



Annual Report 2005

山西長城微光器材股份有限公司

Shanxi Changcheng Microlight Equipment Co. Ltd.*

(a joint stock limited company incorporated in the People's Republic of China) (Stock code: 8286)

* For identification only

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This report, for which the directors (the "Directors") of Shanxi Changcheng Microlight Equipment Co. Ltd. (the "Company") collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM for the purpose of giving information with regard to the Company. The Directors, having made all reasonable enquires, confirm that, to the best of their knowledge and belief: 1) the information contained in this report is accurate and complete in all material respects and not misleading; 2) there are no other matters the omission of which would make any statement in this report misleading; and 3) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

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CORPORATE INFORMATION

BOARD OF DIRECTORS

Executive Directors

Wang Gen Hai (*Chairman*)

Li Kang Sheng

Tian Qun Xu

Non-executive Director

Lin Yin Ping

Independent Non-executive Directors

Ni Guo Qiang

Shen Ming Hong

Li Li Cai

Chen Yue Jie

SUPERVISORS

Zhang Fu Sheng

Meng Yan

Wang Guang Hua

Bai Yin Quan

COMPANY SECRETARY

Poon Shiu Cheong *CPA*

COMPLIANCE OFFICER

Wang Gen Hai

AUTHORISED REPRESENTATIVES

Wang Gen Hai

Poon Shiu Cheong *CPA*

QUALIFIED ACCOUNTANT

Poon Shiu Cheong *CPA*

AUDITORS

Grant Thornton

PRINCIPAL BANKERS

DBS Bank (Hong Kong) Limited

Taiyuan City Commercial Bank

Hua Xia Bank

Industrial and Commercial Bank of China

AUDIT COMMITTEE

Ni Guo Qiang (*Committee Chairman*)

Shen Ming Hong

Li Li Cai

Chen Yue Jie

HONG KONG SHARE REGISTRAR AND TRANSFER OFFICE

Standard Registrars Limited

26/F Tesbury Centre

28 Queen's Road East

Hong Kong

REGISTERED OFFICE

No. 212 Nanneihuan Street

Taiyuan City

Shanxi Province

PRC

PRINCIPAL PLACE OF BUSINESS IN HONG KONG

Rooms 1318-20, 13th Floor

Hollywood Plaza

610 Nathan Road

Kowloon

Hong Kong

STOCK CODE

8286

COMPLIANCE ADVISER

Deloitte & Touche Corporate

Finance Limited

CORPORATE PROFILE

The Company is principally engaged in the design, research, development, manufacture and sale of image transmission fibre optic products in the People's Republic of China ("PRC"). Image transmission fibre optic products produced by the Company are currently used as intermediate products by different manufacturers in Japan, Korea, Singapore, India, Turkey, Europe, Canada and the US.

Image transmission fibre optic products manufactured by the Company are image transmission devices containing a rigidly fused bundle of optical fibres arranged in an ordered fashion so that images can be transmitted from one end of the optical fibre bundle and displayed on the other end of the bundle. A typical image transmission fibre optic product of the Company would consist of over 10 million optical fibres. Image transmission fibre optic products have become one of the key components for digital image transmission equipment. It is a major component for CCD coupling, one of the critical processes of digital imaging. When compared with the traditional way of using lenses to transmit images, image transmission fibre optic products allow images to be transmitted at a higher speed, and with higher efficiency and lower distortion. Even in a dark or dim environment, images can be transmitted through image transmission fibre optic products without the need for additional lighting.

Traditionally, image transmission fibre optic products are used for the manufacture of specialised image transmitting products such as night vision devices. Nowadays, the use of image transmission fibre optic products has been extended to other areas, such as medical radiography and high performance digital consumer products, including high performance photocopiers and digital cameras.

The Company's overseas listed foreign shares ("H Shares") were listed on GEM on 18 May 2004.

MISSION

The Company is poised to experience steady growth in the future and to be one of the major manufacturers of image transmission and light transmission fibre optic products in the PRC.

CHAIRMAN'S STATEMENT

On behalf of the board of Directors (the "Board"), I am pleased to present the audited results of Shanxi Changcheng Microlight Equipment Company Limited (the "Company") for the year ended 31 December 2005 to the shareholders of the Company (the "Shareholders"). The results of the Company of the fiscal year 2005 declined relatively when compared with the same period of last year. For the year ended 31 December 2005, turnover and profits attributable to shareholders were approximately RMB29.5 million and approximately RMB3.6 million respectively.

During the year under review, the Company recorded a decline in its results. Turnover and profits attributable to shareholders decreased by approximately 15.7% and 61.3% respectively compared with last year. The Company's products were distributed to overseas markets such as Europe and Asia.

For the year 2006 ahead, the Company will continue to explore opportunities to strive for growth and profitability despite existing challenges. With the increase of production capacity and capability of Taiyuan Economic and Technology Development Zone (太原經濟技術開發區), the Company's production volume will be increased significantly. The Company will take advantage of low production cost in the PRC, its experience and technological expertise. The Company believes that the production capacity of transmission fibre optic products as well as its profits will increase significantly.

Finally, on behalf of the Board, I would like to express my heartfelt appreciation for Shareholders' confidence and support in the Company's business and prospects, as well as our employees and staff for their devotion and hard work.

By order of the Board

SHANXI CHANGCHENG MICROLIGHT EQUIPMENT CO. LTD.

WANG GEN HAI

Chairman

Shanxi, the People's Republic of China, 28 March 2006

FINANCIAL SUMMARY

The following table summarises the audited results, assets and liabilities of the Company for the five years ended 31 December 2005.

	Year ended 31 December				2005
	(Restated) 2001	(Restated) 2002	(Restated) 2003	(Restated) 2004	
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Turnover	24,927	24,769	30,766	34,968	29,491
Profit from operating activities	8,504	8,236	11,145	12,214	5,125
Share of profit/(loss) of an associate	–	(126)	(30)	7	10
Profit before income tax	7,662	7,422	10,560	11,406	5,135
Tax	–	434	(1,801)	(2,099)	(1,534)
Profit for the year	7,662	7,856	8,759	9,307	3,601
Dividend	7,310	6,266	–	4,633	–
Earnings per share – basic (<i>in RMB</i>)	0.037	0.038	0.042	0.034	0.012

	31 December				2005
	(Restated) 2001	(Restated) 2002	(Restated) 2003	(Restated) 2004	
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
ASSETS AND LIABILITIES					
Total assets	46,321	46,730	54,124	81,824	83,951
Total liabilities	(16,124)	(15,987)	(14,622)	(16,540)	(15,066)
Total equity	<u>30,197</u>	<u>30,743</u>	<u>39,502</u>	<u>65,284</u>	<u>68,885</u>

Note: Certain comparative amounts have been restated due to the adoption of the new or revised standards and interpretations of Hong Kong Financial Reporting Standards effective from 1 January 2005.

BUSINESS REVIEW AND PROSPECTS

BUSINESS REVIEW

During the year, the Company was principally engaged in the design, research, development, manufacture and sale of image transmission fibre optic products in the PRC.

For the year ended 31 December 2005, the Company reported a turnover of approximately RMB29.5 million (2004: approximately RMB35.0 million), representing a decrease of approximately 15.7% from previous year's turnover. This was mainly because the major customer of the Company has formed a joint venture with another company and the newly formed joint venture's sales strategy has affected the sales of the Company. In addition, the higher product quality demand of the fibre optic inverters was noted from overseas customers. The Company should improve its technology to meet the customers' needs. With lower demand and orders from customers, the revenue from fibre optic inverters decreased accordingly.

The gross profit margin ratio for the year ended 31 December 2005 is approximately 50.8%, representing a decrease of approximately 10.0% as compared to the previous year. The decrease was attributable to the increase in cost of raw materials and the decrease in sales of the Company as mentioned above. Furthermore, the decrease in selling price of products, the appreciation of Renminbi and the increase in salary of the production staff also caused the drop in gross profit.

The profit before tax for the year ended 31 December 2005 decreased by approximately 55.0% from approximately RMB11.4 million to approximately RMB5.1 million. The decrease in profit was mainly due to the decrease in the sales of fibre optic inverters, the decrease in sales of the Company as mentioned above and the increase in the administrative expenses.

PROSPECTS

With the development of digital image transmission technology especially in the medical and commercial areas, the Directors believe that the demand for image transmission fibre optic products, which forms part of the major components of digital image transmission devices, will remain strong in the future. Although there was a temporary decrease in profits during the year, the Directors believe the situation will be improved in the long run through the cost control and technical improvement in the future.

MANAGEMENT DISCUSSION AND ANALYSIS

LIQUIDITY AND FINANCIAL RESOURCES

The Company financed its operation primarily with internally generated cash flows and the balance of the net proceeds from the listing of the Company's H Shares on GEM on 18 May 2004.

As at 31 December 2005, the Company had total assets of approximately RMB84.0 million (2004: approximately RMB81.8 million), of which approximately RMB19.7 million (2004: approximately RMB30.9 million) were cash and bank balances.

GEARING RATIO

The gearing ratio of the Company, based on total liabilities to total assets, was approximately 17.9% as at 31 December 2005 (2004: approximately 20.2%).

CAPITAL STRUCTURE AND FOREIGN EXCHANGE RISK EXPOSURE

The books and records of the Company are maintained in RMB. Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction date as quoted by the People's Bank of China (the "PBOC"). Monetary assets and liabilities denominated in other currencies at the balance sheet date are translated into RMB at the applicable exchange rates ruling at that date as quoted by the PBOC. Exchange differences are dealt with in the income statement.

For the year ended 31 December 2005, approximately 93% of the Company's sales was denominated in US dollars. The remaining sales were denominated in RMB. A majority of the Company's cost of sales and capital expenditure were denominated in RMB. Accordingly, the Directors are of the view that, to a certain extent, the Company is exposed to foreign currency exchange risk. For the second half of year 2005, the exchange rate of US dollars to RMB had insignificant fluctuations. The Directors believe that such exposure does not have any significant adverse effect on the Company. Furthermore, the Company has not experienced any material operating difficulties or effects on liquidity as a result of fluctuations in currency exchange rates in the past. Therefore, the Company has not implemented any formal policy in dealing with this foreign exchange risk. For the year ended 31 December 2005, the Company did not enter into any arrangement to hedge its foreign exchange exposure.

PLEDGE OF ASSETS AND BANKING FACILITIES

As at 31 December 2005, the Company did not have any pledge of assets and banking facilities obtained from bank.

MANAGEMENT DISCUSSION AND ANALYSIS

SIGNIFICANT INVESTMENT AND MATERIAL ACQUISITION AND DISPOSAL OF SUBSIDIARIES

The Company did not hold material investments or had made any material acquisition and disposal of subsidiaries and associates during the year ended 31 December 2005 (2004: Nil).

FUTURE PLANS FOR MATERIAL INVESTMENTS AND CAPITAL ASSETS

Details of significant future investment plans and expected financial resources for capital expenses of the Company are set out in the section headed "Business Objectives and Future Plans" in the prospectus of the Company dated 10 May 2004 (the "Prospectus"). Save as disclosed above, the Company had no other significant future investment plan as at 31 December 2005.

EMPLOYEE INFORMATION

For the year ended 31 December 2005, staff remuneration of the Company was approximately RMB7.4 million (2004: approximately RMB7.1 million) and the Company had a total of approximately 434 employees (2004: approximately 429 employees).

There is no significant change in the Company's employees and remuneration policy as compared with last year.

CAPITAL COMMITMENT

Details of capital commitment are set out in note 28(i) of the financial statements.

CONTINGENT LIABILITIES

As at 31 December 2005, the Company had no material contingent liabilities (2004: Nil).

SEGMENT INFORMATION

Details of the segment information for the year ended 31 December 2004 and 2005 are set out in note 6 to the financial statements.

BUSINESS OBJECTIVES REVIEW**COMPARISON OF BUSINESS OBJECTIVES WITH ACTUAL BUSINESS PROGRESS****10 May 2004 to 30 June 2004**

	Business objectives stated in the Prospectus	Actual progress as at 30 June 2004
Increase production capacity and capability	Set up the New Development Zone Joint Venture (as defined below)	The application process of setting up the New Development Zone Joint Venture was still in progress. The Land Use Right Transfer Agreement was signed on 3 December 2004. The Land Use Right Certificate was pending. Upon obtaining the approval in respect of the New Development Zone Joint Venture and the Land Use Right Certificate, the construction of the production plant would commence and machinery would be purchased for production.
<ul style="list-style-type: none"> capital investment in a joint venture between the Company and Shanxi Economic and Trade Limited Liability Company (山西經貿資產經營有限責任公司) ("New Development Zone Joint Venture") purchase of machinery 		

BUSINESS OBJECTIVES REVIEW

From the date of listing on 18 May 2004, use of proceeds has not been utilised by the Company in the following areas because of pending establishment of the New Development Zone Joint Venture. Therefore, the Company could not utilise the proceeds from the placing to invest into the New Development Zone Joint Venture.

From 18 May 2004 (Date of Listing) to 30 June 2004

As stated in the Prospectus	Actual business progress
<i>HK\$' million</i>	<i>HK\$' million</i>

Increase production capacity and capability

- | | | |
|--|----|---|
| • capital investment in New Development Zone Joint Venture | 14 | – |
| • purchase of machinery | | |

Note: The Land Use Right Certificate was still pending. A deposit of approximately RMB14.0 million was paid by the Company to the Management Committee of Taiyuan Economic and Technology Development Zone (太原經濟技術開發區管理委員會).

