

Report of the Directors

SUBSIDIARIES

The Company owns 100% of the issued and outstanding share capital of its subsidiaries. As of December 31, 2004, these subsidiaries are as follows:

1. Semiconductor Manufacturing International (Shanghai) Corporation
Principal country of operation: Shanghai, PRC
Place of incorporation: Shanghai, PRC
Legal entity: Wholly foreign-owned enterprise
Total investment: US\$3,000,000,000
Registered capital: US\$1,000,000,000
Equity holder: the Company (100%)
2. Semiconductor Manufacturing International (Beijing) Corporation
Principal country of operation: Beijing, PRC
Place of incorporation: Beijing, PRC
Legal entity: Wholly foreign-owned enterprise
Total investment: US\$1,250,000,000
Registered capital: US\$650,000,000
Equity holder: the Company (100%)
3. Semiconductor Manufacturing International (Tianjin) Corporation
Principal country of operation: Tianjin, PRC
Place of incorporation: Tianjin, PRC
Legal entity: Wholly foreign-owned enterprise
Total investment: US\$1,100,000,000
Registered capital: US\$690,000,000
Equity holder: the Company (100%)
4. Semiconductor Manufacturing International (Chengdu) Corporation
Principal country of operation: Sichuan, PRC
Place of incorporation: Sichuan, PRC
Legal entity: Wholly foreign-owned enterprise
Total investment: US\$175,000,000
Registered capital: US\$60,000,000
Equity holder: the Company (100%, indirectly through Semiconductor Manufacturing International (AT) Corporation)
5. SMIC Consulting Corporation
Principal country of operation: Shanghai, PRC
Place of incorporation: Shanghai, PRC
Legal entity: Wholly foreign-owned enterprise
Total investment: US\$1,000,000
Registered capital: US\$700,000
Equity holder: the Company (100%)
6. エス・エム・アイ・シ・ジャパン 株式会社
SMIC Japan Corporation (for identification only)
Principal country of operation: Japan
Place of incorporation: Japan
Authorised capital: JPY10,000,000 divided into 200 shares of a par value of JPY50,000
Equity holder: the Company (100%)
7. SMIC, Americas
Principal country of operation: California, US
Place of incorporation: California, US
Registered capital: No registered capital, authorized to issue 50,000,000 shares of common stock
Equity holder: the Company (100%)
8. Better Way Enterprises Limited
Principal country of operation: Western Samoa
Place of incorporation: Western Samoa
Authorised capital: US\$1,000,000 divided into 1,000,000 shares of a par value of US\$1.00
Equity holder: the Company (100%)
9. SMIC Europe S.R.L.
Principal country of operation: Milan, Italy
Place of incorporation: Milan, Italy
Registered capital: Euros10,000
Equity holder: the Company (100%)

Report of the Directors

10. Garrison Consultants Limited
Place of incorporation: Western Samoa
Authorised capital: US\$1,000,000 divided into 1,000,000 shares of a par value of US\$1.00
Equity holder: the Company (100%, indirectly through Better Way Enterprises Limited)
11. Semiconductor Manufacturing International (AT) Corporation
Principal Country of operation: Cayman Islands
Place of incorporation: Cayman Islands
Authorised capital: US\$50,000 divided into 500,000 shares of a par value of US\$0.10 each

SHARE CAPITAL

During the year ended December 31, 2004, the Company issued the following shares:

- 762,343 Series B convertible preference shares, which were converted into 8,439,220 Ordinary Shares (after giving effect to the 10-for-1 stock split immediately prior to the Global Offering) upon the completion of the Global Offering;
- 3,428,571 Series C convertible preference shares, which were converted into 59,999,990 Ordinary Shares upon the completion of the Global Offering;
- 96,628,571 Series D convertible preference shares, which were converted into 1,620,507,900 Ordinary Shares upon the completion of the Global Offering;
- 3,030,303,000 Ordinary Shares including Ordinary Shares represented by American Depositary Receipts, in connection with the Global Offering;
- 487,499,990 Ordinary Shares to Beida Microelectronics Investment Ltd. ("Beida") upon receipt of payment for and conversion

of Series C convertible preference shares pursuant to a Second Amended and Restated Series C Preference Share Purchase Agreement dated December 19, 2003 between the Company, the majority of its existing Series C convertible preference shareholders (including Beida) and an additional investor for the subscription by such investors in Series C convertible preference shares;

- 136,640 Ordinary Shares to a service provider upon achievement of certain milestones pursuant to a warrant to purchase Series B convertible preference shares we issued to the service provider;
- 23,957,830 Ordinary Shares to a technology partner in exchange for machinery and equipment; and
- 20,766,689 Ordinary Shares to certain of the Company's employees pursuant to the Stock Option Plans.

During the year ended December 31, 2004, the Company repurchased 54,750 Series A convertible preference shares (equivalent to 547,500 Ordinary Shares) and 13,367,500 Ordinary Shares from the Company's employees pursuant to the terms of the Stock Option Plans, which repurchases have been reflected on the Company's share register as at December 31, 2004.

	Number of Ordinary Shares Outstanding
Outstanding Share Capital as at December 31, 2004	18,232,959,139*

* This has not included 780,000 Ordinary Shares the Company repurchased from some of its employees pursuant to the Stock Option Plans, but which, for accounting purposes have been reflected in the Company's Consolidated Statement of Shareholders' Equity and Comprehensive Income (Loss).

Report of the Directors

** This has included 487,499,990 Ordinary Shares the Company issued to Beida, but which, for accounting purposes have been reflected in the Company's Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss) as Shares already issued as at January 1, 2004.

REPURCHASE, SALE OR REDEMPTION OF SECURITIES

Other than repurchases by the Company of Ordinary Shares from employees pursuant to the terms of the Stock Option Plans, as disclosed in the paragraphs (Share Capital) above, the Company has not repurchased, sold or redeemed any additional Ordinary Shares since the date of the Company's prospectus dated March 8, 2004 in relation to the Global Offering.

PUBLIC FLOAT

As at the date of this annual report, the public (as defined in the Rules Governing the Listing of Securities on the SEHK ("Listing Rules")) holds more than 25% of the Company's total issued share capital.

DEBT TO EQUITY RATIO

As of December 31, 2004, the Company's debt to equity ratio was 26.6% calculated based on the sum of the short-term borrowings, current portion of long-term debt and long-term debt divided by total shareholders' equity.

DIVIDENDS AND DIVIDEND POLICY

At the end of 2004, the Company's accumulated deficit decreased to US\$136.4 million from an accumulated deficit of US\$207.3 million at the end of 2003. The Company has not declared or paid any cash dividends on the Ordinary Shares. We intend to retain any earnings for use in the Company's business and do not currently intend to pay cash dividends on the Ordinary Shares. Dividends, if any, on the outstanding shares will be declared by and subject to the discretion of the Board and must be approved at the annual

general meeting of shareholders. The timing, amount and form of future dividends, if any, will also depend, among other things, on:

- the Company's results of operations and cash flow;
- the Company's future prospects;
- the Company's capital requirements and surplus;
- the Company's financial condition;
- general business conditions;
- contractual restrictions on the payment of dividends by the Company to its shareholders or by the Company's subsidiaries to the Company; and
- other factors deemed relevant by the Board.

The Company's ability to pay cash dividends will also depend upon the amount of distributions, if any, received by the Company from its wholly owned Chinese operating subsidiaries. Under the applicable requirements of Chinese Company Law, the Company's subsidiaries in China may only distribute dividends after they have made allowances for:

- recovery of losses, if any;
- allocation to the statutory common reserve funds;
- allocation to staff and workers' bonus and welfare funds; and
- allocation to a discretionary common reserve fund if approved by the Company's shareholders.

More specifically, these operating subsidiaries may only pay dividends after 10% of their net profit has been set aside as statutory common reserves and a discretionary percentage of their

net profit has been set aside for the staff and workers' bonus and welfare funds. These operating subsidiaries are not required to set aside any of their net profit as statutory common reserves if such reserves are at least 50% of their respective registered capital. Furthermore, if they record no net income for a year, they generally may not distribute dividends for that year.

CONTRACTS OF SIGNIFICANCE

There were no contracts of significance during the year in which any of the Directors were materially interested.

SUPPLIERS AND CUSTOMERS

In 2004, the Company's largest and five largest raw materials suppliers accounted for approximately 10.6% and 40.7%, respectively, of the Company's overall raw materials purchases. None of the Directors or shareholders (which to the knowledge of the

Directors own more than 5% of the Company's issued share capital) or their respective associates had interests in any of the Company's five largest suppliers. Almost all of the Company's materials are imported free of value-added tax and import duties due to concessions granted to the semiconductor industry in China.

