more than 400 multimedia donation boxes in the inbound area of Shanghai and other arranged spots will be rolled out in the public places with high traffic flow. Based on Shanghai, our strategy is to

20

expand our network to penetrate other large and mid-sized developed cities throughout the PRC. We believe the earnings potential from the advertising service will be a new source of profit in view of the upcoming Special Olympic World Summer Games in 2007 and Word Exposition in 2010 to be held in Shanghai.

Cost of goods sold

The cost of goods sold for the six months ended June 30, 2005 increased by \$466,606 to \$8,998,732 compared to \$8,532,126 for the same period of the prior year, representing an approximately 5.5 % increase. The increase was consistent with the increases of revenue from product sales.

Cost of service

The cost of service for the six months ended June 30, 2005 decreased by \$175,057 to \$329,189 compared to \$504,246 for the same period of the prior year,

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

representing an approximately 34.7% decrease. The decline was mainly due to the decrease of information fees paid to content providers for the value-added service. The breakdown of our service business has changed and the proportion of beep services that are related to financial service has decreased, resulting in a decrease in associated costs pertaining to the securities information fee paid. During 2005, we have continued to maintain current fee structures and establish collaborative relationships or partnerships with Chinese mobile operators and certain information content providers.

Gross profit

After taking into account the cost of goods sold and cost of service, our gross profit for the six months ended June 30, 2005 increased by approximately \$227,796 to \$2,037,939, representing a 12.5% increase, compared to gross profit of \$1,810,143 for the same period of the prior year. The increase in gross profit was primarily attributable to the proceeds generated from the new advertising service during the first half of 2005.

The following table summarizes certain information related to the various components of revenue

	Advertising Service Revenue	Phone Sales	Information Service - Mobile Phone	Informa Servic Page
	-----	-----	-----	-----
For six months ended June 30, 2005				
Revenue	\$ 1,124,742	\$ 9,281,429	\$ 620,606	\$ 339,080
Cost		8,998,732	195,369	133,820
Gross profit	1,124,742	282,697	425,237	205,260
Gross profit ratio	100%	3.0%	68.5%	60.5%
For six months ended June 30, 2004				
Revenue	\$ -	9,187,484	\$ 1,050,200	\$ 608,830
Cost	-	8,532,126	217,638	286,600
Gross profit	-	655,358	832,562	322,230
Gross profit ratio	-	7.1%	79.3%	52.9%

Selling expenses

Selling expenses for the six months ended June 30, 2005 increased by \$9,940 to \$95,025 compared to \$85,085 for the same period of the prior year, representing an increase of 11.7%. The increase was primarily due to the office expenses and fringe benefits attributable to our marketing department. Furthermore, the commission fees paid to the salesmen for mobile phones

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

increased, which was offset by the decline in the advertising expenses.

General and administrative expenses

General and administrative expenses for the six months ended June 30, 2005 decreased by \$812,885 to \$402,367 compared to \$1,215,252 for the same period of the prior year, representing a 66% decrease. The higher expenses in 2004 were mainly due to a one time non-cash compensation of \$1,014,000 related to the reverse merger that was generated at parent level, consisting of 167,895 shares issued to a consultant in lieu of cash payment at a fair market value of \$604,000 and the issuance of 166,667 redeemable shares pursuant to a stock purchase agreement resulting in a charge of \$410,000 representing the premium between the trading price (\$3.60 per share) and the pre-negotiated stock purchase price (\$1.14 per share) of the shares.

General and administrative expenses incurred at the TCH level for the six months ended June 30, 2005 decreased from \$200,830 to \$186,648, representing a slight decrease. The decrease was primarily attributable to the collection of accounts receivable from our clients, resulting in the recovery of provisions for bad debts, and cost control, which led to the decline of utility expenses and communication fees.

The other cash-based expenses incurred at the parent level in the six months ended June 30, 2005 of \$215,719 represent payments for the audit fees, retainer fees and other consultant fees.

Interest income (expense)

During the six months ended June 30, 2004, interest income derived from bank deposits was \$13,592.

During the six months ended June 30, 2004, interest income derived from banks deposits was \$1,800, while the finance expense incurred in discounting bank drafts from our clients was \$5,465.