BUSINESS OBJECTIVES REVIEW**1 July 2004 to 31 December 2004**

	Business objectives stated in the Prospectus	Actual progress as at 31 December 2004
Increase production capacity and capability	Commence the construction of the new production plant in the New Development Zone in Taiyuan, Shanxi Province, the PRC	The application process of setting up the New Development Zone Joint Venture was still in progress and the Land Use Right Certificate was still pending. Upon obtaining the approval in respect of the New Development Zone Joint Venture and the Land Use Right Certificate, the construction of the production plant would commence and machinery would be purchased for production.
<ul style="list-style-type: none"> capital investment in New Development Zone Joint Venture purchase of machinery 	Purchase of imported drawing machine, drawing machine, imported drawing pattern machine, type A heating oven, type B heating oven, type A heater, type B heater, vacuum pump, bridge crane, horizontal cutter, Φ 200 cutter, etc.	

From 1 July 2004, use of proceeds has not been utilised by the Company in the following areas because of pending establishment of the New Development Zone Joint Venture. Therefore, the Company could not utilise the proceeds from the placing to invest into the New Development Zone Joint Venture.

From 1 July 2004 to 31 December 2004

	As stated in the Prospectus <i>HK\$ million</i>	Actual business progress <i>HK\$ million</i>
Increase production capacity and capability		
<ul style="list-style-type: none"> capital investment in New Development Zone Joint Venture purchase of machinery 	7.2	–

BUSINESS OBJECTIVES REVIEW**1 January 2005 to 30 June 2005**

	Business objectives stated in the Prospectus	Actual progress as at 30 June 2005
Increase production capacity and capability	Complete renovation works of the new production plant	The Land Use Right Certificate was issued.
<ul style="list-style-type: none"> capital investment in New Development Zone Joint Venture 	Install new production facilities in the production plant	The renovation of the new production plant has not yet been completed.
<ul style="list-style-type: none"> purchase of machinery 	Recruit more production staff and provide training for these new staff	The construction of the new production plant is in progress and the Company has purchased some machineries.

The Company has utilised the proceeds from the Placing in the following areas:

	From 1 January 2005 to 30 June 2005	
	As stated in the Prospectus	Actual business progress
	<i>HK\$ million</i>	<i>HK\$ million</i>
Increase production capacity and capability		
<ul style="list-style-type: none"> capital investment in New Development Zone Joint Venture 	2.0	11.7 (Note)
<ul style="list-style-type: none"> purchase of machinery 		

Note: For the period from 1 January 2005 to 30 June 2005, approximately HK\$13.8 million (approximately RMB14.6 million) has been invested for the acquisition of a piece of land in which approximately HK\$6.2 million (approximately RMB6.6 million) was funded by the proceeds from the Placing and approximately HK\$7.6 million (approximately RMB8.0 million) was funded by its internal resources. The Directors further confirmed that approximately HK\$3.6 million (approximately RMB3.8 million) has been invested into the design and construction of the new production plant and approximately HK\$1.9 million (approximately RMB2 million) has been invested for the acquisition of machinery.

The establishment of the New Development Zone Joint Venture was still pending.

BUSINESS OBJECTIVES REVIEW

1 July 2005 to 31 December 2005

	Business objectives stated in the Prospectus	Actual progress as at 31 December 2005
Increase production capacity and capability	Trial production of the new production plant	The application process of setting up the New Development Zone Joint Venture is still in progress. The Land Use Right Transfer Agreement was signed on 3 December 2004. The Land Use Right Certificate was issued on 2 June 2005. The construction of the production plant is commenced and machineries, like imported wiredrawing machine, wiredrawing block machine have been purchased for production.
<ul style="list-style-type: none"> capital investment in New Development Zone Joint Venture purchase of machinery 	Fine-tuning of the production lines Employ more production staff and provide training for these new staff	

The Company has utilised the proceeds from the placing in the following areas:

	From 1 July 2005 to 31 December 2005	
	As stated in the Prospectus	Actual business progress
	<i>HK\$ million</i>	<i>HK\$ million</i>
Increase production capacity and capability		
<ul style="list-style-type: none"> capital investment in New Development Zone Joint Venture purchase of machinery 	1.0	15.9

Note: For the period from 1 July 2005 to 31 December 2005, approximately HK\$2.1 million (approximately RMB2.2 million) has been invested for the acquisition of a piece of land which was funded by the proceeds from the Placing. Approximately HK\$6.5 million (approximately RMB7.0 million) has been invested into the design and construction of the new production plant and approximately HK\$7.3 million (approximately RMB7.8 million) has been invested for the acquisition of machinery.

The establishment of the New Development Zone Joint Venture was still pending.

DIRECTORS AND SENIOR MANAGEMENT

BOARD OF DIRECTORS

Executive Directors

Mr. Wang Gen Hai (王根海), aged 58, is the chairman of the Company, and is mainly responsible for the Company's overall strategic planning, management, business development and new product strategy. Mr. Wang graduated from Shanxi Mining College (山西礦業學院) in 1976 after studying 3 years of mechanical engineering. He has been a senior engineer in the PRC since 1994. He has over 20 years of experience in research and general management in the fibre optic industry. Prior to joining the Company, he was with Taiyuan Changcheng Optics and Electronics Industrial Corporation (太原長城光電子工業公司) ("Taiyuan Changcheng") from 1983 to 2000 as General Manager. He joined the Company in November 2000. Mr. Wang Gen Hai is also the compliance officer of the Company.

Mr. Li Kang Sheng (李抗勝), aged 60, is a Director. Mr. Li has over 30 years of experience in research and general management in the fibre optic industry. Mr. Li graduated from Tianjin University (天津大學) in 1968 with a degree in radio engineering. He has been a senior engineer in the PRC since 1994 and is mainly responsible for overseeing the production and the technical department of the Company. Prior to joining the Company, he had been with Taiyuan Changcheng for 30 years. Mr. Li joined the Company in November 2000.

Mr. Tian Qun Xu (田群戌), aged 67, is a Director. Mr. Tian has over 30 years of experience in research and general management in the optical glass industry. Mr. Tian graduated from Taiyuan Industrial Professional School (太原工業專科學校) in 1961. He has been a senior engineer in the PRC since 1988 and is mainly responsible for the research and development department of the Company. Prior to joining the Company, he had been with Taiyuan Changcheng for almost 40 years. Mr. Tian joined the Company in November 2000.

Non-executive Director

Mr. Lin Yin Ping (林殷平), formerly known as Lin Peng, aged 41, is the vice chairman of the Company. Mr. Lin graduated from Guangdong Provincial Social Science College (廣東省社會科學院) with a master degree in politics and economics. Prior to joining the Company, Mr. Lin was with Shenzhen International Investment Securities Company Limited (深圳國投證券有限公司) as an investment banker. Since 2000, Mr. Lin has been the chairman and general manager of Beijing Gensir Venture Capital Management Limited (北京中澤創業投資管理有限公司) ("Beijing Gensir"), a substantial shareholder of the Company. Mr. Lin has over 10 years of experience in the investment and finance field. He joined the Company in November 2000. The daily management and operation of the Company is carried out by Mr. Wang Gen Hai, Mr. Tian Qun Xu and Mr. Li Kang Sheng and Mr. Lin does not take part in the daily management and operation of the Company. Mr. Lin attends the board of Directors meeting of the Company in the capacity of a director.

DIRECTORS AND SENIOR MANAGEMENT

Independent non-executive Directors

Mr. Ni Guo Qiang (倪國強), aged 60, is an independent non-executive Director. Mr. Ni graduated from Beijing Institute of Technology (北京理工大學) in 1989 with a doctorate degree in optical and electrical engineering. He has worked with Beijing Institute of Technology since 1989 and currently is the chief professor of the optic technology doctorate programme in Beijing Institute of Technology. Mr. Ni has been engaged in the research and development of optical technology for more than 20 years. Mr. Ni was appointed by the Company in November 2000.

Mr. Shen Ming Hong (沈明宏), aged 38, is an independent non-executive Director. Mr. Shen is the chief executive of International New Economy Investment Company Limited (國科新經濟投資有限公司). Mr. Shen graduated from Hefei Industrial University (合肥工業大學) with a master degree. Mr. Shen was appointed by the Company in November 2000.

Mr. Li Li Cai (黎禮才), aged 65, is an independent non-executive Director. Mr. Li graduated from Wuhan Iron & Steel Institute (武漢鋼鐵學院). He joined Taiyuan Iron & Steel Factory (太原鋼鐵廠) in 1964. Since 1985, Mr. Li has been the Deputy General Manager of Taiyuan Iron & Steel Company (太原鋼鐵(集團)公司). Before his retirement, Mr. Li was the Vice Chairman of Shanxi Taiyuan Stainless Steel Company Limited (山西太鋼不銹鋼股份有限公司), a company listed on the Shenzhen Exchange in the PRC. He has over 30 years of experience in corporate management and investment. Mr. Li was appointed by the Company in June 2002.

Ms. Chen Yue Jie (陳月潔), aged 33, is an independent non-executive Director. Ms. Chen graduated from Shanxi University of Finance and Economics (山西省財經大學) in 1997. Ms. Chen is a qualified accountant registered in the PRC and has been involved in the audits of a number of major companies. Ms. Chen was appointed by the Company in April 2004.

Supervisors

Mr. Zhang Fu Sheng (張府生), aged 54, is a supervisor of the Company. Mr. Zhang completed high school courses and has been working with Taiyuan Wireless Number Six Factory (太原無線電六廠), and since 1994, he has been an assistant manager of Taiyuan Changcheng. He is also the supervisor (監事) of the labour union (聯工代表監事) of Taiyuan Changcheng since 1996. He joined the Company in 2000.

Mr. Meng Yan, (孟焰), aged 50, is a supervisor of the Company. Mr. Meng graduated from China Financial Science Research Institute (中國財政科學研究所) with a doctorate degree in accountancy. Mr. Meng is currently the dean of the faculty of accountancy in the Chinese Central Finance University (中國中央財經大學). Mr. Meng joined the Company in June 2002.

Mr. Wang Guang Hua (王光華), aged 45, is a supervisor of the Company. Mr. Wang is currently the head of one of the workshop of the Company. Prior to joining the Company in March 2002, he has been with Taiyuan Changcheng since 1988.

DIRECTORS AND SENIOR MANAGEMENT

Mr. Bai Yin Quan (白銀泉), aged 40, is a supervisor of the Company. Mr. Bai graduated from Northeastern Finance University (東北財經大學) in 1988 with a bachelor degree in Finance. He became a registered accountant in the PRC in 1993. He is currently a supervisor of Shanxi Certified Public Accountants (山西會計師事務所). Mr. Bai has over 10 years of experience in accounting and finance. Mr. Bai joined the Company in June 2002.

Senior Management

Mr. Zhu Au Ying (朱歐英), aged 53, is the Production Manager of the Company. Prior to joining the Company in 2000, he was responsible for production management in Taiyuan Changcheng from 1969 to 2000. He is mainly responsible for the overall production management of the Company.

Ms. He Ling Xian (和玲仙), aged 55, is the Financial Controller of the Company. She graduated from Chinese Communist Central College (中共中央學校) in 1995 after studying 3 years of economics. She has been a qualified accountant in the PRC since 1992 and a registered accountant since 2000. Prior to joining the Company in 2000, she was with an accounting firm in Shanxi.

Mr. Fan Ji Min (范繼民), aged 44, is the Technical Improvement Manager of the Company. He graduated from Shanxi Provincial Electronics School (山西省電子工業學校) in 1981 after studying 2 years of radio technology. Prior to joining the Company in February 2001, he had been working in Taiyuan Changcheng since 1981. He became an engineer in the PRC in 1999. He is mainly responsible for overall improvement programmes of the Company. Mr. Fan is an engineer in PRC.

Mr. Guo Zhi Hong (郭志宏), aged 39, is the Administration Manager of the Company. He graduated from Shanxi University (山西大學) in 1989 with a degree in physics. Prior to joining the Company, he has been working in Taiyuan Changcheng from 1989 to 2000. He is mainly responsible for administration and management of the Company.

Ms. Zhang Shu Qin (張淑琴), aged 42, is the Chief Engineer of the Company. She graduated from Shanxi University (山西大學) in 1986 with a degree in chemistry. Prior to joining the Company, she was working in Taiyuan Changcheng from 1986 to 2000. She is mainly responsible for the overall management of the technical department. Ms. Zhang is an advance engineer in the PRC.

Mr. Xie An Ye (解安業), aged 38, is the Secretary of the Board of the Company. He graduated from Technological Management University (中國科技經營管理大學) in 1989 with a professional qualification in applied electronic technology. Prior to joining the Company in 2000, he was with Taiyuan Changcheng from 1990 to 2000. He is mainly responsible for the management and administration of the Company. Mr. Xie is an engineer in the PRC.

Mr. Poon Shiu Cheong (潘兆昌), aged 35, is the Company Secretary and Qualified Accountant of the Company. Mr. Poon graduated from Southern Cross University Australia in 1997 with a Master degree in Business Administration. In 2001, he also obtained Master of Accounting from Central Queensland University Australia. He is a Certified Practising Accountant of CPA Australia and a Certified Public Accountant of the Hong Kong Institute of Certified Public Accountants. Mr. Poon has over 10 years of experience in the field of auditing and accounting. He joined the Company in April 2005.