For 2004, the Company's largest and five largest customers accounted for approximately 13.4% and 59.1%, respectively, of the Company's total overall sales. The Company's Chairman, Richard R. Chang, and his wife together hold shareholding interests of less than 0.1% in one of the Company's five largest customers in 2004, Texas Instruments. None of the other Directors or shareholders (which to the knowledge of the Directors own more than 5% of the Company's issued share capital) or their respective associates had interests in any of the Company's five largest customers in 2004.

Report of the Directors

DIRECTOR'S INTERESTS

Save as disclosed below, none of the Directors or chief executive of the Company had any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance), as recorded in the register kept by the Company under section 352 of the SFO or otherwise notified to the Company and the SEHK pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers as at December 31, 2004:

Board Member	Nature of Interest	Number of Shares	Percentage of Aggregate Interests to Total Issued Share Capital
Richard R. Chang	Personal Interest ⁽¹⁾	29,790,000	
	Personal Interest ⁽²⁾	100,000	
	Corporate Interest ⁽³⁾	20,000,000	
	Interest of Spouse	9,790,000	
	Interest of Child under 18	11,200,000	
Total		70,880,000	*
Ta-Lin Hsu	Corporate Interest ⁽⁴⁾	15,300,010	
	Personal Interest ⁽⁵⁾	500,000	
Total		15,800,010	*
Yen-Pong Jou	Personal Interest ⁽⁵⁾	500,000	*
Tsuyoshi Kawanishi	Personal Interest ⁽⁵⁾	500,000	
	Personal Interest ⁽⁶⁾	1,500,000	
Total		2,000,000	*
Henry Shaw	Personal Interest ⁽⁵⁾	500,000	*
Lip-Bu Tan	Personal Interest ⁽⁵⁾	500,000	*
Yang Yuan Wang	Personal Interest ⁽⁵⁾	500,000	*

Notes:

* Indicates less than 1%.

- Pursuant to a Charitable Pledge Agreement dated December 1, 2003, Richard Ru Gin Chang and his spouse, Scarlett K. Chang (collectively, the "Donors") have pledged to transfer 10,000,000 of such Ordinary Shares as a charitable gift to The Richard and Scarlett Chang Family Foundation, a Delaware nonprofit nonstock corporation organized exclusively for religious, charitable, scientific, literary and education purposes within the meaning of Section 501(c)(3) of the US Internal Revenue Code of 1986, as amended, such transfer to be made in full at or prior to the death of the surviving Donor.
- Richard R. Chang has been granted an option to purchase 100,000 Ordinary Shares, if fully exercised. As of December 31, 2004, the option has not been exercised.
- These Ordinary Shares are held by Jade Capital Company, LLC, a Delaware limited liability company (the "LLC"), of which Richard Ru Gin Chang and his spouse, Scarlett K.

Chang (collectively, the "Members"), are the sole members. It is the current intent of the Members that all or a portion of the net income of the LLC be used for philanthropic purposes, including but not limited to contributions to charitable organizations that are tax-exempt under Section 501(c)(3) of the US Internal Revenue Code of 1986, as amended.

- Ta-Lin Hsu has a controlling interest in AP3 Co-Investment Partners, LDC, which holds 15,300,010 Ordinary Shares.
- Each independent non-executive Director and non-executive Director was granted an option to purchase 500,000 Ordinary Shares, if fully exercised. As of December 31, 2004, these options have not been exercised. Lai Xing Cai has advised the Company that he will decline such option.
- Tsuyoshi Kawanishi has been granted options to purchase an aggregate of 1,500,000 Ordinary Shares, if fully exercised. As of December 31, 2004, these options have not been exercised.

DIRECTORS' SERVICE CONTRACTS

No Director proposed for re-election at the forthcoming AGM has a service contract which is not determinable by the Company or any of its subsidiaries within one year without payment of compensation, other than statutory compensation.

SUBSTANTIAL SHAREHOLDERS

The following table sets forth information regarding the beneficial ownership as of December 31, 2004 of the Ordinary Shares, by each shareholder who is known by the Company to beneficially own more than 5% of the Company's outstanding shares.

Name of Shareholder	Number of Shares Owned	Percentage Owned
Shanghai Industrial Investment (Holdings) Company Limited ("SIIC")	1,814,991,340 (long position) ⁽¹⁾	9.95% (long position)
	9,816,457 (long position) ⁽²⁾	0.054% (long position)
	16,609,680 (long position) and	0.091% (long position)
	4,794,491(short position) ⁽³⁾	0.026% (short position)
Total:	1,841,417,477 (long position) and 4,794,491 (short position)	10.10% (long position) 0.026% (short position)
Motorola, Inc. and Motorola (China) Electronics Limited ⁽²⁾	1,427,915,070 ⁽³⁾	7.8%
Blessington Services Limited ⁽⁴⁾	1,051,493,250	5.8%

Notes:

(1) All such shares are held by S. I. Technology Production Holdings Limited ("SITPHL") which is wholly-owned by Shanghai Industrial Holdings Limited ("SIHL").

In addition, subsidiaries of SIIC namely, SIIC Treasury (B.V.I.) Limited, SIIC Capital (B.V.I.) Limited, Shanghai Investment Holdings Limited, Shanghai Industrial Investment Treasury Company Limited, SIIC CM Development Limited, SIIC CM Development Funds Limited, and Eternal Success Holdings Limited, are entitled to exercise or control the exercise of more than one-third of the voting power at the general meetings of SIHL. By virtue of the SFO, SIIC and its subsidiaries namely, Shanghai Investment Holdings Limited and Shanghai Industrial Investment Treasury Company Limited are deemed to be interested in the 1,814,991,340 Shares held by SITPHL. The Company's Directors, Lai Xing Cai and his alternate director, Yao Fang, are chairman and executive director of SIHL respectively. It is the Company's understanding that voting and investment control over the Ordinary Shares beneficially owned by SIHL are maintained by the board of directors of SIHL.

(2) All such Shares are held by SIIC CM Development Funds Limited which is in turn jointly owned by SIIC CM Development Limited and Eternal Success Holdings Limited (each holding 50%) and which are in turn wholly-owned subsidiaries of SIIC.

(3) All such Shares are held by SIIC Treasury (B.V.I.) Limited which is wholly-owned by SIIC.

(4) It is the Company's understanding that voting and investment control over the Ordinary Shares beneficially owned by Motorola and MCEL are maintained by the respective boards of directors of Motorola and MCEL, which have the power to delegate such authority. All such delegations are revocable by the Motorola and MCEL boards at any time.

(5) On or about February 28, 2005, Motorola and MCEL sold an aggregate of 517,489,221 Ordinary Shares. Following this transaction, Motorola and MCEL own, in the aggregate, 910,425,849 Ordinary Shares.

(6) Consists of 195,594,250 Ordinary Shares registered in the name of Homer Investment Holdings Ltd., 171,179,800 Ordinary Shares registered in the name of Asset Success

Report of the Directors

Investments Limited, 171,179,800 Ordinary Shares registered in the name of Easy Street Investments Limited, 171,179,800 Ordinary Shares registered in the name of Seaboard Investments Limited, 171,179,800 Ordinary Shares registered in the name of Visible Profit Investments Limited and 171,179,800 Ordinary Shares registered in the name of Whole Gain Investments Limited. The Company's Director, Yen-Pong Jou, is a

director of each of these entities, all of which are wholly owned subsidiaries of Blessington Services Limited. Blessington Services Limited is accustomed to act in accordance with the instructions from the directors of its shareholder, Deutsche International Corporation Services Limited, which currently holds 84% of the shareholding in Blessington Services Limited.

EMOLUMENTS TO THE DIRECTORS

Board Member	Directors' Fees	Salaries, Housing Allowances, Other Benefits in Kind	Benefits from options granted*	Discretionary Bonuses	Amounts paid to induce member to join Board
Richard Ru Gin Chang	—	US\$143,518	—	US\$46,825	—

* For a description of any options exercised in 2004, please see the summary of grants of options as set forth under "Outstanding Share Options."

On November 10, 2004, the Board granted to each independent non-executive Director and non-executive Director, an option to purchase 500,000 Ordinary Shares at a price per Ordinary Share of US\$0.22. These options vest on the earlier of (i) March 19, 2005 and (ii) one day prior to the AGM, subject to the Director continuing to serve on the Board on that date. These options expire on November 9, 2009. Lai Xing Cai has advised the Company that he will decline such option.

Emoluments	Number of Individuals
HK\$1,000,001–HK\$1,500,000	3
HK\$4,500,001–HK\$5,000,000	1

FIVE HIGHEST PAID INDIVIDUALS

The five individuals whose emoluments were the highest in the Company for the year include Richard R. Chang, the Company's President and Chief Executive Officer, whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining four individuals during the year are as follows:

	2004
Salaries and other benefits	US\$430,144
Bonus	US\$105,665
Stock option benefits*	US\$620,060

* for a description of any options exercised in 2004, please see the summary of grants of options as set forth under "Outstanding Share Options."

