

Management Discussion and Analysis

Overview

In 2005, the Group delivered healthy revenue growth of 28% and net profit growth of 32%. Even though the industry experienced fairly severe pricing pressure, the Group maintained a gross margin of 30%. During the year, new players joined the competition but the Group continued to gain market share. Unit shipment of the Group increased by 68% while the global mobile phone market grew by 14%.

The Group started a number of initiatives to further secure its wafers supply and to reduce costs. The former related to qualifying more foundries (or wafers sub contractors) so as to ensure stability of wafers supply. The latter involved a proprietary manufacturing process developed in-house that could be applied universally to different foundries. The process necessitates some re-engineering at IC design level and will ultimately save time and cost – leading to more competitive edges for the Group’s display ICs. In addition, the Group continued to use advanced process technology, do die-shrink, improve yield rate and reduce manufacturing steps in an attempt to lower the costs, thereby offsetting the price erosion and maintaining a comfortable margin.

As regards the Group’s business and customers, there were also noteworthy achievements. For instance, the Group had a very solid and strong business with Motorola, especially the mobile TFT (“m-TFT”) display ICs for their best selling mobile phone RAZR V3 Series. On the OLED area, the Group obtained new customers like Sony and Creative for their MP3 players. Regarding large display such as notebook computers and PC monitors, Quanta Display Inc. became the Group’s first significant customer. Further, the Group signed a marketing agreement with Kopin

Corporation, a Boston-based technology company, to sell the plug-and-play binocular display modules. Lastly at the module maker level, the Group won 145 design-wins for the year, a 12% increase year-on-year. The Group believes its global market share in mobile display ICs exceeds 20%.

“We make more things happen” was a good description of the Group’s achievements in 2005. To begin with, the highly regarded “ARC Awards” recognized the Group’s first annual report as the best in Hong Kong. Next, the “Employer of the Year Award” as well as the “Special Mention” from *IR Magazine* clearly recognized the Group’s effort in caring about employees and investors. What is more, the Group received some other awards granted by the Hong Kong Council of Social

1. Having more than 20% global market share in the mobile display ICs area, the Group has all major mobile phone brand names as its end customers. It is noteworthy that Motorola employs the Group’s mobile TFT (m-TFT) display ICs in its best selling RAZR V3 mobile phone series.
2. Sony and Creative are new customers using the Group’s OLED IC in their MP3 players.
3. The Group started mass production of its large display ICs in 2005. Quanta Display Inc. was its first significant customer.



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Service, Red Herring, Deloitte Touche Tohmatsu, Fabless Semiconductor Association, Hong Kong Electronic Industries Association and EDN China.

For the whole of 2005, the Group's trading volume further increased to an average of 13.6 million shares a day, a growth of 27% over the previous year. Just about one year after listing, the Group was included in the MSCI Hong Kong and Small Cap Indices for its shares

liquidity, free float, industry and country representation. In October 2005, there were 202 million shares disposed of by an original venture capital shareholder. With the effect of such activity, the Group's free float was boosted to more than 80%.

Finally, the Group is very pleased with its performance of 2005 and the support from its customers, suppliers, employees and shareholders.

Financial Review

5-year Financial Summary

US\$ million	Restated ^v		2003	2002	2001
	2005	2004			
Sales	394.1	308.2	109.3	60.0	37.5
Gross profit	119.6	96.6	46.0	20.9	12.3
Net profit	76.3	57.9	22.7	6.8	2.7
Assets and liabilities					
Total assets	270.3	250.1	81.6	48.5	32.1
Total liabilities	(63.3)	(73.4)	(31.7)	(15.1)	(5.5)
Shareholders' funds	207.0	176.8	49.9	33.4	26.6
US cents					
Earnings per share					
Basic ⁱ	3.12	2.63	1.09	0.33	0.13
Diluted ⁱⁱ	3.08	2.50	NA	NA	NA
Dividends per share	2.44	1.88 ⁱⁱⁱ	0.85 ⁱⁱⁱ	3.40 ^{iv}	—
Net asset per share ⁱ	8.47	8.02	2.41	1.61	1.33

The Company was incorporated on 21 November 2003. The financial information for the year 2001 to 2003 has been prepared using the merger basis of accounting regarding the Group comprising the Company and its subsidiaries as a continuing entity.