Income tax

The income tax provisions presented in the Company's financial statements are based on the historical actual income tax rates of Sifang Information at 7.5% for the six months ended June 30, 2004 and 15% for the six months ended June 30, 2005. For the six months ended June 30, 2004 and 2005, income tax expense was \$115,337 and \$269,060 respectively, based on pretax income of \$523,398 (which included the stock compensation of \$1,014,000 incurred in the U.S.) and pretax income \$1,537,009, respectively. Because the loss of approximately \$1,014,000 incurred in the U.S. cannot offset the taxable income in the PRC, the income tax expense of \$115,337 incurred in the PRC was based on the taxable income of approximately \$1,537,000 during the six months ended June 30, 2004.

Comprehensive income

We recorded comprehensive income of \$1,267,945 for the six months ended June 30, 2005, a \$859,732 increase in net income compared to net income of \$408,213 for the same period of the prior year, representing a significant increase. The increase in net income was attributable to (i) the non-cash expenses that offset the net profit generated in the six months ended June 30, 2004, and (ii) the contribution of our new advertising business that was initiated in the first six months of 2005.

Earnings per share

The earnings per share for the six months ended June 30, 2005 was \$0.07

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

compared to \$0.03 for the same period of the prior year.

Three Months Ended June 30, 2005 Compared to Three Months Ended June 30, 2004

22

Revenue

Product Sales

Revenue from product sales for the three months ended June 30, 2005 decreased by approximately \$2,011,000, representing an approximately 8.1% decrease, to \$803,693 as compared to \$2,815,589 for the same period of the prior year. Since 2004, we have cultivated our related party, Shanghai Shantian, to be in a good position to distribute mobile phones by establishing its market channel and facility. In focusing our marketing efforts on Shanghai Shantian there has been a decline in direct sales.

We entered an agreement to exclusively distribute select Nokia mobile phones in the Shanghai region of the PRC in May 2005 and have now obtained the right to distribute two popular models of Nokia's mobile phones. We believe that this agreement will enhance both our market share and profitability. In June, we took the initiative to distribute approximately \$62,000 worth of Nokia's mobile phone to our customers with a mark-up of approximately 8% more than the other brands we have been selling. We will continue to strengthen our relationship with Nokia and diversify the mobile phone portfolio to be responsive to market changes and product innovation. The relationship will allow us to benefit from Nokia's position as the leading manufacturer of mobile phones worldwide and Nokia's leadership in the rapidly growing mobile phone market in the PRC.

Product sales to a related party

We distribute Samsung mobile phones to our related party, Shanghai Shantian, in which Sifang Information holds a 51% equity interest, for its retail market channel and facility. During the three month period ended June 30, 2005, we sold \$3,748,031 worth of mobile phones to Shanghai Shantian, with an average mark-up of approximately 3.6%.

Information service revenue, net

Total information service revenue net of related business tax and surcharge for the three months ended June 30, 2005 decreased by \$488,214 representing approximately a 61.8% decrease, to \$301,987 compared to \$790,201 for the same period of the prior year. Value-added service revenue from mobile phone users for the three months ended June 30, 2005 decreased by \$358,727 to \$170,509 compared to \$529,235 for the same period of the prior year, representing a 67.8% decrease. The decrease was due mainly to the decline of our financial value-added service. The sluggish Chinese stock market along with inactive stock exchanges hindered our growth in this segment of business. In addition, service revenue from pager users for the three months ended June 30, 2005 decreased by \$129,488 to \$131,478 compared to \$260,966 for the same period of the prior year, representing approximately a 49.6% decrease. We believe that service revenue from pager users will continue to decrease given the increased popularity of mobile phones over beepers and pagers. We project that the decrease in service revenue from pager users will likely plateau at a certain level as most lower income pager users still like to use pagers to access our information services.

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

Advertising service revenue, net

During the three months ended June 30, 2005, TCH rendered advertisement designing and producing services to Tianci Real Estate for publicity and promoting its business. Net advertising service revenue of \$736,787 was derived from this source.

Cost of goods sold

The cost of goods sold for the three months ended June 30, 2005 decreased by \$423,708 to \$4,428,939 compared to \$4,852,647 for the same period of the prior year, representing a slight decrease. The decrease was consistent with the decreases in revenue from product sales.

Cost of service

The cost of service for the three months ended June 30, 2005 decreased by \$92,041 to \$158,381 compared to \$250,422 for the same period of the prior year, representing an approximately 36.7% decrease. The costs of service consist of value-added service costs and advertising service costs. The decline was due mainly to the decrease of information fees paid to content providers for the

23

value-added service. The breakdown of our service business has changed and the proportion of beep services that are related to financial service has decreased, resulting in a decrease in associated costs pertaining to the securities information fee paid. During 2005, we have continued to maintain current fee structures and establish collaborative relationships or partnerships with Chinese mobile operators and certain information content providers.