REMUNERATION POLICY

The Company's employees are compensated using cash and a variety of additional incentives. In addition to a monthly salary, the Company's employees have the opportunity to earn additional merit-based bonuses on a quarterly basis according to the overall performance of the Company, each individual and his or her department. Furthermore, the Company's employees are eligible to participate on a quarterly basis in the Company's profit-sharing plan. Additional benefits include participation in the Company's 2004 global equity incentive compensation program, social welfare benefits for qualified Chinese employees, a global medical insurance plan for overseas employees and optional housing benefits and educational programs for employees with families.

The Directors are compensated for their services as Directors, primarily by grants of options, to purchase Ordinary Shares under the 2004 Stock Option Plan. The compensation committee of the Company (the "Compensation Committee") proposed to issue each independent non-executive Director and non-executive Director an option to purchase the number of Ordinary Shares, which is consistent with the compensation received by board members in other similar publicly-traded companies.

Pursuant to an incentive program involving the offering for sale of housing constructed by the Company to the Directors, employees and certain service providers, the Company sold one property to each of Richard R. Chang, the Company's Chairman and Chief Executive Officer, and one of the Company's five highest paid employees, at the same price as that at which other properties of the same type have been sold by the Company under the program.

The Company's local Chinese employees are entitled to a retirement benefit based on their basic salary upon retirement and their length of

service in accordance with a state-managed pension plan. The PRC government is responsible for the pension liability to these retired staff. We are required to make contributions to the state-managed retirement plan equivalent to 20%–22.5% of the monthly basic salary of current employees. Employees are required to make contributions equivalent to 6%–8% of their basic salary. The contribution of such an arrangement is approximately US\$2.5 million, US\$1.5 million and US\$1.0 million for the years ended December 31, 2004, 2003 and 2002, respectively. The retirement benefits do not apply to expatriate employees.

None of the Directors is aware of any information which would reasonably indicate that the Company is not, or was not, beginning from the completion of the Global Offering until December 31, 2004, in compliance with the Code of Best Practice as set out in Appendix 14 of the Listing Rules.

The Directors confirm that the Company has adopted a code of conduct regarding securities transactions by Directors on terms no less exacting than required by Appendix 10 of the Listing Rules. After due inquiry of the Directors, the Company reasonably believes that the Directors have complied with required standards set out in the Model Code on Securities Transactions by Directors throughout the financial period.

The retiring auditors, Deloitte Touche Tohmatsu, have signified their willingness to continue in office. A resolution will be proposed at the AGM to reappoint them as the auditors of the Company and to authorize the audit committee of the Company (the "Audit Committee") to fix their remuneration.

CONNECTED TRANSACTIONS

On or around March 18, 2004, upon completion of the Global Offering, the Company entered into identical indemnification agreements with each

Report of the Directors

member of its Board of Directors and its executive officers, whereby the Company agreed to (inter alia) indemnify its Directors and executive officers in respect of liability arising from their capacity as Directors and executive officers of the Company (collectively, the "Indemnification Agreements").

Pursuant to the Indemnification Agreements, the Company is obliged to indemnify each Director, to the fullest extent permitted by law, against all costs, charges, expenses, liabilities, losses and obligations incurred in connection with any threatened, pending or completed action, suit, proceeding or alternative dispute resolution mechanism, or any hearing, inquiry or investigation which might lead to any of the foregoing (an "Applicable Claim") by reason of or arising out of any event or occurrence relating to the fact that he is or was Director of the Company, or any of its subsidiaries, or is or was serving as the Company's request at another incorporation or enterprise, or by reason of any activity or inactivity while serving in such capacity (an "Indemnifiable Event"). The Company's obligation to indemnify its Directors pursuant to the Indemnification Agreement are subject to certain exceptions and limitations set out therein.

The Indemnification Agreements were taken into effect upon execution. The Indemnification Agreements will continue in effect with respect to Applicable Claims relating to Indemnifiable Events regardless of whether the relevant Director continues to serve as a Director or to serve at any other enterprise at its request.

Such transactions with the Directors would constitute continuing connected transactions for the Company under Chapter 14A of the Listing Rules, and would normally require full disclosure by shareholders' circular and prior approval by independent Shareholders. However, such transactions represent a normal commercial arrangement which is common industry practice, and the Company considers that strict

compliance with the requirements under the Listing Rules of (inter alia) full disclosure and obtaining prior Shareholders' approval would be unduly onerous and inappropriate. Accordingly, before the completion of the Global Offering, the Company applied to the SEHK for a waiver from strict compliance with application requirements under Chapter 14A of the Listing Rules, subject to the following conditions:

- (A) obtaining confirmation from the Company's legal advisers as to Cayman Islands law, Maples and Calder, that the Indemnification Agreements are entered into and the Company's obligations thereunder are assumed by the Company in accordance with the Articles and applicable Cayman Islands law; and
- (B) that if and when payment by the Company under any Indemnification Agreement exceeds the higher of either (i) HK\$10,000,000 or (ii) 3 per cent. of the book value of the Company's net tangible assets (as disclosed in its latest published audited accounts), the Company will disclose to its shareholders particulars of such Indemnification Agreement and amounts payable thereunder in accordance with the requirements set out in the Listing Rules.

For the year ended December 31, 2004, no payment was made to any Director under the Indemnification Agreements.

Report of the Directors

The independent non-executive Directors have reviewed the above continuing connected transactions and confirm that these transactions have been entered into:

- (i) in the ordinary and usual course of business of the Company;
- (ii) either on normal commercial terms or, if there are not sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favorable to the Company than terms available to or from independent third parties; and
- (iii) in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the Company's shareholders as a whole.

The Company's external auditors have provided a letter confirming that:

- (i) the continuing connected transactions have received the approval of the Board;
- (ii) the Company has received a confirmation from its legal advisers as to Cayman Islands law, Maples and Calder, that the Indemnification Agreements are entered into and the Company's obligations

thereunder are assumed by it, in accordance with the Articles and applicable Cayman Islands law; and

- (iii) if and when payment by the Company under any Indemnification Agreement exceeds the higher of either (i) HK\$10,000,000 or (ii) 3 per cent. of the book value of the Company's net tangible assets (as disclosed in the Company's latest published audited accounts), the Company had disclosed to its shareholders particulars of such Indemnification Agreement and amounts payable thereunder.

At the AGM, the Company will propose to the shareholders certain amendments to the form of the Indemnification Agreements in order to comply with changes in the Listing Rules. The proposed indemnification agreement ("New Indemnification Agreement") will limit the term of the indemnification agreement to three (3) years and limit the Company's annual aggregate liability. For more details, please see the Circular in relation to the Connected Transactions. If the New Indemnification Agreement is approved by the shareholders in the AGM, any New Indemnification Agreement will supersede any Indemnification Agreement which the Company has previously entered into with any existing Directors.

Report of the Directors

EMPLOYEES

The following table sets forth, as of the dates indicated, the number of the Company's employees serving in the capacities indicated:

Function	As of December 31,		
	2002	2003	2004
Managers	224	338	570
Professionals ⁽¹⁾	817	961	3,109
Technicians	1,837	2,746	3,389
Clerical staff	315	398	572
Total ⁽²⁾	3,193	4,443	7,640

Notes:

- (1) Professionals include engineers, lawyers, accountants and other personnel with specialized qualifications, excluding managers.
- (2) Includes 99, 38 and 14 temporary and part-time employees in 2002, 2003 and 2004, respectively.

The following table sets forth, as of the dates indicated, a breakdown of the number of the Company's employees by geographic location:

Location of Facility	As of December 31,		
	2002	2003	2004
Shanghai	3,146	4,033	5,481
Beijing	40	341	1,026
Tianjin	—	49	1,107
United States	5	13	16
Europe	—	4	5
Japan	2	3	3
Hong Kong	—	—	2
Total	3,193	4,443	7,640

The Company's success depends to a significant extent upon, among other factors, the Company's ability to attract, retain and motivate qualified personnel.

As of December 31, 2004, 920 and 133 of the Company's employees held master's degrees and doctorate degrees, respectively. As of the same date, 2,408 of the Company's employees possessed a bachelor's degree. The Company's engineers received an average of 40 hours of continuing training per person in 2004.

The Company has also entered into agreements with Shanghai University to offer a bachelor's degree program and Shanghai's Fudan University and Jiaotong University to offer graduate degree programs for its technicians. These employees can earn these degrees in either Microelectronics or Solid-state Circuitry. In addition, the Company employs many qualified personnel that have relocated back to China after receiving valuable industry experience overseas.

Report of the Directors

As a supplement to their salaries, the Company's employees have the opportunity to earn additional merit-based bonuses on a quarterly basis according to the overall performance of the Company, each individual and his or her department. Furthermore, the Company's employees are eligible to participate on a quarterly basis in the Company's profit-sharing plan. Additional benefits include participation in the 2004 global equity incentive compensation program, social welfare benefits for qualified Chinese employees, a global medical insurance plan for overseas employees and optional housing benefits and educational programs for employees with families.