- i The basic earnings and net assets per share are based on the weighted average of 1,985,212,280, 2,074,852,711, 2,074,852,711, 2,204,501,037, and 2,445,135,773 ordinary shares in issue during each of the years ended 31 December 2001, 2002, 2003, 2004 and 2005, respectively. In determining the weighted average number of ordinary shares in issue, a total of 1,808,846,553 ordinary shares were deemed to be in issue since 1 January 2001. For 2004 and 2005, the number is based on the weighted average of ordinary shares in issue excluding own shares held during the year.
- ii The diluted earnings per share information was not presented for each of the years ended 31 December 2001, 2002 and 2003 as there were no dilutive potential ordinary shares. For 2004 and 2005, the diluted earnings per share information is based on 2,320,846,751 and 2,473,217,108 ordinary shares respectively, which are the adjusted weighted average number of ordinary shares outstanding to assume conversion of all share options outstanding but excluding unallocated own shares held during the year.
- iii As the first interim dividend of 2004 paid on 1 March 2004 was attributable to the results of 2003, such interim dividend has been included in the computation of dividend per share for 2003 and excluded from the computation for 2004.
- iv The dividend was paid by Solomon Systech Limited ("SSL"), a wholly owned subsidiary of the Company, to its then shareholders during the year. The number of SSL's shares in issue at the time of the payment was 183,290,271 shares.
- v The results for 2004 and the assets and liabilities as at 31 December 2004 have been restated to reflect the adoption of the new / revised standards and interpretation of Hong Kong Financial Reporting Standards as set out in note 2.1 to the financial statements.

Management Discussion and Analysis (continued)

The Group started to promote the Binocular Display Module ("BDM", as shown in picture), which is a complete video subsystem for eyewear that empowered by the Group's microdisplay ICs. The BDM realizes "Video On-the-Go" technology and provides large image that equivalent to a 35-inch TV at a distance of 7 feet, but weighs only less than 1 oz.

Sales and profit

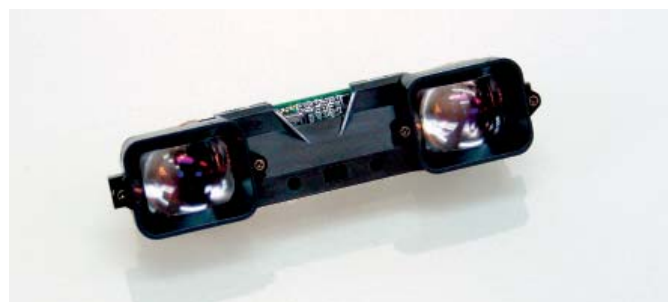
The Group increased its sales by 28% in 2005 to US\$394 million. The growth was mainly a result of m-TFT display ICs ramp-up and very strong unit shipment of OLED display ICs. Gross profit also grew to US\$120 million, an increase of 24% year-on-year. As the Group exercised aggressive cost control, the gross profit margin for 2005 was maintained at 30.3%, compared to 31.3% in 2004.

Net profit for the year was US\$76.3 million, representing an increase of 32% over the previous year. Despite the Group considerably expanded its staff force in the areas of IC design and engineering, it was able to maintain net profit margin at 19.3%, compared to 18.8% in 2004.

Liquidity and financial resources

Net cash flow from operations during the year was US\$98 million. The net cash of the Group amounted to US\$161 million at year end, compared to US\$137 million as at 31 December 2004. The change in cash position was mainly a result of (1) dividends paid of US\$52 million and (2) capital spending of US\$6 million. Regarding the cash reserves, the Group will continue to invest in products development, to secure production capacity, to undertake some corporate venture investments and to keep a certain level of cash for general corporate purposes. As at 31 December 2005, the Group had no borrowings and its cash balance was mainly deposited in interest-bearing accounts.

All of the Group's account receivables and most of its payables are quoted in US dollars. The Group closely monitors foreign exchange rates and does its best to obtain favorable exchange rates for



conversion of US dollars into other currencies for the payment of local operating expenses. During the review period, the Group did not use any derivative instruments to hedge its foreign currency exposure as it considered the exposure was insignificant.

In light of the Group's record net profit made and relatively rich cash position, the Board of the Group resolved to declare a final dividend of 15 HK cents per share to shareholders whose names appear on the Register of Members of the Company on 20 April 2006. In summary, the full year dividends per share of 19 HK cents represent a payout ratio of approximately 80% of earnings, or a yield of 7.3% based on the average daily closing price of HK\$2.60 for 2005.

Capital expenditure and contingent liabilities

In 2005, the Group spent a total of US\$6 million in capital expenditure, comprising computer hardware and software, intellectual property ("IP") licenses, research and development tools, critical packaging and testing equipment. Currently, all research and development tools are located in the Group's offices while all production equipment is consigned to sub-contractors. As at 31 December 2005, the Group had no material capital commitments or contingent liabilities.