REPORT OF THE DIRECTORS

The Directors have the pleasure to present their report together with the audited financial statements of the Company for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The Company is principally engaged in the design, research, development, manufacture and sale of image transmission fibre optic products in the PRC.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2005, the five largest customers and the largest customer of the Company accounted for approximately 99.9% and 66.6% respectively of the Company's total turnover. (For the year ended 31 December 2004: 99.9% and 78.0% respectively). For the year ended 31 December 2005, the five largest suppliers and the largest supplier of the company accounted for approximately 74.8% and 19.1% respectively of the Company's total purchases (For the year ended 31 December 2004: 79.7% and 24.2% respectively). None of the Directors, or any of their associates, or any shareholder (which, to the best knowledge of the Directors, own more than 5% of the Company's issued share capital) had any beneficial interest in the Company's five largest customers or suppliers.

RESULTS AND APPROPRIATIONS

Details of the Company's results for the year ended 31 December 2005 are set out in the income statement on page 33.

The Directors did not recommend the payment of a final dividend for the year ended 31 December 2005.

FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Company for the past five financial years is set out on page 6.

SHARE CAPITAL

There were no movements in either the Company's authorised or issued share capital during the year.

REPORT OF THE DIRECTORS

RESERVES

Details of movements in the reserves of the Company during the year are set out in the statement of changes in equity on page 35.

DISTRIBUTABLE RESERVES

As at 31 December 2005, the Company's reserves available for distribution, calculated in accordance with the relevant rules and regulations, amounted to approximately RMB12,322,000.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Articles of Association and there is no restriction against such rights under the Companies Law (Revised) of the PRC.

PROPERTY, PLANT AND EQUIPMENT

Details of movements in property, plant and equipment of the Company during the year are set out in note 13 to the financial statements.

RETIREMENT PLANS

All members of staff are entitled to participate in the public welfare fund, which was set up for the purpose of ensuring that the participating employees will have sufficient means to support their living after retirement. Upon participation, the Company and its employees are required to contribute to such fund. The contributions made by the Company are on the basis of not more than 20% (2004: 23%) of the employees' salaries while the employees are required to contribute at least 8% of their salaries each month.

Once the contribution has been made by the Company for its employees, the Company cannot withdraw the contribution on the basis that the employee has left the Company. For the two years ended 31 December 2004 and 2005, the amount paid by the Company for the pension scheme was approximately RMB1,123,000 and RMB1,196,000 respectively.

CONNECTED TRANSACTIONS

For the year ended 31 December 2005, the Company had several continuing connected transactions in relation to the lease of land and property from Taiyuan Changcheng to the Company which were exempt from all the reporting, announcement and independent shareholders' approval requirement under Chapter 20 of the Rules Governing the Listing of Securities on GEM ("the GEM Listing Rules").

REPORT OF THE DIRECTORS

DIRECTORS AND SUPERVISORS

The Directors who held office during the year and up to the date of this report are:

Executive Directors

Mr. Wang Gen Hai
Mr. Li Kang Sheng
Mr. Tian Qun Xu

Non-executive Director

Mr. Lin Yin Ping

Independent non-executive Directors

Mr. Ni Guo Qiang
Mr. Shen Ming Hong
Mr. Li Li Cai
Ms. Chen Yue Jie

The Supervisors who held office during the year and up to the date of this report are:

Zhang Fu Sheng
Meng Yan
Wang Guang Hua
Bai Yin Quan

DIRECTORS' AND SUPERVISORS' SERVICE CONTRACTS

Except for Ms. Chen Yue Jie, each of the Executive Directors, Non-executive Directors and Independent non-executive Directors has entered into a service contract with the Company for an initial term of three years commencing from 10 November 2003. For Ms. Chen Yue Jie, the service contract with the Company is for an initial term of three years commencing from 20 April 2004. The service contracts shall continue thereafter until terminated by either party after the expiration of the said initial fixed term.

Each of the supervisors of the Company (the "Supervisors") has entered into an appointment contract with the Company with effect from 10 November 2003 to 9 November 2006 whereby each of the Supervisors was appointed subject to termination on certain circumstances as stipulated in the relevant appointment contract.

REPORT OF THE DIRECTORS

Save as disclosed above, none of the Directors or the Supervisors had entered into service contracts with the Company which were not terminable by the Company within one year without compensation (other than statutory compensation).

DIRECTORS', SUPERVISORS' AND SENIOR MANAGEMENT'S BIOGRAPHIES

Biographical details of the Directors, Supervisors and the senior management of the Company are set out on pages 15 to 17.

DIRECTORS' AND SUPERVISORS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 31 December 2005, so far as the Directors are aware, the Directors who have any interest and short position in shares, underlying shares or debentures of the Company in the registered capital of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO") (a) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 & 8 of Part XV of the SFO (including interests and short positions which are taken or deemed to have taken under such provisions of the SFO) or (b) which were required pursuant to section 352 of the SFO; to be entered in the register referred to in that section, or (c) which were required, pursuant to the required standards of dealing by the Directors as referred to in Rule 5.46 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange are as follows:

Name	Nature and capacity in the shareholding of the Company	Number of domestic shares	Approximate percentage of holding of the domestic shares of the Company*	Approximate percentage of holding of the total share capital of the Company*
Lin Yin Ping	Interest in a controlled corporation	82,200,000	41.34%	26.61%

Note:

- Lin Yin Ping holds approximately 78.52% of the equity interest in Beijing Gensir Venture Capital Management Limited ("Beijing Gensir") and Beijing Gensir holds approximately 36.37% of the equity interest in Taiyuan Tanghai Automatic Control Company Limited ("Taiyuan Tanghai"). As Lin Yin Ping is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Beijing Gensir, for the purpose of the SFO, Lin Yin Ping is deemed to be interested in the entire 57,300,000 domestic shares held by Beijing Gensir and 24,900,000 domestic shares held by Taiyuan Tanghai.

* Shareholding percentages have been rounded to the nearest two decimal places.

REPORT OF THE DIRECTORS

DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE H SHARES

During the year ended 31 December 2005, none of the Directors or Supervisors of the Company was granted options to subscribe for H shares of the Company. As at 31 December 2005, none of the Directors or the Supervisors nor their spouses or children under the age of 18 had any right to acquire H shares in the Company or had exercised any such right during the year.

DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

Save as disclosed, the Directors and Supervisors did not have contracts of significance in relation to the Company's business to which the Company was a party and in which a Director or Supervisor of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or any time during the year.

SHARE OPTION SCHEME

The Company does not have any share option scheme.

SUBSTANTIAL SHAREHOLDERS

As at 31 December 2005, so far as the Directors are aware, the persons who have an interest or short position in the shares and underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Division 2 and 3 of Part XV of the SFO or which will be required, pursuant to section 336 of the SFO to be recorded in the register of the Company or be directly or indirectly interested in 5% or more of the nominal value of any class of issued share capital carrying rights to vote in all circumstances of general meetings are as follows:

Name	Nature and capacity in the shareholding of the Company	Number and type of domestic shares/H shares	Approximate percentage of holding of the domestic shares of the Company*	Approximate percentage of the holding of the H shares of the Company*	Approximate percentage of holding of the total share capital of the Company*
Taiyuan Changcheng Optics and Electronics Industrial Corporation	Registered and beneficial owner of the domestic shares	80,160,000 domestic shares	40.31%	–	25.95%

REPORT OF THE DIRECTORS

Name	Nature and capacity in the shareholding of the Company	Number and type of domestic shares/H shares	Approximate percentage of holding of the domestic shares of the Company*	Approximate percentage of the holding of the H shares of the Company*	Approximate percentage of holding of the total share capital of the Company*
Beijing Gensir	Registered and beneficial owner of the domestic shares and interest in a controlled corporation	82,200,000 domestic shares (Note 1)	41.34%	–	26.61%
Dandong Shuguang Industrial Group Company Limited (“Dandong Shuguang”)	Registered and beneficial owner of the domestic shares	34,000,000 domestic shares	17.10%	–	11.01%
Taiyuan Tanghai	Registered and beneficial owner of the domestic shares	24,900,000 domestic shares	12.52%	–	8.06%
Lin Yin Ping	Interest in a controlled corporation	82,200,000 domestic shares (Note 2)	41.34%	–	26.61%
Shen Gang	Interest in a controlled corporation	24,900,000 domestic shares (Note 3)	12.52%	–	8.06%
Li Jin Dian	Interest in a controlled corporation	34,000,000 domestic shares (Note 4)	17.10%	–	11.01%
Zhang Wen Qin	Family interest	82,200,000 domestic shares (Note 2)	41.34%	–	26.61%
Liu Gui Ying	Family interest	34,000,000 domestic shares (Note 4)	17.10%	–	11.01%
Ma Fong Ping	Family interest	24,900,000 domestic shares (Note 3)	12.52%	–	8.06%

REPORT OF THE DIRECTORS

Name	Nature and capacity in the shareholding of the Company	Number and type of domestic shares/H shares	Approximate percentage of holding of the domestic shares of the Company*	Approximate percentage of the holding of the H shares of the Company*	Approximate percentage of holding of the total share capital of the Company*
Liu Li, Luis	Beneficial owner of H shares and interest in a controlled corporation	35,055,000 H shares (Note 5)	–	31.87%	11.35%
Lu Jun	Family interest	35,055,000 H shares (Note 6)	–	31.87%	11.35%
Kwong Tat Finance Limited	Beneficial owner of H shares	34,155,000 H shares (Note 5)	–	31.05%	11.06%

* Shareholding percentages have been rounded to the nearest two decimal places.

Notes:

- Part of these domestic shares (24,900,000 domestic shares) are registered in the name of Taiyuan Tanghai. Taiyuan Tanghai is owned as to approximately 36.37% by Beijing Gensir. As Beijing Gensir is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Taiyuan Tanghai, for the purpose of the SFO, Beijing Gensir is deemed to be interested in the entire 24,900,000 domestic shares held by Taiyuan Tanghai.
- Part of these domestic shares (57,300,000 domestic shares) are registered in the name of Beijing Gensir. Beijing Gensir is owned as to an approximately 78.52% by Lin Yin Ping, a non-executive Director. The rest of these shares are registered in the name of Taiyuan Tanghai in which Lin Yin Ping has an indirect interest through his shareholdings in Beijing Gensir. As Lin Yin Ping is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Beijing Gensir, for the purpose of the SFO, Lin Yin Ping is deemed to be interested in the entire 57,300,000 domestic shares held by Beijing Gensir and 24,900,000 domestic shares held by Taiyuan Tanghai. Ms. Zhang Wen Qin (張文琴), as the wife of Lin Yin Ping, is taken to be interested in the shares held by Lin Yin Ping by virtue of Part XV of the SFO.
- These 24,900,000 domestic shares are registered in the name of Taiyuan Tanghai. Taiyuan Tanghai is owned as to approximately 47.28% by Shen Gang. As Shen Gang is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Taiyuan Tanghai, for the purpose of the SFO, Shen Gang is deemed to be interested in the entire 24,900,000 domestic shares held by Taiyuan Tanghai. Ma Fong Ping (馬鳳萍), as the wife of Shen Gang, is taken to be interested in the shares held by Shen Gang by virtue of Part XV of the SFO.

REPORT OF THE DIRECTORS

4. These 34,000,000 domestic shares are registered in the name of Dandong Shuguang. Dandong Shuguang is owned as to approximately 48.11% by Li Jin Dian. As Li Jin Dian is entitled to exercise or control the exercise of one-third or more of the voting power at the general meeting of Dandong Shuguang, for the purpose of the SFO, Li Jin Dian is deemed to be interested in the entire 34,000,000 domestic shares held by Dandong Shuguang. Liu Gui Ying (劉桂英), as the wife of Li Jin Dian, is taken to be interested in the shares held by Li Jin Dian by virtue of Part XV of the SFO.
5. Part of these H shares (34,155,000 H shares) are registered in the name of Kwong Tat Finance Limited. Kwong Tat Finance Limited is wholly owned by Liu Li, Luis. The rest of these H shares (900,000 H shares) are registered in the name of Liu Li, Luis. For the purpose of SFO, Liu Li, Luis is deemed to be interested in all the H shares held by Kwong Tat Finance Limited.
6. Lu Jun is the spouse of Liu Li, Luis and is deemed to be interested in all 35,055,000 H shares held by Liu Li, Luis by virtue of Part XV of the SFO.

COMPETING INTEREST

Up to 31 December 2005, none of the Directors, Supervisors and management shareholders of the Company (as defined under the GEM Listing Rules) had any interest in a business which competes or may compete with the business of the Company.

COMPLIANCE ADVISER'S INTEREST

As notified and updated by the Company's compliance adviser, Deloitte & Touche Corporate Finance Limited ("DTCFL"), as at 31 December 2005, none of DTCFL, its directors, employees and their associates (as defined under the GEM Listing Rules) had any interest in the share capital of the Company, or any right to subscribe for or to nominate persons to subscribe for the shares of the Company.

Pursuant to the sponsor agreement dated 17 May 2004 entered into between DTCFL and the Company, DTCFL will receive fees for acting as the Company's compliance adviser for the period from 18 May 2004 up to 31 December 2006 or until such agreement is terminated upon the terms and conditions set out therein.

AUDIT COMMITTEE

In compliance with Rules 5.28 and 5.29 of the GEM Listing Rules, the Company has established an audit committee with written terms of reference. The primary duties of the audit committee are to review, in draft form, the Company's annual report and accounts, half-year report, quarterly report and to provide advice and comments thereon to the Board. The audit committee is also responsible for reviewing and supervising the financial reporting procedures and internal control system of the Company.