Gross profit

After taking into account the cost of goods sold and cost of service, our gross profit for the three months ended June 30, 2005 increased by approximately \$2,438 to approximately \$1,034,761, representing a slight increase, compared to gross profit of \$1,000,740 for the same period of the prior year. The increase in gross profit was primarily attributable to the proceeds generated in the new advertising service which offset the decrease in information service during the first half of 2005.

The following table summarizes certain information related to the various components of revenue

	Advertising Service Revenue -----	Phone Sales -----	Information Service - Mobile Phone -----	Informati Service Pager -----
For the quarter ended June 30, 2005				
Revenue	\$ 736,787	\$ 4,551,724	\$ 170,509	\$ 131,4
Cost	4,428,939	92,043	66,338	4,587,3
Gross profit	736,787	122,785	78,466	65,1
Gross profit ratio	100%	2.7%	46.0%	49

For the quarter ended June 30, 2004

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

Revenue	\$	--	5,313,608	\$	529,235	\$	260,9
Cost		--	4,852,647		145,620		104,8
Gross profit		--	460,961		383,615		156,1
Gross profit ratio		--	8.7%		72.5%		59

Selling expenses

Selling expenses for the three months ended June 30, 2005 increased by \$2,888 to \$51,736 compared to \$48,849 for the same period of the prior year, representing a 5.9% increase. The increase was mainly due to the increase of commission fees paid to the salesmen for mobile phones. This was offset by the decline of advertising expense.

General and administrative expenses

General and administrative expenses for the three months ended June 30, 2005 decreased by \$878,743 to \$210,328 compared to \$1,089,071 for the same period of the prior year, representing an 80.6% decrease. The higher expenses in 2004 were mainly due to a one time non-cash compensation of \$1,014,000 related to the reverse merger that was generated at parent level, consisting of 167,895 shares issued to a consultant in lieu of cash payment at a fair market value of \$604,000 and the issuance of 166,667 redeemable shares pursuant to a stock purchase agreement resulting in a charge of \$410,000 representing the premium between the trading price (\$3.60 per share) and the pre-negotiated stock purchase price (\$1.14 per share) of the shares.

General and administrative expenses incurred at the TCH level in the three months ended June 30, 2005 increased from \$74,649 to \$84,647, representing a \$9,997 increase. The increase was primarily attributable to the increase of audit fees and consultant fees. This was offset by the decrease of office expense and other expenses for administration.

In June 2005, we signed a Consulting Agreement with HNZ Bearings Point Inc., a firm that helps companies with fund raising and arranging investor conferences. Under this agreement, we prepaid \$45,000 for consulting fees for

24

the first three months of service. Also in June 2005, we entered an agreement with Insight Communication Inc., and prepaid \$130,000 for its management consulting and advisory services. These prepaid consulting fees will be recorded in the next quarter accordingly.

Interest income (expense)

During the three months ended June 30, 2004, interest income derived from deposits in banks was \$13,592.

During the three months ended June 30, 2005, interest income derived from deposits in banks was \$1,335; the finance expense incurred in discounting the bank draft was \$5,465.

Income tax

The income tax provisions presented in the Company's financial statements are based on the historical actual income tax rates of Sifang Information at 7.5% for the three months ended June 30, 2004 and 15% for the

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

three months ended June 30, 2005. In the three months ended June 30, 2004 and 2005, income tax expense was \$66,813 and \$135,570, respectively, based on pretax loss of \$123,588 (which included the stock compensation of \$1,014,000 incurred in the U.S.) and pretax income \$737,111. Because the loss of approximately \$1,014,000 incurred in the U.S. did not offset the taxable income in the PRC, the income tax expense of \$66,813 incurred in the PRC was based on the taxable income of approximately \$1,205,000 during the three months end June 30, 2004.

Net income

We recorded net income of \$601,541 for the three months ended June 30, 2005 compared to a net loss of \$190,401 for the same period of the prior year, representing a significant increase. The increase in net income was attributable to (i) the non-cash expenses offsetting the net profit generated in the three months ended June 30, 2004, and (ii) the contribution of our new advertising business.

Earnings per share

The earnings per share for the three months ended June 30, 2005 was \$0.04 compared to negative \$0.01 for the same period of the prior year.