The Company provides occupational health and hygiene management for the welfare of the Company's employees. This includes the

monitoring of air quality, illumination, radiation, noise and drinking water. The Company's employees are not covered by any collective bargaining agreements.

Market risk is the risk of loss related to adverse changes in market prices, including foreign currency exchange rates and interest rates of financial instruments. The Company is exposed to these risks in the ordinary course of our business. The Company's exposure to financial risks derives primarily from changes in interest rates and foreign currency exchange rates. To mitigate some of these risks, the Company utilizes spot, forward, and derivative financial instruments. The Company does not engage in any speculative activities.

Report of the Directors

SHARE OPTION SCHEMES

Stock Option Plan

The following is a summary of the principal terms of the 2004 Stock Option Plan (the "SOP") conditionally adopted by the Company by way of shareholders' resolution dated February 16, 2004 and Directors' resolutions passed on January 16, 2004. Adoption of the SOP took effect on March 18, 2004 being the first date of dealings in the Ordinary Shares.

Summary of the terms of the SOP

(a) *Purpose of the SOP*

The purposes of the SOP are to attract, retain and motivate employees and Directors of, and other service providers to the Company, to provide a means, on and after the Global Offering, of compensating them through the grant of stock options for their contribution to the Company's, growth and profits, and to allow such employees, Directors and service providers to participate in such growth and profitability.

(b) *Who may join*

The Compensation Committee may, at its discretion, invite any employee, officer or other service provider of (including, but not limited to, any professional or other adviser of, or consultant or contractor to) the Company whether located in China, the United States or elsewhere to take up options to subscribe for Ordinary Shares at a price calculated in accordance with sub-paragraph (e) below. The Compensation Committee may also grant stock options to a Director who is not an employee of the Company ("Non Employee Director").

(c) *Stock Options*

Stock options granted under the SOP ("Stock Options") shall entitle a participant ("Participant") of the SOP to purchase a specified number of Ordinary Shares or ADSs (the "Plan Shares") during a specified period at a price calculated in accordance with sub-paragraph (e) below. Three types of Stock Options may be granted under the Plan, an Incentive Stock Option, a Non-Qualified Stock Option or a Director Option. An Incentive Stock Option is a stock option that falls within the meaning of Section 422 of the U.S. Internal Revenue Code of 1986 and may only be granted to employees of the Company and its subsidiaries from time to time. A Non-Qualified Stock Option is a stock option that is not an Incentive Stock Option. A Director Option is a Non-Qualified Stock Option granted to a Non-Employee Director.

The Company shall issue an Award Document to each Participant of the SOP who is granted a Stock Option. The Award Document shall set out the terms and provisions of the grant of a Stock Option to a Participant including applicable vesting dates or the attainment of specified performance goals (as determined by the Compensation Committee or the Administrator (as defined below), as the case may be) by the Participant. The Company may allow a Participant to exercise his or her Stock Options prior to vesting, provided the Participant agrees to enter into a repurchase agreement in respect of the Stock Option with the Company. The Compensation Committee may also (i) accelerate the vesting of a Stock Option, (ii) set the date on which any Stock Option may first become exercisable, or (iii) extend the period during which a Stock

Option remains exercisable, except that no Stock Options may be exercised after the tenth anniversary of the date of grant.

The SOP does not provide for any payment upon application or acceptance of an option.

(d) *Administration of the SOP*

The Compensation Committee shall be responsible for the administration of the SOP. Its responsibilities include granting Stock Options to eligible individuals, determining the number of Plan Shares subject to each Stock Option, and determining the terms and conditions of each Stock Option. The Compensation Committee is not obliged to grant Stock Options to Participants in uniform terms.

Accordingly, the terms and conditions which may be imposed may vary between Participants. Any determination by the Compensation Committee in relation to the carrying out and administering of the SOP shall be final and binding. No member of the Compensation Committee shall be liable for any action or determination made in good faith, and the members of the Compensation Committee shall be entitled to indemnification and reimbursement in the manner provided in the Articles.

The Compensation Committee may delegate some or all of its authority under the SOP to an individual or individuals (each an "Administrator") who may either be one or more of the members of the Committee or one or more of the officers of the Company. An individual's status as an Administrator shall not affect his or her eligibility to participate in the SOP. The Compensation Committee shall not

delegate its authority to grant Stock Options to executive officers of the Company.

(e) *Exercise Price*

The exercise price per Plan Share purchasable under a Stock Option shall be fixed by the Committee at the time of grant or by a method specified by the Compensation Committee at the time of grant, but in no event shall be less than the Fair Market Value of a Plan Share on the date such Stock Option is granted.

The Fair Market Value of a Share will be the higher of (i) the closing price of the Ordinary Shares on the SEHK's daily quotation sheet on the applicable date of grant (which must be a business day), and (ii) the average closing price of the Ordinary Shares on the SEHK (as stated in the relevant daily quotation sheets of the SEHK) for the five business days immediately preceding the date of grant.

The Fair Market Value of the ADSs shall be the highest of (i) the closing price of the ADSs on the New York Stock Exchange on the applicable date of grant, and (ii) the average closing price of the ADSs on the New York Stock Exchange for the five business days immediately preceding the date of grant.

(f) *Limit of the SOP*

The number of Ordinary Shares that may be issued under the SOP and the Employee Stock Purchase Plan (the "Global Limit") shall not exceed ten per cent. of the issued and outstanding Ordinary Shares immediately following the closing of the Global Offering (i.e., 1,694,186,849 Ordinary Shares of the Company, which represents approximately 9.29% of the total issued shares of the Company as at March 29, 2005).

Report of the Directors

The number of Ordinary Shares which may be issued pursuant to any outstanding Stock Options granted and yet to be exercised under the SOP and all outstanding purchase right granted under the Employee Stock Purchase Plan or other employee stock purchase plan of the Company must not exceed in aggregate 30 per cent. of the issued and outstanding Ordinary Shares in issuance from time to time.

(g) *Individual Limit*

The total number of Ordinary Shares underlying Stock Options or other options granted by the Company to, and the total number of Ordinary Shares that may be purchased under one or more purchase rights granted under the Employee Stock Purchase Plan or any other employee stock purchase plan granted by the Company by, a Participant (including both exercised and outstanding Stock Options) in any twelve-month period may not exceed at any time one per cent. (1%) (or 0.1 per cent. in the case of an independent non-executive Director) of the then issued and outstanding Ordinary Shares unless otherwise allowed under the Listing Rules.

(h) *Exercise of Option*

A Stock Option shall vest, and be exercised, in accordance with the terms of the SOP, the relevant Award Document and any rules and procedures established by the Compensation Committee for this purpose. However, the term of each Stock Option shall not exceed ten years from the date of grant.

(i) *Director Options*

Each non-employee Director may be granted Stock Options to purchase Ordinary Shares (or an equivalent of ADSs) on the terms set out in the relevant Award Document.

The Directors shall exercise all authority and responsibility with respect to Stock Options granted to Directors subject to the requirements of the Listing Rules.

All non-employee Directors' Stock Options shall only vest provided that the Director has remained in service as a Director through such vesting date. The unvested portion of a Stock Option granted to a Director shall be forfeited in full if the Director's service with the Board ends for any reason prior to the applicable vesting date.

Following termination of a non-employee Director's service on the Board, such non-employee Director (or his or her estate, personal representative or beneficiary, as the case may be) shall be entitled to exercise those of his or her Stock Options which have vested as of the date of such termination within 120 days following such termination.

(j) *Termination or lapse of Option*

A Stock Option shall terminate or lapse automatically on:

- (i) the expiry of ten years from the date of grant;
- (ii) the termination of a Participant's employment or service with the Company for a reason set out in sub-paragraph (l) below;

Report of the Directors

- (iii) save as to any contrary directions of the Compensation Committee, in the event of a complete liquidation or dissolution of the Company, all Stock Options outstanding at the time of the liquidation or dissolution shall terminate without further action by any person;
- (iv) the sale or other divestiture of a subsidiary, division or operating unit of the Company (where the Participant is employed by such subsidiary, division or operating unit); and
- (v) termination of the service relationship with a service provider (where the Participant is a service provider of the Company).

(k) *Rights are personal to Participant*

A Stock Option is personal to the Participant and shall be exercisable by such Participant or his Permitted Transferee (as defined below) only. An option shall not be transferred other than by will, by the laws of descent and distribution or pursuant to a domestic relations order. The Compensation Committee may also, at its discretion and subject to such terms and conditions as it shall specify, permit the transfer of a Stock Option for no consideration to a Participant's family members or to a trust or partnership established for the benefit of such family members (collectively "Permitted Transferees"). Any Stock Option transferred to a Permitted Transferee shall be further transferable only by will or the laws of descent and distribution or, for no consideration, to another Permitted Transferee of the Participant.