REPORT OF THE DIRECTORS

The audit committee comprises four independent non-executive Directors, Ni Guo Qiang, Shen Ming Hong, Li Li Cai and Chen Yue Jie. Ni Guo Qiang is appointed as the chairman of the audit committee. The audit committee has reviewed with the management the accounting principles and practices adopted by the Company and discussed internal controls and financial reporting matters, including a review of the annual report of the Company for the year ended 31 December 2005, with the Directors.

CORPORATE GOVERNANCE

The Company has complied throughout the period under review with the provisions on board practice and procedures in the GEM Listing Rules, which was substantially revised with effect from 1 January 2005. Subject to the transitional arrangements, the Company will comply with the revised GEM Listing Rules, in particular, the Code on Corporate Governance Practices set out in Appendix 15 of the GEM Listing Rules, from the financial year commencing on 1 January 2005 except that:

The remuneration committee and the nomination committee have not yet been set up by the Company.

CODE OF CONDUCT REGARDING SECURITIES TRANSACTIONS BY DIRECTORS

During the year ended 31 December 2005, the Company had adopted a code of conduct regarding securities transactions by Directors on terms no less exacting than the required standard of dealings set out in Rules 5.48 to 5.67 of the GEM Listing Rules. The Company had also made specific enquiry of all Directors and the Company was not aware of any non-compliance with the required standard of dealings and its code of conduct regarding securities transactions by Directors.

PURCHASE, SALES OR REDEMPTION OF LISTED SECURITIES OF THE COMPANY

During the year ended 31 December 2005, there was no purchase, sales or redemption of the Company's listed securities by the Company.

AUDITORS

Ernst & Young were the auditors of the Company for the year ended 31 December 2003. The financial statements of the Company for that year were audited by Ernst & Young.

Grant Thornton were appointed as the auditors of the Company by the board of Directors on 14 January 2005 to fill the casual vacancy arising from the resignation of Ernst & Young on 5 January 2005. The financial statements of the Company for the year ended 31 December 2004 and 2005 were audited by Grant Thornton, who will retire and a resolution to re-appoint Grant Thornton as the auditors of the Company will be proposed at the forthcoming annual general meeting.

REPORT OF THE DIRECTORS

DIRECTORS

Executive Directors: Mr. Wang Gen Hai, Mr. Li Kang Sheng and Mr. Tian Qun Xu. Non-executive Director: Mr. Lin Yin Ping. Independent non-executive Directors: Mr. Ni Guo Qiang, Mr. Shen Ming Hong, Mr. Li Li Cai and Ms. Chen Yue Jie.

The Company confirmed that it has received from each of its independent non-executive Directors an annual confirmation of his/her independence pursuant to Rule 5.09 of the GEM Listing Rules and the Company considers each of the independent non-executive Directors to be independent.

On behalf of the Board of Directors

WANG GEN HAI

Chairman

Shanxi, the People's Republic of China, 28 March 2006

CORPORATE GOVERNANCE REPORT

INTRODUCTION

Subject to the deviations as disclosed in this report, the Company has complied with all the code provisions on Corporate Governance Practices as set out in the GEM Listing Rules by establishing a formal and transparent procedure to protect and maximize the interests of shareholders during the period under review.

DIRECTORS' SECURITIES TRANSACTIONS

The Company has adopted a code of conduct regarding Directors' securities transactions on terms no less exacting than the required standard of dealings as set out in Rules 5.48 to 5.67 of the GEM Listing Rules. Having made specific enquiry of all Directors, the Directors have complied with such code of conduct and the required standard of dealings and its code of conduct regarding securities transactions by the Directors throughout the year ended 31 December 2005.

BOARD OF DIRECTORS AND BOARD MEETING

The board of Directors, which currently comprises eight Directors, is responsible for corporate strategy, annual and interim results, succession planning, risk management, major acquisitions, disposals and capital transactions, and other significant operational and financial matters. Major corporate matters that are specifically delegated by the board of Directors to the management including the preparation of annual and interim accounts for board approval before public reporting, execution of business strategies and initiatives adopted by the board of Directors, implementation of adequate systems of internal controls and risk management procedures, and compliance with relevant statutory requirements and rules and regulations.

Details of backgrounds and qualifications of the chairman of the Company and other Directors are set out in the section of Directors and Senior Management. All Directors have given sufficient time and attention to the affairs of the Company. Each executive Director has sufficient experience to hold the position so as to carry out his duties effectively and efficiently. Mr. Wang Gen Hai is the chairman of the board of Director and an executive Director and Mr. Li Kang Sheng is the chief executive officer of the Company and an executive Director. There is no relationship among the members of the board of Directors.

To improve the transparency and independency of the corporate governance, the chairman and chief executive officer of the Company are segregated and are not exercised by the same individual since August 2004.

The Company appointed four independent non-executive Directors who have appropriate and sufficient experience and qualification to carry out their duties so as to protect the interests of shareholders. Mr. Ni Guo Qiang, Mr. Shen Ming Hong, Mr. Li Li Cai and Ms. Chen Yue Jie are the independent non-executive Directors. Except Ms. Chen Yue Jie who was appointed on 20 April 2004, all has been appointed as an independent non-executive Director for a term of three years commencing on 10 November 2003 and is subject to re-election at the annual general meeting in accordance with the Company's articles of association. The Company appointed Mr. Lin Yin Ping as a non-executive Director for a term of three years commencing on 10 November 2003 and is subject to re-election at the annual general meeting in accordance with the Company's articles of association.

CORPORATE GOVERNANCE REPORT

The board of Directors held a full board meeting for each quarter.

Details of the attendance of the board of Directors are as follows:–

Directors	Attendance
Mr. Wang Gen Hai	4/4
Mr. Li Kang Sheng	4/4
Mr. Tian Qun Xu	4/4
Mr. Lin Yin Ping	2/4
Mr. Ni Guo Qiang	4/4
Mr. Shen Ming Hong	3/4
Mr. Li Li Cai	4/4
Ms. Chen Yue Jie	4/4

Apart from the above regular board meetings of the year, the board of Directors will meet on other occasions when a board-level decision on a particular matter is required. The Directors will receive details of agenda items for decision and minutes of committee meetings in advance of each board meeting.

REMUNERATION OF DIRECTORS

The remuneration committee has not yet established by the Company. The Company is now in the progress of forming its remuneration committee and drafting its term of reference.

NOMINATION OF DIRECTORS

The nomination committee has not yet established by the Company. The Company currently does not have any plans to set up a nomination committee considering the small size of the Board. The Board is responsible for considering the suitability of an individual to act as a Director, and approving and terminating the appointment of a Director.

AUDITORS' REMUNERATION

The audit committee of the Company is responsible for considering the appointment of the external auditor and reviewing any non-audit functions performed by the external auditor, including whether such non-audit functions could lead to any potential material adverse effect on the Company. During the year under review, the Company is required to pay an aggregate of approximately RMB400,000 to the external auditors for their audit service. Non-audit services have not been provided by the external auditors to the Company.

CORPORATE GOVERNANCE REPORT

AUDIT COMMITTEE

The Company established an audit committee with written terms of reference in compliance with Rules 5.28 and 5.33 of the GEM Listing Rules. The primary duties of the audit committee are to review and supervise the financial reporting process and internal controls system of the Company. The audit committee comprises four members, Mr. Ni Guo Qiang, Mr. Shen Ming Hong, Mr. Li Li Cai and Ms. Chen Yue Jie. All of them are independent non-executive Directors. The chairman of the audit committee is Mr. Ni Guo Qiang.

The audit committee held four meetings during the year under review. Details of the attendance of the audit committee meetings are as follows:

Members	Attendance
Mr. Ni Guo Qiang	4/4
Mr. Shen Ming Hong	4/4
Mr. Li Li Cai	4/4
Ms. Chen Yue Jie	4/4

The Company's unaudited quarterly and interim results and annual audited results during the year ended 31 December 2005 have been reviewed by the audit committee, which was of the opinion that the preparation of such results complied with the applicable accounting standards and requirements and that adequate disclosure have been made.

DIRECTORS' AND AUDITORS' RESPONSIBILITIES FOR ACCOUNTS

The Directors' responsibilities for the accounts and the responsibilities of the external auditors to the shareholders are set out on page 32.

INTERNAL CONTROL

The Company has conducted a review of its system of internal control periodically to ensure the effective and adequate internal control system. The Company convened meeting periodically to discuss financial, operational and risk management control.

INVESTORS RELATIONS

The Company has disclosed all necessary information to the shareholders in compliance with GEM Listing Rules. Meetings are held with media and investors periodically. The Company also replied the enquiries from shareholders timely. The Directors convene the annual general meeting each year to meet the shareholders and answer their enquiries.

REPORT OF THE SUPERVISORY COMMITTEE

To shareholders of Shanxi Changcheng Microlight Equipment Co. Ltd.:

The supervisory committee ("the Supervisory Committee") of Shanxi Changcheng Microlight Equipment Co. Ltd. (the "Company") has performed its duties conscientiously in compliance with the Company Law of the PRC, relevant laws and regulations of Hong Kong and the articles of association of the Company. By adhering to the principle of good faith, it has discharged its duties diligently and carried out its work in an honest, reasonable, prudent and proactive manner to safeguard the interests of the Company and the shareholders.

During the year under review, the Supervisory Committee has carefully reviewed the use of proceeds from the placing in accordance with the plan disclosed in the Prospectus of the Company and put forward reasonable recommendations and opinions to the Board in respect of the operation and development plans of the Company. It has monitored strictly and effectively various important decisions made by the Board of directors to ensure that such decisions are in compliance with the laws and regulations of the PRC and the articles of association of the Company, and in the best interests of the shareholders.

The Supervisory Committee has reviewed diligently and was satisfied with the report of the Directors, the audited financial statements to be tabled at the forthcoming annual general meeting of the Company. In the opinion of the Supervisory Committee, the members of the Board, the Chairman and other senior management of the Company have strictly followed the principle of good faith, discharged their duties diligently, honestly worked for the best interests of the Company, performed their duties in accordance with the articles of association, standardised the operation and enhanced the internal control system. No abuse of rights, acts detrimental to the interests of the Company, shareholders and staff, infringement of laws, regulations or the articles of association of the Company by the Directors, chairman and senior management was found.

The Supervisory Committee considered that the performance and economic results of the Company for 2005 were satisfactory and was confident of the development prospect of the Company.

By order of the Supervisory Committee

Zhang Fu Sheng

Chairman of the Supervisory Committee

Shanxi, the People's Republic of China, 28 March 2006

AUDITORS' REPORT

Certified Public Accountants
Member of
Grant Thornton International

Grant Thornton 
均富會計師行

To the shareholders of Shanxi Changcheng Microlight Equipment Co. Ltd.

(incorporated in the People's Republic of China with limited liability)

We have audited the financial statements on pages 33 to 74 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company as at 31 December 2005 and of the Company's profit and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Grant Thornton

Certified Public Accountants

Hong Kong
28 March 2006

INCOME STATEMENT

for the year ended 31 December 2005

	<i>Notes</i>	2005 RMB'000	Restated 2004 RMB'000
Revenue	5	29,491	34,968
Cost of sales		<u>(14,507)</u>	<u>(13,711)</u>
Gross profit		14,984	21,257
Other income and gains	5	730	247
Selling and distribution expenses		(823)	(905)
Administrative expenses		(9,192)	(8,110)
Other operating expenses		<u>(574)</u>	<u>(275)</u>
Operating profit		5,125	12,214
Finance costs	7	–	(815)
Share of profit of an associate		<u>10</u>	<u>7</u>
Profit before income tax	7	5,135	11,406
Income tax expense	10	<u>(1,534)</u>	<u>(2,099)</u>
Profit for the year		<u>3,601</u>	<u>9,307</u>
Dividend			
– Interim	11	<u>–</u>	<u>4,633</u>
Earnings per share for profit attributable to the equity holders of the Company during the year	12		
– Basic		<u>RMB0.012</u>	<u>RMB0.034</u>
– Diluted		<u>N/A</u>	<u>N/A</u>

BALANCE SHEET

as at 31 December 2005

	Notes	2005 RMB'000	Restated 2004 RMB'000
ASSETS AND LIABILITIES			
Non-current assets			
Property, plant and equipment	13	18,156	13,450
Land use rights	14	17,126	2,845
Deposit for acquisition of a land use right	15	–	14,054
Deposit for acquisition of property, plant and equipment		7,638	150
Interest in an associate	16	3,066	3,056
Deferred tax assets	17	–	434
		45,986	33,989
Current assets			
Due from shareholders	18	2,124	226
Due from a director	19	71	–
Inventories	20	4,999	6,010
Trade receivables	21	9,864	10,092
Prepayments, deposits and other receivables		1,104	507
Financial assets at fair value through profit or loss/short term investment	22	102	100
Cash and cash equivalents	23	19,701	30,900
		37,965	47,835
Current liabilities			
Due to directors	19	30	30
Trade payables	24	321	133
Tax payable		377	499
Accrued liabilities, deposits received and other payables		4,178	2,858
Dividend payable		–	3,020
		4,906	6,540
Net current assets		33,059	41,295
Total assets less current liabilities		79,045	75,284
Non-current liability			
Deferred government grants	25	10,160	10,000
Net assets		68,885	65,284
EQUITY			
Equity attributable to Company's equity holders			
Share capital	26	30,886	30,886
Reserves	27	37,999	34,398
Total equity		68,885	65,284

Wang Gen Hai
DirectorTian Qun Xu
Director

STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2005

	Equity attributable to equity holders of the Company						
	Share capital	Capital surplus*	Statutory surplus reserve*	Statutory public welfare fund*	Proposed dividend*	Retained earnings*	Total equity
	RMB'000 (Note 26)	RMB'000 (Note 27)	RMB'000 (Note 27)	RMB'000 (Note 27)	RMB'000	RMB'000	RMB'000
At 1 January 2004	20,886	1,187	2,786	1,393	6,266	7,235	39,753
Effect of changes in accounting policies	—	—	—	—	—	(251)	(251)
At 1 January 2004, as restated	20,886	1,187	2,786	1,393	6,266	6,984	39,502
Profit for the year, as previously reported	—	—	—	—	—	9,360	9,360
Effect of initial adoption of HKAS 17	—	—	—	—	—	(60)	(60)
Effect of initial adoption of HKAS 28	—	—	—	—	—	7	7
Profit for the year, as restated	—	—	—	—	—	9,307	9,307
Total recognised income and expense for the year	—	—	—	—	—	9,307	9,307
Proposed 2002 dividend approved by shareholders and paid in 2004	—	—	—	—	(6,266)	—	(6,266)
Issue of H shares	10,000	32,424	—	—	—	—	42,424
Share issue expenses	—	(15,050)	—	—	—	—	(15,050)
Transfer from retained earnings to statutory reserves	—	—	1,190	595	—	(1,785)	—
Interim 2004 dividend – note 11	—	—	—	—	—	(4,633)	(4,633)
At 31 December 2004 and 1 January 2005, as restated	30,886	18,561	3,976	1,988	—	9,873	65,284
Profit for the year	—	—	—	—	—	3,601	3,601
Total recognised income and expense for the year	—	—	—	—	—	3,601	3,601
Transfer from retained earnings to statutory reserves	—	—	768	384	—	(1,152)	—
At 31 December 2005	30,886	18,561	4,744	2,372	—	12,322	68,885

* These reserve accounts comprise the reserves of RMB37,999,000 (2004 (restated): RMB34,398,000) in the balance sheet.