Liquidity and Capital Resources

Our net cash generated during the six months ended June 30, 2005 increased from approximately \$75,511 as of December 31, 2004 to approximately \$1,719,410 as of June 30, 2005.

Net cash flows used in operating activities was \$2,204,299 during the six months ended by June 30, 2005 compared to cash generated of \$2,620,992 during the same period of the prior year. The decrease in cash provided was due to the cash used in other current assets and the related party despite the cash generated from net income and the collection of accounts receivable.

Net cash flows generated in investing activities for the six months ended June 30, 2005 reached \$2,348,202 compared to cash flows used \$1,492,204 for the same period of the prior year, representing a material positive increase. The cash generated in investing activities was mainly due to the return of the money invested in related parties.

Net cash provided by financing activities for the six months ended June 30, 2005 was \$1,500,000 compared to \$282,570 for the same period of the prior year. The \$1,500,000 relates to proceeds for shares that were issued in fiscal 2004 but were held in escrow until the Company filed a Registration Statement on Form SB-2 with the SEC. The Company treated the proceeds held in escrow as a current asset as the entire amount was released from escrow in March 2005 and paid to the Company.

We believe that current cash balance and cash flows from operations, if any, will be sufficient to meet present growth strategies and related working capital. In regards to the capital expenditures, we have sufficient funds to expand our operations. We plan to utilize a combination of internally generated funds from operations with potential debt and/or equity financings to fund its longer-term growth over a period of two to five years. The availability of future financings will depend on market conditions. There is no assurance that the future funding will be available.

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

The forecast of the period of time through which our financial resources will be adequate to support operations is a forward-looking statement that involves risks and uncertainties.

Recent Accounting Pronouncements

In December 2003, the FASB issued Interpretation No. 46R ("FIN 46R"), a revision to FIN 46, "Consolidation of Variable Interest Entities". FIN 46R clarifies some of the provisions of FIN46 and exempts certain entities from its requirements. FIN 46R is effective at the end of the first interim period ending after March 15, 2004. Entities that have adopted FIN 46 prior to this effective date can continue to apply the provisions of FIN 46 until the effective date of FIN 46R. The adoption of FIN 46R did not have any effect on the Company's consolidated financial statements.

In March 2004, the FASB issued EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-1") which provides new guidance for assessing impairment losses on debt and equity investments. Additionally, EITF 03-1 includes new disclosure requirements for investments that are deemed to be temporarily impaired. In September 2004, the FASB delayed the accounting provisions of EITF 03-1. The Company will evaluate the effect, if any, of EITF 03-1 when final guidance is released.

In November 2004, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 151, Inventory Costs, which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. SFAS No. 151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not believe the adoption of SFAS No. 151 will have a material impact on our consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123-R, Share Based Payments, which requires that the compensation cost relating to share-based payment transactions (including the cost of all employee stock options) be recognized in the financial statements. The cost will be measured based on the estimate fair value of the equity or liability instruments issued. SFAS 123-R covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Management believes the adoption of this pronouncement will not have a material effect on our consolidated financial statements.

Also, in December 2004, the FASB issued SFAS 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions." The amendments made by SFAS No. 153 are based on the principle that the exchange of nonmonetary assets should be measured using the estimated fair market value of the assets exchanged. SFAS No. 153 eliminates the narrow exception for nonmonetary exchanges of similar productive assets, and replaces it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has "commercial substance" if the future cash flows of the entity are expected to change significantly as a result of the transaction. This pronouncement is effective for monetary exchanges in fiscal periods beginning after June 15, 2005. Management believes the adoption of this pronouncement will not have a material effect on our consolidated financial statements.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

ITEM 3. CONTROLS AND PROCEDURES

Prior to the conclusion of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13(a)-14(c). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to us (including our consolidated subsidiaries) required to be included in our periodic SEC filings.

There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out this evaluation.

26

PART II OTHER INFORMATION

ITEM 6. EXHIBITS

The following documents are filed as part of this report:

- 31.1 Chief Executive Officer Certification furnished pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Chief Financial Officer Certification furnished pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Chief Executive Officer Certification furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Chief Financial Officer Certification furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

27

Edgar Filing: CHINA DIGITAL WIRELESS INC - Form 10QSB

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHINA DIGITAL WIRELESS, INC.
(Registrant)

Date: August 12, 2005

/s/ Fu Sixing

Fu Sixing, Chief Executive Officer

Date: August 12, 2005

/s/ Qian Fang

Qian Fang, Chief Financial Officer