(l) *Termination of employment or service*

If a Participant's employment or service with the Company is terminated for the following reasons:

- (i) the failure or refusal of the Participant to substantially perform the duties required of him or her as an employee or officer of, or service provider to, the Company;
- (ii) any material violation by the Participant of any law or regulation applicable to any business of the Company, or the Participant's conviction of, or a plea of nolo contendere to, a felony, or any perpetration by the Participant of a common law fraud against the Company; or
- (iii) any other misconduct by the Participant that is materially injurious to the financial condition, business or reputation of the Company, then all Stock Options granted to the Participant, whether or not then vested, shall immediately lapse.

The Compensation Committee may permit any Incentive Stock Option to convert into a Non-Qualified Stock Option as of a Participant's termination of employment for purposes of providing such Participant with the benefit of any extended exercise period applicable to Non-Qualified Stock Options when the contract of employment of the holder of Incentive Stock Option terminates.

(m) *Change in control of the Company*

The Compensation Committee may specify at or after the date of grant of a Stock Option the effect that a Change in Control (as defined in the SOP) will have on such Stock Option. The Compensation

Report of the Directors

Committee may also, in contemplation of a Change in Control, accelerate the vesting, exercisability or payment of Stock Options to a date prior to the Change in Control, if the Compensation Committee determines that such action is necessary or advisable to allow the participants to realise fully the value of their share options in connection with such Change in Control.

(n) *Change in the capital structure of the Company*

In the event of an alteration in the capital structure of the Company (which includes a capitalisation issue, reduction of capital, consolidation, sub-division of Plan Shares, or rights issue to purchase Plan Shares at a price substantially below market value), the Compensation Committee may equitably adjust the number and kind of Plan Shares authorised for issuance in order to preserve, the benefits or potential benefits intended to be made available under the SOP. In addition, upon the occurrence of any of the foregoing events, the number of outstanding Stock Options and the number and kind of shares subject to any outstanding Stock Option and the purchase price per share under any outstanding Stock Option shall be equitably adjusted so as to preserve the benefits or potential benefits intended to be made available to Participants.

(o) *Period of the SOP*

The SOP shall remain in force for a period of ten years commencing on the date of Shareholders' approval of the Plan.

(p) *Amendments and Termination*

The SOP may be altered, amended in whole or in part, suspended and terminated by the Board at any time

provided alterations or amendments of a material nature or any change to the terms of the Stock Options granted must be approved by the shareholders of the Company. Any alteration or amendment must be in accordance with the requirements of the Listing Rules or permitted by the Hong Kong Stock Exchange.

If the SOP is terminated early by the Board, no further Stock Options may be offered but unless otherwise stated in the Plan, Stock Options granted before such termination shall continue to be valid and exercisable in accordance with the SOP.

(q) *Voting and dividend rights*

No voting rights shall be exercisable and no dividends shall be payable in relation to Stock Options that have not been exercised.

(r) *Cancellation of Stock Options*

Stock Options granted but not exercised may not be cancelled unless an offer to cancel share options has been made pursuant to Rule 13 of the Hong Kong Code on Takeovers and Mergers and the Hong Kong Securities and Futures commission has consented to such cancellation.

(s) *Ranking of Ordinary Shares*

The Ordinary Shares to be allotted upon the exercise of a Stock Option will be subject to the Articles for the time being in force and will rank pari passu with the Plan Shares in issue on the date of such allotment.

EMPLOYEE STOCK PURCHASE PLAN

The following is a summary of the principal terms of the Employee Stock Purchase Plan (the "ESPP") conditionally adopted by the Company by way of shareholders' resolutions dated February 16, 2004 and Directors' resolutions passed on January 16, 2004.

Summary of the terms of the ESPP

(a) *Purposes of the ESPP*

The purposes of the ESPP are to attract, retain and motivate employees of the Company, to provide a means of compensating the employees for their contributions to the growth and profitability by permitting such employees to purchase the ADSs of the Company at a discount and receive favourable U.S. income tax treatment on a subsequent qualifying disposition of such ADSs.

(b) *Who may join*

Subject to any contrary directions given by the Compensation Committee, all full-time and regular part-time employees (the "Employees") of the Company as at the first business day (the "Offering Date") of a given period specified by the Committee (the "Offering Period") shall be eligible to enroll in the ESPP. To be eligible to purchase ADSs, all Employees must maintain his or her employment status, without interruption, with the Company through the last day of each Offering Period (the "Purchase Date").

(c) *Administration of the ESPP*

The Compensation Committee shall be responsible for the administration of the ESPP. Its responsibility includes determining the maximum amount that any Employee may contribute to his or her account under the ESPP during any

calendar year; determining the starting and ending dates of each Offering Period; changing the Offering Periods, limiting the frequency and/or number of changes in the amount withheld during an Offering Period, permitting payroll withholding in excess of the amounts designated by a participant ("Participant") of the ESPP in order to adjust for delays or mistakes in the Company's processing of properly completed withholding elections, and ensuring that amounts applied towards the purchase of the Plan Shares for each Participant properly correspond with amounts withheld from the Participant's compensation.

Any determination by the Compensation Committee in relation to the carrying out and administering of the ESPP shall be final and binding. The Compensation Committee may delegate some or all of its authority under the ESPP to an Administrator. Any actions undertaken by the Administrator in accordance with the Compensation Committee's delegation of authority shall have the same force and effect as if undertaken directly by the Compensation Committee. No member of the Compensation Committee shall be liable for any action or determination made in good faith, and the members of the Compensation Committee shall be entitled to indemnification and reimbursement in the manner provided by the Company's by-laws as they may be amended from time to time.

(d) *Offering Period*

The ESPP shall be implemented by a series of Offering Periods. An eligible Employee of the Company may elect to participate in the ESPP for any Offering Period by completing the requisite documents. No Offering Period shall commence until the closing of an initial Public Offering (as

Report of the Directors

defined in the ESPP). The Compensation Committee shall determine the starting and ending dates of each Offering Period but no Offering Period shall be shorter than 6 months or longer than 27 months.

(e) *Employees' Contributions under the ESPP*

All amounts that a Participant contributes ("Contributions") shall be credited to his or her account under the ESPP. Participants must elect to have payroll deductions made on each payday during the Offering Period in a dollar amount specified in the documents submitted by him or by her. The Compensation Committee may permit Participants to make supplemental Contributions into his or her account, on such terms and subject to such limitations as the Compensation Committee may decide.

Participants may, on one occasion only during an Offering Period, decrease the rate of his or her Contributions to his or her account for the Offering Period, including a decrease to zero. The Participant may restore his or her Contributions to the original level, prior to the earlier of,

- (i) six months after the effective date of any such decrease; and
- (ii) the end of the relevant Offering Period.

In addition, a Participant who has elected such a decrease in rate of Contribution may, prior to the end of the relevant Offering Period, make one or more supplemental Contributions into his or her account. The aggregate of the supplemental Contributions shall not exceed, in the aggregate, the total Contributions the Participant would have made for that Offering Period had the

original rate of Contribution remained in effect throughout the entire Offering Period and the Participant's actual Contributions.

A Participant may change his or her rate of Contribution by filing the requisite documents with the Company. The change in amount shall be effective as at the beginning of the next payroll period following the date of filing of the requisite documents, provided the Participant filed the documents at least five business days prior to the beginning of the next payroll period. Should the Participant fail to file within five business days prior to the beginning of the next payroll period, the change in amount shall be effective as of the beginning of the next succeeding payroll period.

(f) *Grant of Purchase Right*

Each eligible Employee who elects to participate in the ESPP in any given Offering Period shall be granted on the Purchase Date, a right to purchase the Plan Shares (the "Purchase Right"). The Purchase Right of a Participant shall be calculated in accordance with the following formula:

- (i) dividing (A) the product of US\$25,000 and the number of calendar years during all or part of which the Purchase Right shall be outstanding by (B) the closing price of the Plan Shares on the applicable exchange on which Plan Shares are trading (the "Fair Market Value") on the applicable exchange of the Plan Shares on the Offering Date; and
- (ii) subtracting from the quotient thereof (A) the number of Plan Shares that the Employee has purchased during the calendar year in which the Offering Date occurs under the ESPP or under

any other employee stock purchase plan of the Company or any subsidiary of the Company which is intended to qualify under Section 423 of the U.S. Internal Revenue Code of 1986 plus (B) the number of Plan Shares subject on the Offering Date to any outstanding Purchase Rights granted to the Employee under any related Plan.

If application of the above formula would result in the grant of Purchase Rights covering, in the aggregate, more than the number of Plan Shares that the Compensation Committee has made available for the relevant Offering Period, then the Compensation Committee shall adjust the number of Plan Shares subject to the Purchase Right in order that, following such adjustment, the aggregate number of Plan Shares subject to the purchase Right shall remain within the applicable limit.