CASH FLOW STATEMENT

for the year ended 31 December 2005

	Notes	2005 RMB'000	Restated 2004 RMB'000
Cash flows from operating activities			
Profit before income tax		5,135	11,406
Adjustments for:			
Depreciation	7	2,930	2,705
Amortisation of land use rights	7	353	60
Amortisation of deferred government grants	5	(200)	–
Fair value gain on financial assets at fair value through profit or loss	5	(2)	–
Interest income	5	(185)	(85)
Dividend income from financial assets at fair value through profit or loss	5	(3)	(4)
Finance costs		–	815
Loss on disposal of property, plant and equipment	7	–	8
Allowance for irrecoverable trade receivables	7	–	535
Share of profit of an associate		(10)	(7)
		<hr/>	<hr/>
Operating profit before working capital changes		8,018	15,433
Net movement in balance with an associate		–	120
Net movement in balances with the shareholders		(1,898)	(928)
Net movement in balances with the directors		(71)	50
Decrease in inventories		1,011	1,941
Decrease in trade receivables		228	48
(Increase)/decrease in prepayments, deposits and other receivables		(597)	5,276
Increase/(decrease) in trade payables		188	(207)
Increase/(decrease) in accrued liabilities, deposits received and other payables		1,320	(3,077)
		<hr/>	<hr/>
Cash generated from operations		8,199	18,656
Interest paid		–	(815)
Income taxes paid		(1,222)	(2,240)
		<hr/>	<hr/>
<i>Net cash from operating activities</i>		6,977	15,601

CASH FLOW STATEMENT

for the year ended 31 December 2005

	Notes	2005 RMB'000	Restated 2004 RMB'000
Cash flows from investing activities			
Additions to land use rights		(580)	–
Deposit paid for acquisition of a land use right		–	(10,054)
Purchases of property, plant and equipment		(7,486)	(767)
Government grants received	25	360	10,000
Proceeds from disposal of property, plant and equipment		–	1
Deposit paid for acquisition of property, plant and equipment		(7,638)	–
Interest received		185	85
Dividend income from financial assets at fair value through profit or loss		3	4
		<u>(15,156)</u>	<u>(731)</u>
Net cash used in investing activities			
Cash flows from financing activities			
Proceeds from issuance of H shares		–	42,424
Share issue expenses		–	(15,050)
Repayments of bank loans		–	(15,000)
Proceeds from a bank loan		–	8,000
Dividends paid		(3,020)	(7,879)
		<u>(3,020)</u>	<u>12,495</u>
Net cash (used in)/generated from financing activities			
Net (decrease)/increase in cash and cash equivalents		(11,199)	27,365
Cash and cash equivalents at 1 January		30,900	3,535
Cash and cash equivalents at 31 December		19,701	30,900

Notes:

Major non-cash transactions

During the year ended 31 December 2005, the Company had the following major non-cash transactions:

- (i) A deposit of RMB150,000 paid in the prior year for acquisition of property, plant and equipment was capitalised as property, plant and equipment.
- (ii) A deposit of RMB14,054,000 paid in prior year for acquisition of a land use right was capitalised as a land use right.

During the year ended 31 December 2004, 10,000,000 domestic shares of the Company of RMB0.10 each held by Taiyuan Changcheng Optics and Electronics Industrial Corporation ("Taiyuan Changcheng"), a shareholder of the Company, was converted into 10,000,000 H shares of RMB0.10 each.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

1. GENERAL INFORMATION

Shanxi Changcheng Microlight Equipment Co. Ltd. (the "Company") was incorporated in the Mainland of the People's Republic of China (the "PRC") on 10 November 2000 as a joint stock limited company. The Company was established by Taiyuan Changcheng Optics and Electronics Industrial Corporation ("Taiyuan Changcheng"), transferring all of its operational net assets to the Company for 9,016,000 domestic shares as capital contribution by Taiyuan Changcheng to the Company, and Beijing Gensir Venture Capital Management Limited, Dandong Shuguang Industrial Group Company Limited, Taiyuan Tanghai Automatic Control Company Limited ("Taiyuan Tanghai") and Shanxi Shenhua Material Company Limited subscribing for 5,730,000, 3,400,000, 2,490,000 and 250,000 domestic shares respectively of the Company of nominal value of RMB1.00 each, in cash. Since then, the principal activities of the Company were the manufacture and sale of optical fibre products.

On 28 April 2002, the shareholders of the Company authorised the Company to sub-divide the Company's 20,886,000 issued domestic shares of nominal value of RMB1.00 each into 208,860,000 issued domestic shares of RMB0.1 each.

In connection with the listing of the Company's H shares on the Growth Enterprise Market (the "GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange"), 10,000,000 domestic shares of the Company of RMB0.10 each held by Taiyuan Changcheng was converted into 10,000,000 H shares of RMB0.10 each (the "Sale H Share").

The Company was listed on the GEM of the Stock Exchange on 18 May 2004 and 110,000,000 H shares, consisting of 100,000,000 new shares and 10,000,000 Sale H Shares with a par value of RMB0.10 each were issued to the public by way of placement at HK\$0.40 each.

The financial statements of the Company on pages 33 to 74 have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRS") issued by The Hong Kong Institute of Certified Public Accountants ("HKICPA"), the disclosure requirements of the Hong Kong Companies Ordinance and the Rules Governing the Listing of Securities on the GEM of the Stock Exchange ("GEM Listing Rules").

The registered office of the Company is located at No.212 Nanneihuan Street, Taiyuan City, Shanxi Province, PRC.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

2. ADOPTION OF NEW OR REVISED HKFRS

From 1 January 2005, the Company has adopted the new or revised standards and interpretations of HKFRS which are relevant to its operations. This includes the following new, revised and renamed standards:

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 12	Income Taxes
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 20	Accounting for Government Grants and Disclosure of Government Assistance
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 28	Investments in Associates
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKFRS 3	Business Combinations
HK(SIC) Int-15	Operating Leases – Incentives

All the standards have been applied retrospectively except where specific transitional provisions require a different treatment and accordingly the 2004 financial statements and their presentation have been amended in accordance with HKAS 8. Due to the change in accounting policies, the 2004 comparatives contained in these financial statements differ from those published in the financial statements of the Company for the year ended 31 December 2004.

Significant effects on current, prior or future periods arising from the first-time application of the standards listed above in respect to presentation, recognition and measurement of accounts are described in the following notes:

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

2. ADOPTION OF NEW OR REVISED HKFRS *(Continued)*

2.1 Adoption of HKAS 1

Upon adoption of HKAS 1, the Company's share of post-acquisition results of associates is presented net of the Company's share of tax attributable to associates.

2.2 Adoption of HKAS 17

Upon the adoption of HKAS 17, the land and building elements are considered separately for the purposes of lease classification, unless the lease payments cannot be allocated reliably between the land and buildings elements, in which case, the entire lease is generally treated as a finance lease. To the extent that the allocation of the lease payments between the land and buildings elements can be made reliably, the leasehold interests in land are reclassified to prepaid land lease payments under operating leases, which are carried at cost and subsequently recognised in the income statement on a straight-line basis over the lease term. This change in accounting policy has been applied retrospectively.

2.3 Adoption of HKAS 28

In prior years, investments in associates were stated at cost less impairment loss, and the results of associates were accounted for on the basis of dividends received or receivable during the year. On adoption of HKAS 28, interest in associates is accounted for using the equity method, with the cost of investment being adjusted by the share of the associates' post acquisition change in net assets. The Company's income statement reflects its share of the associates' post acquisition profit or loss after tax for the year.

2.4 Other standards adopted

The adoption of HKAS 2, 7, 8, 10, 12, 14, 16, 18, 19, 20, 21, 24, 27, 32, 33, 36, 37, 38, 39, HKFRS 3 and HK(SIC) Int-15 did not result in significant changes to the Company's accounting policies. The specific transitional provisions contained in some of these standards were considered. The adoption of these other standards did not result in significant changes to the amounts or disclosures in these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

2. ADOPTION OF NEW OR REVISED HKFRS *(Continued)***2.5 The effect of changes in the accounting policies on the income statement are summarised below:**

	Effect of adopting		Total
	HKAS 17 RMB'000	HKAS 28 RMB'000	
Year ended 31 December 2005			
Increase in amortisation of land use rights	(353)	–	(353)
Increase in share of profit of an associate	–	10	10
	<hr/>	<hr/>	<hr/>
Total (decrease)/increase in profit for the year	(353)	10	(343)
	<hr/>	<hr/>	<hr/>
(Decrease)/increase in basic earnings per share	RMB(0.114 cent)	RMB0.003 cent	RMB(0.111cent)
	<hr/>	<hr/>	<hr/>
		Effect of adopting	
	HKAS 17	HKAS 28	Total
	RMB'000	RMB'000	RMB'000
Year ended 31 December 2004			
Increase in amortisation of land use rights	(60)	–	(60)
Increase in share of profit of an associate	–	7	7
	<hr/>	<hr/>	<hr/>
Total (decrease)/increase in profit for the year	(60)	7	(53)
	<hr/>	<hr/>	<hr/>
(Decrease)/increase in basic earnings per share	RMB(0.022 cent)	RMB0.003 cent	RMB(0.019 cent)
	<hr/>	<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

2. ADOPTION OF NEW OR REVISED HKFRS *(Continued)***2.6 The effect of changes in the accounting policies on the balance sheet are summarised below:**

	Effect of adopting		Total <i>RMB'000</i>
	HKAS 17 <i>RMB'000</i>	HKAS 28 <i>RMB'000</i>	
At 1 January 2004 (Equity only)			
<u>Decrease in equity</u>			
Retained earnings	(95)	(156)	(251)
At 31 December 2004			
<u>Increase/(decrease) in assets</u>			
Property, plant and equipment	(2,845)	–	(2,845)
Land use rights	2,845	–	2,845
Interest in an associate	–	(149)	(149)
<u>(Decrease)/increase in equity</u>			
Retained earnings	(60)	7	(53)
	Effect of adopting		Total <i>RMB'000</i>
	HKAS 17 <i>RMB'000</i>	HKAS 28 <i>RMB'000</i>	
At 31 December 2005			
<u>Increase/(decrease) in assets</u>			
Property, plant and equipment	(17,126)	–	(17,126)
Land use rights	17,126	–	17,126
Interest in an associate	–	10	10
<u>Increase in equity</u>			
Retained earnings	–	10	10

The above adjustments in note 2.5 and 2.6 are applied retrospectively.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

2. ADOPTION OF NEW OR REVISED HKFRS *(Continued)***2.7 New Standards or interpretations that have been issued but are not yet effective:**

The Company has not early adopted the following standards or interpretations that have been issued but are not yet effective. The adoption of such standards and interpretations will not result in substantial changes to the Company's accounting policies.

HKAS 1 (Amendment)	Capital Disclosures ¹
HKAS 19 (Amendment)	Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures ²
HKAS 21 (Amendment)	The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation ²
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions ²
HKAS 39 (Amendment)	The Fair Value Option ²
HKAS 39 & HKFRS 4 (Amendment)	Financial Instruments: Recognition and Measurement and Insurance Contracts – Financial Guarantee Contracts ²
HKFRS 1 & HKFRS 6 (Amendments)	First-time Adoption of Hong Kong Financial Reporting Standards and Exploration for and Evaluation of Mineral Resources ²
HKFRS 6	Exploration for and Evaluation of Mineral Resources ²
HKFRS 7	Financial Instruments – Disclosures ¹
HK(IFRIC) – Int 4	Determining whether an Arrangement contains A Lease ²
HK(IFRIC) – Int 5	Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds ²
HK(IFRIC) – Int 6	Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment ³
HK(IFRIC) – Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies ⁴

1 Effective for annual periods beginning on or after 1 January 2007

2 Effective for annual periods beginning on or after 1 January 2006

3 Effective for annual periods beginning on or after 1 December 2005

4 Effective for annual periods beginning on or after 1 March 2006

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

The significant accounting policies that have been used in the preparation of these financial statements are summarised below.

The financial statements have been prepared on the historical cost basis except for certain financial liabilities and financial assets held for trading or are designated by the Company to be carried at fair value through profit or loss upon initial recognition. These financial assets have been measured at fair value. The measurement bases are fully described in the accounting policies below.

It should be noted that accounting estimates and assumptions are used in preparation of the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates.

(b) Associates

An associate is a company, not being a subsidiary, in which the Company has a long term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Company's share of the post-acquisition results and reserves of associates is included in the income statement and reserves, respectively. The Company's interests in associates are stated in the balance sheet at the Company's share of net assets under the equity method of accounting, less any impairment losses.

Unrealised gains on transactions between the Company and its associates are eliminated to the extent of the Company's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

(c) Foreign currency translation

The financial statements are presented in Renminbi ("RMB"), which is also the functional and presentation currency of the Company.

In the financial statements of the Company, foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the transaction date. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies at year-end exchange rates are recognised in the income statement.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)***(d) Income and expense recognition**

Revenue is recognised when it is probable that the economic benefits will flow to the Company and when the revenue can be measured reliably, on the following bases:

- from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Company maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;
- from the rendering of services, when the relevant services have been rendered;
- interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable; and
- dividend income, when the Company's right as a shareholder to receive payment is established.

Operating expenses are recognised in the income statement upon utilisation of the service.

(e) Property, plant and equipment

Property, plant and equipment, other than construction in progress, are stated at acquisition cost less accumulated depreciation and impairment losses.

The gain or loss arising on the disposal of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)***(e) Property, plant and equipment** *(Continued)*

Depreciation on property, plant and equipment is calculated using the straight-line method to allocate their costs less their residual values over their estimated useful lives as follows:

Medium term leasehold building	10 years or over the lease terms, whichever is shorter
Leasehold improvements	10 years or over the lease terms, whichever is shorter
Plant and machinery	10 years
Furniture and fixtures	5 years
Motor vehicles	5 years

The residual values and useful lives of property, plant and equipment are reviewed, and adjusted if appropriate, at each balance sheet date.

Construction in progress represents property, plant and equipment under construction, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction. Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

(f) Impairment testing of other intangible assets and property, plant and equipment

The Company's other intangible assets and property, plant and equipment are subject to impairment testing.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). As a result, some assets are tested individually for impairment and some are tested at the cash-generating unit level.

All individual assets or cash-generating units are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognised for the amount by which the asset's or cash-generating unit's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of fair value, reflecting market conditions less costs to sell and value in use, based on an internal discounted cash flow evaluation.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)***(g) Leases (as the lessee)**

The economic ownership of a leased asset is transferred to the lessee if the lessee bears substantially all the risks and rewards related to the ownership of the leased asset. The related asset is recognised at the time of inception of the lease at the present value of the lease payments plus incidental payment, if any, to be borne by the lessee. A corresponding amount is recognised as a finance lease liability, irrespective of whether some of these lease payments are payable up-front at the date of inception of the lease.

Subsequent accounting for assets held under finance lease agreement, such as depreciation methods and useful lives, corresponds to that applied to comparable acquired assets. The corresponding finance lease liability is reduced by lease payments less finance charges, which are expensed in income statement.

Operating lease payments are recognised as an expense on a straight-line basis. Affiliated costs, such as maintenance and insurance, are expensed as incurred.

(h) Financial assets

The Company's financial assets include amount due from shareholders, amount due from a director, trade and other receivables and financial assets at fair value through profit or loss/short term investment. They are included in balance sheet line items 'Due from shareholders', 'Due from a director', 'Trade receivables', 'Prepayments, deposits and other receivables', 'Financial assets at fair value through profit or loss/short term investment' and 'Cash and cash equivalent'.

The Company classifies its investment into the following categories: loans and receivables, financial assets at fair value through profit or loss, available-for-sale financial assets and held-to-maturity investments. Financial assets are assigned to the different categories by management on initial recognition, depending on the purpose for which the investments were acquired. The designation of financial assets is re-evaluated at every reporting date at which a choice of classification or accounting treatment is available.

All financial assets are recognised on their settlement date. All financial assets that are not classified as fair value through profit or loss are initially recognised at fair value, plus transaction costs.

Derecognition of financial instruments occurs when the rights to receive cash flows from the investments expire or are transferred and substantially all of the risks and rewards of ownership have been transferred. An assessment for impairment is undertaken at least at each balance sheet date whether or not there is objective evidence that a financial asset or a group of financial assets is impaired.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(h) Financial assets *(Continued)*

Financial assets at fair value through profit or loss include financial assets that are either classified as held for trading or are designated by the entity to be carried at fair value through profit or loss upon initial recognition. In addition, derivative financial instruments that do not qualify for hedge accounting are classified as held for trading.

Subsequent to initial recognition, the financial assets included in this category are measured at fair value with changes in fair value recognised in income statement. Financial assets originally designated as financial assets at fair value through profit or loss may not subsequently be re-classified.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Company provides money, goods or services directly to a debtor with no intention of trading the receivables. Loans and receivables are subsequently measured at amortised cost using the effective interest method, less provision for impairment. Any change in their value is recognised in income statement.

Trade receivables are provided against when objective evidence is received that the Company will not be able to collect all amounts due to it in accordance with the original terms of the receivables. The amount of the write-down is determined as the difference between the asset's carrying amount and the present value of estimated future cash flows.

(i) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate portion of direct overheads. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

(j) Accounting for income taxes

Current income tax assets and/or liabilities comprise those obligations to, or claims from, fiscal authorities relating to the current or prior reporting period, that are unpaid at the balance sheet date. They are calculated according to the tax rates and tax laws applicable to the periods to which they relate, based on the taxable profit for the year. All changes to current tax assets or liabilities are recognised as a component of tax expense in the income statement.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)***(j) Accounting for income taxes** *(Continued)*

Deferred income taxes are calculated using the liability method on temporary differences. This involves the comparison of the carrying amounts of assets and liabilities in the financial statements with their respective tax bases. However, in accordance with the rules set out in HKAS 12, no deferred taxes are recognised in conjunction with goodwill. This applies also to temporary differences associated with shares in subsidiaries and joint ventures if reversal of these temporary differences can be controlled by the Company and it is probable that reversal will not occur in the foreseeable future. In addition, tax losses available to be carried forward as well as other income tax credits to the Company are assessed for recognition as deferred tax assets.

Deferred tax liabilities are provided for in full. Deferred tax assets are recognised to the extent that it is probable that they will be able to be offset against future taxable income. Deferred tax assets and liabilities are calculated, without discounting, at tax rates that are expected to apply to their respective period of realisation, provided they are enacted or substantively enacted at the balance sheet date.

Most changes in deferred tax assets or liabilities are recognised as a component of tax expense in the income statement. Only changes in deferred tax assets or liabilities that relate to a change in value of assets or liabilities that are dealt with directly in equity are dealt with directly in equity.

(k) Cash and cash equivalents

Cash and cash equivalents include cash at bank and in hand as well as short term highly liquid investments.

(l) Retirement benefits

The Company participates in a central pension fund (the "CPS"), operated by the PRC government, for its entire staff. The Company is required to contribute a certain percentage of its payroll to the CPS to fund the benefits. The only obligation to the Company with respect to the CPS is to pay the ongoing required contributions under the CPS. Contributions under the CPS are charged to the income statement as they become payable in accordance with the rules of the CPS.

Short-term employee benefits are recognised for the number of paid leave days (usually holiday entitlement) remaining at the balance sheet date. They are included in accrued liabilities, deposits received and other payables at the undiscounted amount that the Company expects to pay as a result of the unused entitlement.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(m) Financial liabilities

The Company's financial liabilities include amount due to directors and trade and other payables. They are included in balance sheet line items 'Due to directors', 'Trade payables', 'Accrued liabilities, deposits received and other payables', 'Tax payable' and 'Dividend payable'.

Financial liabilities are recognised when the Company becomes a party to the contractual agreements of the instrument. All interest related charges are recognised as an expense in the income statement.

Trade payables are recognised initially at their fair value and subsequently measured at amortised cost, using the effective interest method.

(n) Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions. Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate. Government grants relating to assets are included in non-current liabilities as deferred government grants and are recognised in the income statement on a straight line basis over the expected useful lives of the related assets.

(o) Research and development cost

All research costs are charged to the income statement as incurred.

Expenditure incurred on projects to develop new products is capitalised and deferred only when the Company can demonstrate the technical feasibility of completing the project so that the products it will be available for use or sale, the Company's intention to complete and ability to use or sell the products, how the products will generate future economic benefits, the availability of resources to complete the project and the ability to measure reliably the expenditure during the development. Product development expenditure which does not meet these criteria is expensed when incurred.

Deferred development costs are stated at cost less any impairment losses and are amortised using the straight-line basis over the commercial lives of the underlying products commencing from the date when the products are available for use.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)***(p) Dividends**

Dividends proposed by the directors are classified as a separate allocation of retained earnings within the equity section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

(q) Related parties

A party is considered to be related to the Company if:

- (a) directly, or indirectly through one or more intermediaries, the party (i) controls, is controlled by, or is under common control with, the Company; (ii) has an interest in the Company that gives it significant influence over the Company; or (iii) has joint control over the Company;
- (b) the party is an associate;
- (c) the party is a jointly-controlled entity;
- (d) the party is a member of the key management personnel of the Company or its parent;
- (e) the party is a close member of the family of any individual referred to in (a) or (d);
- (f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
- (g) the party is a post-employment benefit plan for the benefit of employees of the Company, or of any entity that is a related party of the Company.

(r) Provisions and contingencies

A provision is recognised when there is a present obligation, legal or constructive, as a result of past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed regularly and adjusted to reflect the current best estimate. Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

(r) Provisions and contingencies *(Continued)*

Contingent liabilities are not recognised in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. A contingent asset is not recognised in the financial statements but disclosed when an inflow of economic benefits is probable.

4. CRITICAL ACCOUNTING ESTIMATES

Estimates are continually evaluated and are based on historical experiences and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal to the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(i) Net realisable value of inventories

This estimate is based on the current market condition and the historical experience of selling products of similar nature. It could change significantly as a result of competitor actions in response to severe industry cycles. The Company's management reassesses these estimations at the balance sheet dates.

(ii) Allowance for irrecoverable trade receivables

The Company's management determines the allowance for irrecoverable trade receivables. This estimate is based on the credit history of the Company's customers, past default experience and the current market condition. The Company's management reassesses these estimations at the balance sheet dates.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

5. REVENUE, OTHER INCOME AND GAINS

Revenue, which is also the Company's turnover, represents the net invoiced value of goods sold, after allowances for returns, trade discounts, value added tax and other taxes related to sales where applicable, and services rendered.

An analysis of the Company's revenue recognised during the year is as follows:

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
Revenue:		
Sale of goods	29,491	34,394
Rendering of services	–	574
	<hr/> 29,491	<hr/> 34,968
Other income and gains:		
Amortisation of deferred government grants	200	–
Government grants	340	71
Bank interest income	185	85
Fair value gain on financial assets at fair value through profit or loss	2	–
Dividend income from financial assets at fair value through profit or loss	3	4
Others	–	87
	<hr/> 730	<hr/> 247

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

6. SEGMENT INFORMATION

As over 90% of the turnover and the profit from operating activities of the Company for the years ended 31 December 2004 and 2005 are generated from the manufacture and sale of optical fibre products, no further segment information by business activity has been presented.

The Company has determined that geographical segment based on the location of customers is its primary segment reporting format. The Company's operating businesses are organised and managed separately, according to the location of the customers. In determining the Company's geographical segments, revenues and results are attributed based on the location of the customers. Over 90% of the Company's assets are located in the PRC.