All Purchase Rights outstanding at the tenth anniversary of the Plan shall remain outstanding through, and may be exercised upon the relevant Purchase Date, but no additional Purchase Right shall be granted under the ESPP.

(g) *Exercise of Purchase Right*

Unless a Participant withdraws from the ESPP, his or her Purchase Right shall become exercisable automatically, on the Purchase Date of the relevant Offering Period for the number of Plan Shares obtained by dividing the accumulated Contributions credited to the Participant's account as of the Purchase Date by the applicable Purchase Price, being an amount not less than 85 per cent. of the Fair Market Value of the Plan Shares on the Offering Date or on the Purchase Date, whichever is lower (the "Purchase Price").

The Compensation Committee may credit any Contributions that have been credited to a Participant's account under the ESPP with interest. Any interest credited to a Participant's account shall not be used to purchase ADSs and shall instead be paid to the Participant at the end of the relevant Offering Period.

If any portion of a Participant's accumulated Contributions is not used to purchase Ordinary Shares on a given Purchase Date, the remaining amount shall be held in the Participant's account and used for the purchase of Plan Shares under the next Offering Period, unless the Participant withdraws from the next Offering Period.

The exercise of the Purchase Right granted under the ESPP is not subject to any performance target.

(h) *Limit of the ESPP*

The number of Ordinary Shares that may be issued under the SOP and the ESPP (the "Global Limit") shall not exceed ten per cent. of the issued and outstanding Ordinary Shares immediately following the closing of the Global Offering (i.e., 1,694,186,849 Ordinary Shares of the Company, which represents approximately 9.29% of the total issued shares of the Company as at March 29, 2005).

The number of Ordinary Shares that may be issued upon exercise of all outstanding Purchase Rights granted under the ESPP or other employee stock purchase plan of the Company or and any outstanding stock options granted under the Stock Option Plan or other stock option plan of the Company must not exceed, in the aggregate, thirty per cent. of the issued and outstanding Ordinary Shares in issuance from time to time.

Report of the Directors

No Employee shall be granted a Purchase Right pursuant to the terms of the ESPP if:

- (i) immediately after the grant, such Employee would own capital stock of the Company and/or hold outstanding Purchase Right to purchase stock possessing five per cent. or more of the total combined voting power or value of all classes of stock of the Company or of any of its subsidiaries;
- (ii) such Purchase Right would permit the Employees' rights to purchase ADSs under all employee stock purchase plans of the Company and its subsidiaries to accrue at a rate that exceeds US\$25,000 of the Fair Market Value of such ADSs or such lower amount as the Compensation Committee may determine for each calendar year in which such Purchase Right is outstanding at any time; and
- (iii) such Purchase Right would permit the Employee's rights to purchase ADSs under all employee purchase plans or option plans of the Company granted to him or her in any twelve-month period to exceed one per cent. of the then issued and outstanding Ordinary Shares unless otherwise allowed under the Listing Rules.

(i) *Purchase Rights are personal to the Participants*

During his or her lifetime, a Participant's Purchase Right shall be exercised by him or her only. Neither contributions credited to a Participant's account under the ESPP nor any rights with regard to the exercise of a Purchase Right to receive Plan Shares under the ESPP may be assigned, transferred, pledged or otherwise disposed in any way by any Participant.

(j) *Designation of Beneficiary*

A Participant may designate a beneficiary to receive any ADSs and cash, if any, from his or her account under the ESPP in the event of the Participant's death. If a Participant is married and the designated beneficiary is not the spouse, the Company may determine that spousal consent shall be required for such designation to be effective.

A Participant may change a designation of beneficiary at any time by filing the requisite notice. In the event of the death of the Participant and in the absence of a beneficiary validly designated under the Plan who is living at the time of such Participant's death, the Company shall deliver ADSs and/or cash from the Participant's account under the ESPP to the executor or administrator of the Participant's estate, or if no such person has been appointed, the Company, in its discretion, may deliver such ADSs and/or cash to the Participant's spouse or to any one or more dependents, relatives, or such other person as the Company may designate.

(k) *Voluntary Withdrawal*

A Participant may withdraw all but not less than all the Contributions credited to his or her account under the ESPP at any time prior to a Purchase Date by submitting the requisite documents. A Participant's Purchase Right for the current period shall automatically be terminated and cancelled, and no further Contributions for the purchase of ADSs shall be accepted from the Participant during the Offering Period. A Participant's withdrawal from an offering shall not have any effect upon his or her eligibility to participate in the ESPP for the succeeding Offering Period.

Report of the Directors

(l) *Termination of Employment*

If a Participant to the ESPP terminates his or her employment under circumstances that qualify the Participant as a Qualified Terminated Participant, (as defined in the ESPP) and the effective date of the Participant's termination of employment is less than three months prior to the next Purchase Date, then the Participant shall continue to participate in the ESPP for the Offering Period then in progress, and the Participant's Purchase Right for such Offering Period shall be exercised in accordance with sub-paragraph (g) above. However, the Participant's Contribution to his or her account shall cease with the Contribution made from his or her final paycheck, and the Participant shall not be permitted to make any supplemental Contributions to the ESPP save as directed otherwise by the Compensation Committee. The Participant shall not be eligible to participate in any Offering Period that starts after the effective date of his or her termination of employment.

If a Participant terminates his or her employment under circumstances which do not qualify him or her as a Qualified Terminated Participant, the Company shall pay to the Participant all contributions credited to his or her account under the ESPP and the Participant's Purchase Right shall automatically terminate and lapse.

(m) *Voting and dividend rights*

No voting rights shall be exercisable and no Participants under the ESPP shall have any claim to the dividends in the ADSs covered by his or her rights to purchase the ADSs until such rights have been exercised.

(n) *Ranking of the ADSs*

ADSs allotted upon the exercise of Purchase Right shall rank *pari passu* (including, but not limited to, with respect to voting, dividend transfer rights and rights arising upon liquidation of the Company) in all respects with the ADSs in issue on the date of such allotment and will be subject to all the provisions of the Articles for the time being in force.

(o) *Change in the capital structure of the Company*

In the event of an alteration in the capital structure of the Company (which includes a capitalisation issue, reduction of capital, consolidation, sub-division of Plan Shares, or rights issue to purchase Plan Shares at a price substantially below market value) the Compensation Committee shall have discretion to make the appropriate adjustments in the number and/or the kind of shares which are subject to purchase under outstanding Purchase Rights, including, if the Compensation Committee deems appropriate, the substitution of similar Purchase Rights in shares of another company so that a Participant shall be entitled to the same proportion of the equity capital of the Company as that to which he or she was previously entitled to.

(p) *Period of the ESPP*

The ESPP shall continue for a term of ten years from the date of its approval by the Shareholders unless terminated in accordance with sub-paragraph (r).

(q) *Use of Funds*

The Company may, but shall not be obligated to, segregate Contributions under the ESPP and/or arrange for Contributions to be held by a third party

Report of the Directors

financial institution or trustee for the benefit of the Participants. Whether or not segregated, Contributions shall remain the property of the relevant Participants and shall be subjected to the rights of the Participants and not to the claims of the Company's creditors.

(r) *Amendments and Termination of the ESPP*

The Compensation Committee may at any time amend the ESPP in any respect or terminate the ESPP, except that, without the approval of the Company's shareholders at a meeting duly called, no amendment shall be made in relation to:

- (i) increasing the number of ADSs approved for the ESPP; or
- (ii) decreasing the Purchase Price per ADSs.

Any alterations or amendments of a material nature or any change to the terms of the Purchase Rights granted must be approved by the shareholders of the Company. Any amendment made to the ESPP must be in accordance with the requirements of the Listing Rules or permitted by the SEHK.

If the ESPP is terminated by the Board prior to the tenth anniversary of the date of Board approval, unless the Compensation Committee has also terminated any Offering Period then in progress, Purchase Rights granted before such termination shall continue to be valid and exercisable in accordance with, and subject to, the terms and conditions of the Plan.

Rule 17.03(9) of the Listing Rules provide that the exercise price of any share option scheme operated by listed issuers may not be lower than effectively the market price of the Ordinary Shares. As a result of the capital intensive nature of the Company's business, we have traditionally relied on share options, rather than cash, as an important means of remunerating its employees. This is common in the industry and we wish to continue this practice following the Global Offering. Accordingly, we have applied to and obtained from the SEHK a waiver from strict compliance with Rule 17.03(9) of the Listing Rules such that the Company is allowed to continue to grant options over its ADSs to its employees under the ESPP at an exercise price which is at a discount (up to 15 per cent. discount) to market price.