The following table presents revenue and profit information for each of the Company's geographical segments:

	Hong Kong		PRC		Europe		Total	
	2005	2004	2005	2004	2005	2004	2005	Restated 2004
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Segment revenue:								
Sales to external customers	8,068	5,956	2,122	1,672	19,301	27,340	29,491	34,968
Segment results	4,216	3,494	959	981	9,531	16,039	14,706	20,514
Interest income							185	85
Administrative expenses							(9,192)	(8,110)
Other operating expenses							(574)	(275)
Operating profit							5,125	12,214
Finance costs							-	(815)
Share of profit of an associate							10	7
Profit before income tax							5,135	11,406
Income tax expense							(1,534)	(2,099)
Profit for the year							3,601	9,307

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

7. PROFIT BEFORE INCOME TAX

	2005	Restated
	RMB'000	2004
		<i>RMB'000</i>
Profit before income tax is arrived at after charging/(crediting):		
Auditors' remuneration	400	300
Cost of inventories sold	14,507	13,550
Cost of services provided	–	161
Staff costs (including directors' and supervisors' emoluments – note 8):		
Wages, salaries and other benefits	6,159	5,979
Pension scheme contributions	1,196	1,123
	7,355	7,102
Depreciation	2,930	2,705
Amortisation of land use rights	353	60
Research and development costs	468	181
Minimum lease payments under operating lease rentals in respect of:		
Land and buildings	672	672
Machineries	–	120
	672	792
Loss on disposal of property, plant and equipment	–	8
Allowance for irrecoverable trade receivables	–	535
Finance costs:		
Interest on bank loans wholly repayable within five years	–	815
Amortisation of deferred government grants	(200)	–

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

8. DIRECTORS' AND SUPERVISORS' REMUNERATION

Director's and supervisors' remuneration for the year disclosed pursuant to the GEM Listing Rules and Section 161 of the Hong Kong Companies Ordinance is as follows:

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
Directors		
Fees	–	–
Other emoluments		
Salaries, allowances and benefits in kind	751	579
Pension scheme contributions	14	14
	765	593

The emoluments of each director, on a named basis, for the year ended 31 December 2005 are set out below:

	Fees <i>RMB'000</i>	Salaries, allowances and benefits in kind <i>RMB'000</i>	Pension scheme contributions <i>RMB'000</i>	Total <i>RMB'000</i>
2005				
Executive directors				
Wang Gen Hai	–	290	8	298
Tian Qun Xu	–	182	–	182
Li Kang Sheng	–	183	6	189
Non executive directors				
Lin Yin Ping	–	48	–	48
Ni Guo Qiang#	–	12	–	12
Shen Ming Hong#	–	12	–	12
Li Li Cai#	–	12	–	12
Chen Yue Jie#	–	12	–	12
	–	751	14	765

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

8. DIRECTORS' AND SUPERVISORS' REMUNERATION (Continued)

	Fees	Salaries, allowances and benefits in kind	Pension scheme contributions	Total
	RMB'000	RMB'000	RMB'000	RMB'000
2004				
Executive directors				
Wang Gen Hai	–	196	7	203
Tian Qun Xu	–	150	–	150
Li Kang Sheng	–	141	7	148
Non executive directors				
Lin Yin Ping	–	48	–	48
Ni Guo Qiang#	–	12	–	12
Shen Ming Hong#	–	12	–	12
Li Li Cai#	–	12	–	12
Chen Yue Jie#	–	8	–	8
	–	579	14	593

Independent non-executive directors

	2005	2004
	RMB'000	RMB'000
Supervisors		
Fees	–	–
Other emoluments		
Salaries, allowances and benefits in kind	14	14
	14	14

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

8. DIRECTORS' AND SUPERVISORS' REMUNERATION *(Continued)*

The emoluments of each supervisor, on a named basis, for the year ended 31 December 2005 are set out below:

	Fees <i>RMB'000</i>	Salaries and allowances <i>RMB'000</i>	Pension scheme contributions <i>RMB'000</i>	Total <i>RMB'000</i>
2005				
Zhang Fu Sheng	-	2	-	2
Meng Yan	-	5	-	5
Wang Guang Hua	-	2	-	2
Bai Yin Quan	-	5	-	5
	-	14	-	14
2004				
Zhang Fu Sheng	-	2	-	2
Meng Yan	-	5	-	5
Wang Guang Hua	-	2	-	2
Bai Yin Quan	-	5	-	5
	-	14	-	14

There was no arrangement under which a director or supervisor waived or agreed to waive any remuneration during the year.

During the year, no emoluments were paid by the Company to a director or supervisor as an inducement to join, or upon joining the Company, or as compensation for loss of office.

Included in staff costs are key management personnel compensation which comprises the following categories:

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
Short term employee benefits	765	593
Post-employment benefits	14	14
	779	607

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees in the Company for the year included three (2004: three) directors, details of whose remuneration are reflected in the analysis presented in note 8 above. Details of the remuneration of the remaining two (2004: two) non-director, highest paid employees for the year are as follows:

	2005 RMB'000	2004 <i>RMB'000</i>
Salaries and allowances	211	192
Pension scheme contributions	13	10
	224	202

The remuneration of each of the non-director, highest paid individuals is as follows:

	2005 RMB'000	2004 <i>RMB'000</i>
I	126	72
II	98	130
	224	202

During the year, no emoluments were paid by the Company to the two non-directors, highest paid employees as an inducement to join or upon joining the Company, or as compensation for loss of office.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

10. INCOME TAX EXPENSE

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
Current		
– PRC	1,100	2,099
Deferred	434	–
	<hr/>	<hr/>
Total income tax expense	1,534	2,099
	<hr/>	<hr/>

Hong Kong profits tax has not been provided as the Company had no assessable profits arising in Hong Kong during the year (2004: Nil). Taxes on profits assessable elsewhere have been calculated at the applicable rates of tax prevailing in the jurisdiction in which the Company operates, based on existing legislation, interpretations and practices in respect thereof during the year.

According to the applicable corporate income tax law of the PRC, the Company, which operates in the high technology industrial development zone in Taiyuan (太原高新技術產業開發區), the PRC, and which is registered as a high technology development enterprise, is entitled to a concessionary corporate income tax rate of 15%, which has been applied for the two years ended 31 December 2005 and 2004.

Reconciliation between tax expense applicable to profit before income tax using the applicable rate in the PRC to the tax expense at the applicable tax rate is as follows:

	2005 <i>RMB'000</i>	Restated 2004 <i>RMB'000</i>
Profit before income tax	5,135	11,406
	<hr/>	<hr/>
Tax at applicable tax rate of 33% (2004: 33%)	1,695	3,764
Effect of concessionary rate granted by local authority	(592)	(1,663)
Effect of temporary differences in prior years	434	–
Effect of share of after tax profit of an associate	(3)	(2)
	<hr/>	<hr/>
Income tax expense	1,534	2,099
	<hr/>	<hr/>

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

11. DIVIDEND

	2005 RMB'000	2004 <i>RMB'000</i>
Interim dividend of RMBNil per share (2004: RMB0.015 per share)	<u> -</u>	<u> 4,633</u>

At an extraordinary general meeting held on 24 December 2004, the Company declared an interim dividend of RMB0.015 per share for the nine months ended 30 September 2004 amounting to approximately RMB4,633,000.

The directors did not recommend the payment of a final dividend in respect of the year.

12. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to equity holders of the Company of RMB3,601,000 (2004 (restated): RMB9,307,000) and 308,860,000 (2004: the weighted average of 271,155,082) shares in issue during the year.

No diluted earnings per share amounts have been presented for the two years ended 31 December 2005 and 2004 as no diluting events existed during these years.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

13. PROPERTY, PLANT AND EQUIPMENT

	Medium term						Restated Total RMB'000
	leasehold building	Leasehold improvements	Plant and machinery	Furniture and fixtures	Motor vehicles	Construction in progress	
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	
At 1 January 2004							
Cost	2,539	781	13,225	2,810	1,316	4,563	25,234
Accumulated depreciation	(783)	(190)	(6,324)	(1,461)	(1,079)	-	(9,837)
Net book amount	<u>1,756</u>	<u>591</u>	<u>6,901</u>	<u>1,349</u>	<u>237</u>	<u>4,563</u>	<u>15,397</u>
Year ended 31 December 2004							
Opening net book amount	1,756	591	6,901	1,349	237	4,563	15,397
Additions	-	-	432	37	298	-	767
Transfer	-	-	4,563	-	-	(4,563)	-
Disposals	-	-	-	-	(9)	-	(9)
Depreciation	(254)	(78)	(1,532)	(566)	(275)	-	(2,705)
Closing net book amount	<u>1,502</u>	<u>513</u>	<u>10,364</u>	<u>820</u>	<u>251</u>	<u>-</u>	<u>13,450</u>
At 31 December 2004							
Cost	2,539	781	18,220	2,847	1,436	-	25,823
Accumulated depreciation	(1,037)	(268)	(7,856)	(2,027)	(1,185)	-	(12,373)
Net book amount	<u>1,502</u>	<u>513</u>	<u>10,364</u>	<u>820</u>	<u>251</u>	<u>-</u>	<u>13,450</u>
Year ended 31 December 2005							
Opening net book amount	1,502	513	10,364	820	251	-	13,450
Additions	-	-	562	64	-	7,010	7,636
Depreciation	(254)	(78)	(1,839)	(575)	(184)	-	(2,930)
Closing net book amount	<u>1,248</u>	<u>435</u>	<u>9,087</u>	<u>309</u>	<u>67</u>	<u>7,010</u>	<u>18,156</u>
At 31 December 2005							
Cost	2,539	781	18,782	2,911	1,436	7,010	33,459
Accumulated depreciation	(1,291)	(346)	(9,695)	(2,602)	(1,369)	-	(15,303)
Net book amount	<u>1,248</u>	<u>435</u>	<u>9,087</u>	<u>309</u>	<u>67</u>	<u>7,010</u>	<u>18,156</u>

The leasehold building of the Company is located at No.212 Nanneihuan Street, Taiyuan City, Shanxi Province in the PRC. The land use right to which the medium term leasehold building attached is held by Taiyuan Changcheng and is leased to the Company for use under an operating lease (note 28). The land use right is situated in the PRC.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

14. LAND USE RIGHTS

The Company's interests in land use rights represent prepaid operating lease payments and their net book values are analysed as follows:

	2005	Restated
	RMB'000	2004
		<i>RMB'000</i>
At beginning of the year		
Cost	3,000	3,000
Accumulated amortisation	(155)	(95)
Net book value	2,845	2,905
For the year ended		
Opening net book value	2,845	2,905
Additions	14,634	–
Amortisation	(353)	(60)
Net book value	17,126	2,845
At end of the year		
Cost	17,634	3,000
Accumulated amortisation	(508)	(155)
Net book value	17,126	2,845

The Company's land use rights are situated in the PRC and are held under medium term leases.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

15. DEPOSIT FOR ACQUISITION OF A LAND USE RIGHT

On 26 September 2004, the Company entered into an agreement (the "Agreement") with Taiyuan Economic and Technology Development Zone Management Committee (the "Taiyuan ETD Committee") (太原經濟技術開發區管理委員會) for constructing and establishing new production facilities on a piece of land with an approximate area of 59,000 square metres (the "Land") in Taiyuan Economic and Technology Development Zone (the "Taiyuan ETD Zone") (太原經濟技術開發區), the PRC.

The Agreement was supplemented by a supplemental agreement dated on the same date entered into between the Company and Taiyuan ETD Committee, whereby the Company agreed to the aggregate consideration for the acquisition of the land use right in respect of the Land (the "Land Consideration") at approximately RMB14,054,000. The Land Consideration has been fully paid by the Company during the year ended 31 December 2004.

The Company has obtained the relevant land use right certificate and accordingly the deposit for acquisition of a land use right was capitalised as land use right during the year ended 31 December 2005 (note 14).

16. INTEREST IN AN ASSOCIATE

	2005 RMB'000	Restated 2004 RMB'000
Share of net assets	3,179	3,169
Due to an associate	(113)	(113)
	<u>3,066</u>	<u>3,056</u>

Particulars of the associate at 31 December 2005 are as follows:

Name	Business structure	Place of registration and operation	Particulars of registered capital	Percentage of equity interest directly attributable to the Company	Principal activities
Shanxi Huayuan Transport Optical Technology and Engineering Company Limited ("Shanxi Transport")*#	Corporate	PRC	RMB11,000,000	36.36%	Development of fibre optic intelligent transport system business in the PRC

* *Not audited by Grant Thornton*

Registered as a limited liability company under the PRC law

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

16. INTEREST IN AN ASSOCIATE *(Continued)*

The amount due to an associate is unsecured, interest-free and not repayable within one year.

A summary of the results for the years ended 31 December 2005 and 31 December 2004, and of the assets and liabilities of the associate at the respective balance sheet date is set out below:

	2005 RMB'000	2004 <i>RMB'000</i>
Total revenue	1,256	1,101
Profit for the year	28	20
	At 31 December 2005 RMB'000	At 31 December 2004 <i>RMB'000</i>
Total assets	11,624	11,014
Total liabilities	1,005	423

17. DEFERRED TAX ASSETS

The movement of the deferred tax assets is as follows:

	Decelerated tax depreciation <i>RMB'000</i>	Others <i>RMB'000</i>	Total <i>RMB'000</i>
At 1 January 2004	113	321	434
Deferred tax credited/(charged) to the income statement during the year	<u>—</u>	<u>—</u>	<u>—</u>
Deferred tax assets at 31 December 2004 and 1 January 2005	113	321	434
Deferred tax charged to the income statement during the year	<u>(113)</u>	<u>(321)</u>	<u>(434)</u>
Deferred tax assets at 31 December 2005	<u>—</u>	<u>—</u>	<u>—</u>

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

18. DUE FROM SHAREHOLDERS

Details of the amounts due from shareholders are set out below:

Name	2005 RMB'000	2004 <i>RMB'000</i>
Taiyuan Changcheng	1,777	226
Taiyuan Tanghai	347	–
	2,124	226

The maximum amounts outstanding during the years are as follows:

Name	2005 RMB'000	2004 <i>RMB'000</i>
Taiyuan Changcheng	1,777	226
Taiyuan Tanghai	347	5

The movement of the balance with Taiyuan Changcheng in current year was mainly attributable to the Company's payments of operating expenses on behalf of Taiyuan Changcheng.

The amounts due from shareholders are unsecured, interest-free and repayable on demand.

19. BALANCES WITH DIRECTORS

Particulars of the amount due from a director, disclosed pursuant to Section 161B of the Hong Kong Companies Ordinance, are as follows:

Name	2005 RMB'000	Maximum amount outstanding during the year <i>RMB'000</i>	2004 <i>RMB'000</i>
Wang Gen Hai	71	146	–

Balances with directors are unsecured, interest-free and repayable on demand.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

20. INVENTORIES

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
Raw materials	410	355
Work in progress	2,271	4,130
Finished goods	2,318	1,525
	4,999	6,010

21. TRADE RECEIVABLES

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
Trade receivables, net	9,864	10,092

An allowance for impairment has been made for estimated irrecoverable amounts from the sales of goods of RMB500,000 (2004: RMB583,000). The basis of determination for an allowance for impairment are set out in note 4.

An ageing analysis of the Company's net trade receivables as at the balance sheet date is as follows:

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
0 – 90 days	7,655	9,556
91 – 180 days	1,848	82
181 – 365 days	361	454
	9,864	10,092

The trading terms with customers are largely on credit. Invoices are normally payable within three months (2004: three months) of issuance. The Company maintains strict control over its outstanding receivables and has credit control policy in place to minimise its credit risk. Overdue balances are regularly reviewed by management.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

22. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS/SHORT TERM INVESTMENT

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
Fair value of interest in unlisted investment fund	102	100

The financial assets at fair value through profit or loss/short term investment of the Company as at the balance sheet date, which are stated at their fair value, represent interest in an unlisted investment fund registered in the PRC.

23. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include the following components:

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
Cash at bank and in hand	19,701	30,900

Included in cash and cash equivalents of the Company is RMB19,598,000 (2004: RMB6,440,000) of bank balances denominated in RMB placed with banks in the PRC. RMB is not a freely convertible currency.

Cash at bank earns interest at floating rates based on daily bank deposit rates.

At 31 December 2005, certain bank deposits of the Company amounted to RMB2,005,000 (2004: Nil) were held as guarantee in respect of acquisition of machineries and temporarily not available for use by the Company. This guarantee has been released subsequent to the balance sheet date in January 2006.

24. TRADE PAYABLES

An ageing analysis of the Company's trade payables as at the balance sheet date is as follows:

	2005 <i>RMB'000</i>	2004 <i>RMB'000</i>
0 – 90 days	284	99
91 – 180 days	–	3
181 – 365 days	6	13
Over 365 days	31	18
	321	133

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

25. DEFERRED GOVERNMENT GRANTS

	<i>Notes</i>	<i>RMB'000</i>
At 1 January 2004		–
Additions during the year	(a)	10,000
At 31 December 2004 and 1 January 2005		10,000
Additions during the year	(b)	360
Amortisation during the year		(200)
At 31 December 2005		10,160

Notes:

- (a) The balance represented a subsidy granted by the Taiyuan Ministry of Finance and the Taiyuan City Development and Planning Bureau (太原市發展計劃委員會) for the Company's business expansion project (the "Project") in the Taiyuan ETD Zone (note 15).
- (b) The balance represented subsidies granted by the Taiyuan Ministry of Finance, the Taiyuan Foreign Trade Bureau (太原市外經貿廳) and the Taiyuan City Science and Technology Bureau (太原市科技局) for enhancing the Company's facilities for development of foreign trade and research and development.

26. SHARE CAPITAL

	2005	2004
	<i>RMB'000</i>	<i>RMB'000</i>
Authorised, issued and fully paid:		
198,860,000 (2004: 198,860,000) domestic shares of RMB0.10 each (<i>note a</i>)	19,886	19,886
110,000,000 (2004: 110,000,000) H shares of RMB0.10 each (<i>note b</i>)	11,000	11,000
	30,886	30,886

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

26. SHARE CAPITAL *(Continued)*

There was no movement in the Company's share capital during the year ended 31 December 2005. The movements in the Company's share capital during the year ended 31 December 2004 were as follows:

- (a) In connection with the listing of the Company's H shares on the GEM of the Stock Exchange, 10,000,000 domestic shares of the Company of RMB0.10 each held by Taiyuan Changcheng was converted into 10,000,000 H shares of RMB0.10 each and the movements of the Company's issued domestic shares were as follows:

	Number of shares issued	Total RMB'000
At 1 January 2004	208,860,000	20,886
Reduction of domestic shares and conversion into H shares <i>(note (b))</i>	<u>(10,000,000)</u>	<u>(1,000)</u>
At 31 December 2004	<u>198,860,000</u>	<u>19,886</u>

- (b) The Company was listed on the GEM of the Stock Exchange on 18 May 2004 and 110,000,000 H shares, consisting of 100,000,000 new shares (the "New H shares") and 10,000,000 Sale H shares (note a) with a par value of RMB0.10 each were issued to the public by way of placement at HK\$0.40 each. The net proceeds from placing of 100,000,000 New H Shares, after deducting share issue expenses, was approximately RMB27,374,000.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

27. RESERVES

The amounts of the Company's reserves and the movements therein for the current and prior years are presented in the statement of changes in equity on page 35.

The statutory reserves consist of the statutory surplus reserve and the statutory public welfare fund:

(a) Statutory surplus reserve

The Company's articles of association require the appropriation of 10% of the Company's profit after tax each year to the statutory surplus reserve until the balance reaches 50% of the Company's registered capital. According to the provisions of the Company's articles of association, in normal circumstances, the statutory surplus reserve shall only be used for making up losses, capitalisation into share capital and expansion of the Company's production and operations. For the capitalisation of the statutory surplus reserve into share capital, the remaining amount of such reserve shall not be less than 25% of the registered capital.

(b) Statutory public welfare fund

Pursuant to the PRC Company Laws, the Company shall make an allocation from its profit after tax at the rate of 5% to 10% to the statutory public welfare fund. The statutory public welfare fund may only be utilised for capital items for the collective welfare of the employees. Individual employees only have the right to the use of the facilities purchased with the statutory public welfare fund and the titles to such facilities will remain with the Company. The statutory public welfare fund forms part of the total equity but is non-distributable other than in the event of liquidation.

The capital surplus of the Company represents the excess of the issue price over the nominal value of the Company's shares issued at a premium.

In accordance with the article of association of the Company, the Company's profit available for distribution is determined based on the lower of the amounts reported in accordance with the PRC accounting standards and regulations and those reported in accordance with accounting principles generally accepted in Hong Kong.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

28. COMMITMENTS

At the balance sheet date, the Company had the following outstanding commitments:

(i) Capital commitments

	<i>Note</i>	2005 RMB'000	2004 <i>RMB'000</i>
Contracted, but not provided for			
– Buildings		9,192	–
– Plant and machinery		5,593	–
		14,785	–
Authorised, but not contracted for			
– Establishment of a joint venture	(a)	15,000	15,000
– Development of Project	(a)	–	16,000
		15,000	31,000

Note:

- (a) On 18 September 2002, the Company entered into a letter of intent with Shanxi Economic and Trade Limited Liability Company to establish a joint venture, which the Company will own a 60% interest, for the development of the Project (note 25). The Company's contribution to the joint venture will amount to approximately RMB15,000,000. Up to the date of these financial statements, the joint venture has not yet been established.

(ii) Operating lease commitments

The Company leases its office properties and land use right from Taiyuan Changcheng under operating lease arrangements for terms ranging from five to thirty years with an option to renew the lease and renegotiate the terms at the expiry dates or at dates mutually agreed between the Company and Taiyuan Changcheng. None of the leases include contingent rentals.

At the balance sheet date, the total future minimum lease payments under non-cancellable operating leases payable by the Company are as follows:

	2005 RMB'000	2004 <i>RMB'000</i>
Within one year	672	672
In the second to fifth years, inclusive	2,538	2,588
After five years	12,613	13,235
	15,823	16,495

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

29. RISK MANAGEMENT OBJECTIVES AND POLICIES

The Company is exposed to market risk, including primarily changes in currency exchange rates.

The Company does not have written risk management policies and guidelines. However, the board of directors meets periodically to analyse and formulate measures to manage the Company's exposure to market risk, including primarily changes in currency exchange rates. Generally, the Company uses a conservative strategy toward its risk management. As the Company's exposure to the market risk is kept to a minimum, the Company has not used any derivatives and other instruments for hedging purposes. The Company does not hold or issue derivative financial instruments for trading purposes.

(a) Interest rate risk

The Company has no significant interest rate risk as there are no interest-bearing borrowings.

(b) Foreign currency risk

The Company is exposed to foreign exchange risk arising from the exposure of RMB against United States Dollars ("USD") and Hong Kong Dollars ("HKD") respectively, in respect of its receipt of settlement from overseas customers. Considering that there was insignificant fluctuation in the exchange rates between RMB and USD and between RMB and HKD, the directors of the Company believes its exposure to exchange rate risk is not high, and accordingly, the Company does not intend to hedge its exposure to foreign exchange movements.

(c) Credit risks

Generally, the maximum credit risk exposure of financial assets is the carrying amount of the financial assets as shown on the face of the balance sheet. Credit risk, therefore, is only disclosed in circumstances where the maximum potential loss differs significantly from the financial asset's carrying amount.

The Company's bank deposits are mainly deposited with banks in Hong Kong and the PRC.

The Company has concentration of credit risk due to its relatively small customer base. The Company performs ongoing credit evaluation of its customers' financial positions. Provision for impairment is based upon a review of the expected collectibility of all receivables.

(d) Fair value

The fair values of current financial assets and financial liabilities are not materially different from their carrying amounts because of their immediate or short term maturity.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December 2005

30. RELATED PARTY TRANSACTIONS

In addition to the transactions and balances detailed elsewhere in these financial statements, the Company had the following material related party transactions:

	<i>Notes</i>	2005 RMB'000	2004 <i>RMB'000</i>
Rental expenses incurred to a shareholder	<i>(i)</i>	672	672
Rental expense incurred to an associate	<i>(ii)</i>	—	120

Notes:

- (i) The rental expenses incurred to Taiyuan Changcheng are for the leases of the office premises and a land use right. The rental expenses incurred to Taiyuan Changcheng were based on mutually agreed terms.
- (ii) The rental expenses were incurred to Shanxi Transport for the lease of production equipment to the Company. The rental expenses incurred to Shanxi Transport were based on mutually agreed terms. The rental agreement between both parties was terminated in January 2005.
- (iii) During the year ended 31 December 2005, the Company entered into an agreement amounted to RMB3,089,400 with Taiyuan Tanghai for acquisition of machineries. A deposit of RMB309,000 was paid by the Company to Taiyuan Tanghai and was included in the amount due from Taiyuan Tanghai of RMB347,000 at 31 December 2005 (note 18).

The directors of the Company have confirmed that all of the above transactions were entered into in the ordinary course of the Company's business.

31. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements on pages 33 to 74 were approved and authorised for issue by the board of directors on 28 March 2006.

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN that an annual general meeting (“**AGM**”) of Shanxi Changcheng Microlight Equipment Co. Ltd. (the “**Company**”) will be held at No. 212 Nanneihuan Street, Taiyuan City, Shanxi Province, the People’s Republic of China (the “**PRC**”) on Thursday, 18 May 2006 at 4:00 p.m. for the following purposes:

- I. As ordinary resolutions:
 1. to consider and approve the report of the directors of the Company for the year ended 31 December 2005;
 2. to consider and approve the report of the supervisory committee of the Company for the year ended 31 December 2005;
 3. to consider and approve the audited financial statements of the Company for the year ended 31 December 2005;
 4. to consider and approve the re-appointment of Grant Thornton as the auditors of the Company for the year 2006 with a term of office until the conclusion of the next AGM and to authorise the board of directors to fix their remunerations; and
 5. to discuss any other issues.

By order of the Board

Wang Gen Hai

Chairman

Taiyuan City, Shanxi Province, the PRC, 28 March 2006

Notes:

1. Any shareholder of the Company entitled to attend and vote at the AGM mentioned above is entitled to appoint one or more proxies to attend and vote at the AGM on his or her behalf in accordance with the articles of association of the Company. A proxy need not be a shareholder of the Company.
2. In order to be valid, a proxy form of holder of H Shares and, if such proxy form is signed by a person under a power of attorney or other authority on behalf of the appointer, a notarially certified copy of that power of attorney or authority shall be deposited at the Standard Registrars Limited at 26/F Tesbury Centre, 28 Queen’s Road East, Hong Kong (“the Company’s Share Registrar”) not less than 24 hours before the time for holding the AGM or 24 hours before the time appointed for taking the poll.
3. In order to be valid, a proxy form of holder of domestic shares and, if such proxy form is signed by a person under a power of attorney or other authority on behalf of the appointer, a notarially certified copy of that power of attorney or authority shall be deposited at the registered address of the Company not less than 24 hours before the time for holding the AGM or 24 hours before the time appointed for taking the poll.
4. Shareholders of the Company or their proxies shall produce documents of their proof of identity when attending the AGM.

NOTICE OF ANNUAL GENERAL MEETING

5. A proxy may exercise the right to vote by a show of hands or by poll. However, if more than one proxy is appointed by a shareholder, such proxies shall only exercise the right to vote by poll.
6. The register of shareholders of the Company will be closed from 18 April 2006 to 18 May 2006 (both days inclusive), during which no transfer of shares will be registered. As regards holders of H Shares and in order to ascertain the entitlement to attendance at the AGM, all properly completed transfer forms accompanied by the relevant share certificate must be lodged with the Company's Share Registrar not later than 17 April 2006 at 4:00 p.m. for registration.
7. Shareholders of the Company who intend to attend the AGM have to notify in writing of their attendance by sending such notice to the Company by hand, post or fax (fax number: 86 351 706 5996) not later than 27 April 2006.
8. Registered address of the Company and the contact details of the Company are as follows:

No. 212 Nanneihuan Street
Taiyuan City
Shanxi Province
The PRC
Fax number: 86 351 706 5996
9. The AGM is expected to last for about half a day. Shareholders or proxies are reminded that any expenses in transportation, accommodation and meals will be incurred at their own cost.