OUTSTANDING SHARE OPTIONS

Details of the Stock Option Plans and the SOP are as follows:

2001 Stock Plans — Ordinary Shares

Name/Eligible Employees	Date Granted	Period during which Rights Exercisable	No. of Options Granted	Exercise Price Per Share (USD)	Options Outstanding as of 1/1/04	Options Lapsed During Period	Options Repurchased During Period	Options Exercised During Period	Options Cancelled During Period	Options Outstanding as of 12/31/04	Weighted Average Closing Price of Shares immediately before Dates on which Options were Exercised (USD)	Weighted Average Closing Price of Shares immediately before Dates on which Options were Granted (USD)
Tsuyoshi Kawanishi	July 11, 2002	July 11, 2002–July 10, 2012	500,000	\$0.05	500,000	—	—	—	—	500,000	—	\$0.07
Tsuyoshi Kawanishi	January 15, 2004	January 15, 2004–January 14, 2006	1,000,000	\$0.10	—	—	—	—	—	1,000,000	—	\$0.33
Senior Management	April 10, 2002	April 10, 2002–April 9, 2012	1,350,000	\$0.02	1,350,000	—	—	—	—	1,350,000	—	\$0.05
Senior Management	January 15, 2004	January 15, 2004–January 14, 2014	9,100,000	\$0.10	—	—	—	—	—	9,100,000	—	\$0.33
Senior Management	February 16, 2004	February 16, 2004–February 15, 2014	500,000	\$0.25	—	—	—	—	—	500,000	—	\$0.33
Others	March 28, 2001	March 28, 2001–March 27, 2011	300,000	\$0.01	600,000	—	150,000	—	—	600,000	—	\$0.03
Others	September 26, 2002	September 26, 2002–September 25, 2012	600,000	\$0.05	20,000	—	—	—	—	20,000	—	\$0.14
Others	July 15, 2003	July 15, 2003–July 14, 2013	20,000	\$0.05	20,000	—	—	—	—	20,000	—	\$0.33
Others	January 15, 2004	January 15, 2004–January 14, 2014	10,800,000	\$0.10	—	2,000,000	—	—	—	8,800,000	—	\$0.33
Others	February 16, 2004	February 16, 2004–February 15, 2014	12,900,000	\$0.25	—	5,420,000	—	—	—	7,480,000	—	\$0.33
Service Provider	July 11, 2002	July 11, 2002–July 10, 2012	200,000	\$0.05	200,000	—	—	200,000	—	—	\$0.23	\$0.03
Employees	March 28, 2001	March 28, 2001–March 27, 2011	89,085,000	\$0.01	8,886,000	19,000	420,000	771,000	—	8,096,000	\$0.23	\$0.03
Employees	April 2, 2001	April 2, 2001–April 1, 2011	2,216,000	\$0.01	4,16,000	—	—	—	—	416,000	—	\$0.03
Employees	April 16, 2001	April 16, 2001–April 15, 2011	575,000	\$0.01	39,000	—	—	4,000	—	35,000	\$0.21	\$0.03
Employees	April 28, 2001	April 28, 2001–April 27, 2011	60,000	\$0.01	60,000	—	—	18,000	—	42,000	\$0.25	\$0.03
Employees	May 14, 2001	May 14, 2001–May 13, 2011	1,597,000	\$0.01	47,000	—	200,000	—	—	47,000	—	\$0.03
Employees	May 15, 2001	May 15, 2001–May 14, 2011	95,000	\$0.01	35,000	—	—	—	—	35,000	—	\$0.03
Employees	May 24, 2001	May 24, 2001–May 23, 2011	35,000	\$0.01	35,000	—	—	—	—	35,000	—	\$0.03
Employees	June 1, 2001	June 1, 2001–May 31, 2011	80,000	\$0.01	40,000	—	—	—	—	40,000	—	\$0.03
Employees	June 18, 2001	June 18, 2001–June 17, 2011	3,300,000	\$0.01	—	—	4,250,000	—	—	69,000	—	\$0.03
Employees	July 1, 2001	July 1, 2001–June 30, 2011	745,000	\$0.01	75,000	—	—	6,000	—	—	\$0.25	\$0.03
Employees	July 5, 2001	July 5, 2001–July 4, 2011	80,000	\$0.01	8,000	—	—	8,000	—	—	—	\$0.03
Employees	July 10, 2001	July 10, 2001–July 9, 2011	20,000	\$0.01	20,000	—	—	—	—	20,000	—	\$0.03
Employees	July 12, 2001	July 12, 2001–July 11, 2011	25,000	\$0.01	2,500	—	—	2,500	—	—	\$0.22	\$0.03
Employees	July 15, 2001	July 15, 2001–July 14, 2011	1,045,000	\$0.01	910,000	56,000	—	—	—	788,000	\$0.22	\$0.03
Employees	July 16, 2001	July 16, 2001–July 15, 2011	2,220,000	\$0.01	35,730,000	539,000	—	253,000	—	128,000	\$0.22	\$0.03
Employees	July 20, 2001	July 20, 2001–July 19, 2011	20,000	\$0.01	20,000	—	—	6,000	—	14,000	\$0.20	\$0.03
Employees	July 27, 2001	July 27, 2001–July 26, 2011	50,000	\$0.01	50,000	—	—	—	—	50,000	—	\$0.03
Employees	July 30, 2001	July 30, 2001–July 29, 2011	140,000	\$0.01	100,000	—	—	—	—	100,000	—	\$0.03
Employees	August 1, 2001	August 1, 2001–July 31, 2011	195,000	\$0.01	195,000	—	—	6,000	—	189,000	\$0.24	\$0.03
Employees	August 7, 2001	August 7, 2001–August 6, 2011	20,000	\$0.01	20,000	—	—	—	—	20,000	—	\$0.03
Employees	August 15, 2001	August 15, 2001–August 14, 2011	100,000	\$0.01	100,000	—	—	—	—	100,000	—	\$0.03
Employees	August 20, 2001	August 20, 2001–August 19, 2011	20,000	\$0.01	20,000	—	—	—	—	20,000	—	\$0.03
Employees	September 24, 2001	September 24, 2001–September 23, 2011	100,358,500	\$0.01	57,687,200	3,126,300	960,000	2,512,600	—	52,048,300	\$0.22	\$0.03
Employees	September 28, 2001	September 28, 2001–September 27, 2011	50,000	\$0.01	50,000	—	—	—	—	50,000	—	\$0.03
Employees	January 24, 2002	January 24, 2002–January 23, 2012	55,337,500	\$0.01–\$0.02	45,155,100	1,841,960	803,000	1,822,300	—	41,930,840	\$0.22	\$0.03
Employees	April 10, 2002	April 10, 2002–April 9, 2012	48,664,000	\$0.01–\$0.02	35,673,000	2,110,150	1,020,000	809,350	—	32,663,500	\$0.21	\$0.39
Employees	April 11, 2002	April 11, 2002–April 10, 2012	4,100,000	\$0.01	2,100,000	—	—	—	—	2,100,000	—	\$0.39
Employees	June 28, 2002	June 28, 2002–June 27, 2012	59,614,000	\$0.01–\$0.05	50,719,000	5,353,500	2,400,000	1,882,500	—	43,683,000	\$0.22	\$0.06
Employees	July 11, 2002	July 11, 2002–July 10, 2012	4,730,000	\$0.01–\$0.05	155,000	100,000	—	770,000	—	1,830,000	\$0.20	\$0.07
Employees	September 26, 2002	September 26, 2002–September 25, 2012	71,168,300	\$0.02–\$0.05	57,824,600	5,826,321	2,524,500	1,730,129	—	50,888,150	\$0.22	\$0.08
Employees	January 9, 2003	January 9, 2003–January 8, 2013	53,831,000	\$0.05	41,946,000	2,298,800	—	421,400	—	39,225,800	\$0.23	\$0.10
Employees	January 10, 2003	January 10, 2003–January 9, 2013	720,000	\$0.05	720,000	—	—	—	—	720,000	—	\$0.10
Employees	January 22, 2003	January 22, 2003–January 21, 2013	1,060,000	\$0.05	1,060,000	—	—	—	—	1,060,000	—	\$0.10

Report of the Directors

Name/Eligible Employees	Date Granted	Period during which Rights Exercisable	No. of Options Granted	Exercise Price Per Share (USD)	Options Outstanding as of		Options Lapsed Due to Repurchase of Ordinary Shares During Period*	Options Exercised During Period		Options Outstanding as of 12/31/04	Weighted Average Closing Price of Shares Immediately before Dates on which Options were	
					1/1/04	12/31/04		During Period	During Period		Exercised	Granted
Employees	April 1, 2003	April 1, 2003-March 31, 2013	18,804,900	\$0.05	18,148,780	1,113,760	—	21,200	—	17,013,820	\$0.23	\$0.14
Employees	April 15, 2003	April 15, 2003-April 14, 2013	550,000	\$0.05	550,000	—	—	—	—	550,000	—	\$0.14
Employees	April 24, 2003	April 24, 2003-April 23, 2013	60,338,000	\$0.05	50,015,000	9,406,000	—	187,500	—	40,421,500	\$0.23	\$0.14
Employees	July 15, 2003	July 15, 2003-July 14, 2013	59,699,900	\$0.05	54,459,300	12,801,200	—	1,728,200	—	39,939,900	\$0.22	\$0.18
Employees	October 10, 2003	October 10, 2003-October 9, 2013	49,535,400	\$0.10	47,249,000	9,185,400	—	74,000	—	37,989,600	\$0.21	\$0.23
Employees	January 5, 2004	January 5, 2004-January 4, 2014	130,901,110	\$0.10	—	20,677,970	—	5,000	—	110,218,140	\$0.19	\$0.33
Employees	January 15, 2004	January 15, 2004-January 14, 2014	12,685,000	\$0.10-\$0.25	—	6,300,000	—	200,000	—	6,185,000	\$0.24	\$0.33
Employees	February 2, 2004	February 2, 2004-February 1, 2014	2,240,000	\$0.05	—	—	—	2,240,000	—	—	\$0.24	\$0.33
Employees	February 16, 2004	February 16, 2004-February 15, 2014	92,003,460	\$0.10-\$0.25	—	16,910,890	—	—	—	75,092,590	—	\$0.33

* These represent Ordinary Shares repurchased by the Company pursuant to the terms of the Stock Option Plans.

Options to purchase Ordinary Shares issued to new employees generally vest at a rate of 10% upon the second anniversary, an additional 20% on the third anniversary and an additional 70% upon the fourth anniversary of the vesting commencement date. Beginning in January 2004, options to purchase Ordinary Shares issued to then-existing employees generally vest at a rate of 25% upon the first, second, third and fourth anniversaries of the vesting commencement date.

2001 Stock Plans — Preference Shares

Name/Eligible Employees	Date Granted	Period during which Rights Exercisable	No. of Options Granted	Exercise Price Per Share (USD)	Options Outstanding as of 1/1/04	Options Lapsed Due to Repurchase of Ordinary Shares During Period*	Options Exercised During Period	Options Cancelled During Period	Options Outstanding as of 12/31/04	Weighted Average Closing Price of Shares (USD)	
										before Dates on which Options were Exercised	immediately before Dates on which Options were Granted
Service Provider	July 11, 2002	July 11, 2002-July 10, 2012	200,000	\$0.11	200,000	—	200,000	—	—	\$0.21	\$0.14
Others	July 11, 2002	July 11, 2002-July 10, 2012	262,000	\$0.11	262,000	—	—	—	262,000	—	\$0.14
Employees	September 26, 2002	September 26, 2002-September 25, 2012	50,000	\$0.11	50,000	—	—	—	50,000	—	\$0.15
Employees	September 24, 2001	September 24, 2001-September 23, 2011	255,298,700	\$0.11	37,104,200	2,489,800	2,334,100	—	32,280,300	\$0.22	\$0.11
Employees	September 28, 2001	September 28, 2001-September 27, 2011	50,000	\$0.11	50,000	—	—	—	50,000	—	\$0.11
Employees	November 3, 2001	November 3, 2001-November 2, 2011	780,000	\$0.11	780,000	50,000	—	—	680,000	—	\$0.11
Employees	January 24, 2002	January 24, 2002-January 23, 2012	58,357,500	\$0.11	9,865,600	496,360	167,900	—	9,201,340	\$0.23	\$0.12
Employees	April 10, 2002	April 10, 2002-April 9, 2012	51,984,000	\$0.11	8,905,000	472,150	724,850	—	7,108,000	\$0.23	\$0.13
Employees	June 28, 2002	June 28, 2002-June 27, 2012	63,632,000	\$0.11	18,632,000	1,440,500	337,500	—	16,926,000	\$0.22	\$0.14
Employees	July 11, 2002	July 11, 2002-July 10, 2012	4,530,000	\$0.11	2,650,000	—	25,000	—	2,555,000	\$0.21	\$0.14
Employees	September 26, 2002	September 26, 2002-September 25, 2012	73,804,800	\$0.11	23,078,600	2,089,620	635,660	—	20,383,320	\$0.22	\$0.15
Employees	January 9, 2003	January 9, 2003-January 8, 2013	12,686,000	\$0.11	2,176,000	—	19,000	—	2,157,000	\$0.25	\$0.17

* These represent Ordinary Shares repurchased by the Company pursuant to the terms of the Stock Option Plans.

Options to purchase preference shares issued to new employees generally vest at a rate of 10% upon the second anniversary, an additional 20% on the third anniversary and an additional 70% upon the fourth anniversary of the vesting commencement date. Employees may early exercise their options to purchase preference shares. If an employee early exercises 100% of his or her options, the options vest at a rate of 25% upon each of the first, second, third and fourth anniversary of the vesting commencement date. Furthermore, in this case, if the employee remains employed by the Company and the Company has completed its initial public offering as of the third anniversary of the vesting commencement date, all of the options shall vest.

The options to purchase preference shares converted into options to purchase Ordinary Shares upon completion of the Global Offering.

Report of the Directors

2004 Employee Stock Option Plan

Name/Eligible Employees	Grant Date	Period during which Rights Exercisable	No. of Options Granted	Exercise Price Per Share (USD)	Options Outstanding as of 1/1/04	Options Exercised During Period	Options Cancelled During Period	Options Outstanding as of 12/31/04	Weighted Average Closing Price of Shares (USD)	
									Options Lapsed Due to Repurchase of Ordinary Shares During Period	Options which were immediately exercised before Dates on which Options were Granted
Richard Chang	April 7, 2004	April 7, 2004 — April 6, 2014	100,000	\$0.31	—	—	—	100,000	—	0.31
Lai Xing Cai	November 10, 2004	earlier of (i) March 19, 2005 and (ii) one day prior to the 2005 AGM	500,000	\$0.22	—	—	500,000	—	—	0.22
Te-Lin Hsu	November 10, 2004	earlier of (i) March 19, 2005 and (ii) one day prior to the 2005 AGM	500,000	\$0.22	—	—	—	500,000	—	0.22
Sean Hunter	November 10, 2004	earlier of (i) March 19, 2005 and (ii) one day prior to the 2005 AGM	500,000	\$0.22	—	500,000	—	—	—	0.22
Yen-Pon Jou	November 10, 2004	earlier of (i) March 19, 2005 and (ii) one day prior to the 2005 AGM	500,000	\$0.22	—	—	—	500,000	—	0.22
Tsuyoshi Kawanishi	November 10, 2004	earlier of (i) March 19, 2005 and (ii) one day prior to the 2005 AGM	500,000	\$0.22	—	—	—	500,000	—	0.22
Henry Shaw	November 10, 2004	earlier of (i) March 19, 2005 and (ii) one day prior to the 2005 AGM	500,000	\$0.22	—	—	—	500,000	—	0.22
Lip-Bu Tan	November 10, 2004	earlier of (i) March 19, 2005 and (ii) one day prior to the 2005 AGM	500,000	\$0.22	—	—	—	500,000	—	0.22
Wang Yang Yuan	November 10, 2004	earlier of (i) March 19, 2005 and (ii) one day prior to the 2005 AGM	500,000	\$0.22	—	—	—	500,000	—	0.22
Senior Mgmt Advisors	March 18, 2004	March 18, 2006 — March 18, 2014	110,000	\$0.35	—	—	—	110,000	—	0.35
Advisors	March 18, 2004	March 18, 2006 — March 18, 2014	60,000	\$0.35	—	—	—	60,000	—	0.35
Employees	July 27, 2004	July 27, 2006 — July 27, 2014	200,000	\$0.20	—	—	—	200,000	—	0.20
Employees	March 18, 2004	March 18, 2006 — March 18, 2014	49,949,700	\$0.35	—	4,831,950	—	45,117,750	—	0.35
Employees	April 25, 2004	April 25, 2006 — April 24, 2014	22,591,800	\$0.28	—	1,755,000	—	20,836,800	—	0.28
Employees	July 27, 2004	July 27, 2006 — July 26, 2014	35,985,800	\$0.20	—	2,791,000	—	33,194,800	—	0.20
Employees	November 10, 2004	November 10, 2006 — November 9, 2014	52,036,140	\$0.22	—	263,410	—	51,772,730	—	0.22

* These represent Ordinary Shares repurchased by the Company pursuant to the terms of the SOP.

Options to purchase Ordinary Shares issued to new employees generally vest at a rate of 10% upon the second anniversary, an additional 20% on the third anniversary and an additional 70% upon the fourth anniversary of the resting commencement date. Options to purchase Ordinary Shares issued to then-existing employees generally vest at a rate of 25% upon the first, second, third and fourth anniversaries of the vesting commencement date.