Display ICs Shipped (million units)	2005	2004	Growth (%)
Monochrome STN	45.3	47.1	-3.8
Color STN	142.5	88.2	61.6
m-TFT	33.5	7.1	371.8
OLED	40.5	14.1	187.2
L-TFT	0.3	–	NA
Miscellaneous	0.9	0.5	80.0
Total	263.0	157.0	67.5

Note: L-TFT denotes large display TFT driver ICs. Miscellaneous includes graphics controller, display ICs for PDA and other applications.

Business Review

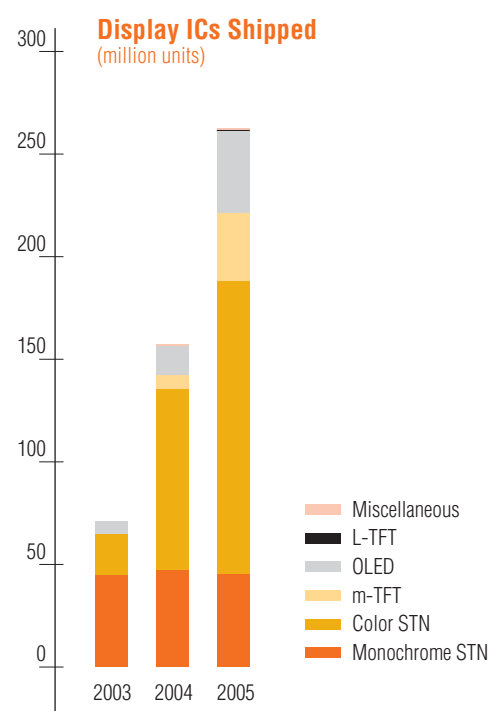
Products shipment

At the beginning of 2005, both the semiconductor and mobile phone markets were seasonally weak. As a result, the utilization rate at the foundries was relatively low, making the wafers supply more readily available. Going into the second half, tightness of wafers supply emerged and it created pressure on the Group's gross margin.

For 2005, the book to bill ratio stood at 0.93. In total, the Group shipped 263 million units of display ICs, a growth of 68% year-on-year. The driver for the spectacular growth was the popularity of the Group's m-TFT and OLED display ICs. The blended average selling price (ASP) of the Group's products was US\$1.50 for 2005, down from US\$1.96 for 2004. The decrease was mainly due to the product mix and the pricing pressure exerted at the end-customer level.

As regards unit shipment, the Group's monochrome STN display ICs slightly declined by 3.8% in 2005 due to migration from black-and-white display to color display in the industry. Color STN display ICs, however, grew by 61.6%. The growth was attributable to a number of factors, including more new products launched, dedicated customer support, right pricing and time-to-market. Another encouraging result was

the rapid adoption of the Group's m-TFT display ICs, which achieved a 372% growth and were commercially used in top brand mobile phones such as RAZR V3. Boosted by the 3-digit growth of global MP3 players market, the shipment of the Group's OLED display ICs was very promising with a growth rate of 187%. After working in close collaboration with Quanta Display Inc., the Group started mass production in late 2005 of large display driver ICs.



Management Discussion and Analysis (continued)

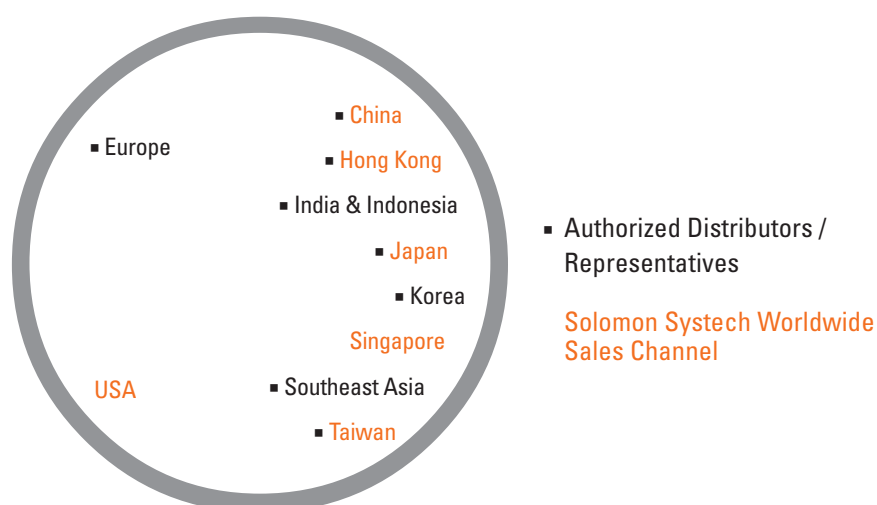
Exhibition / conference	Location	Date
The 10th Annual International IC – China Conference & Exhibition	Shenzhen / Shanghai	4–5 April / 12– 14 April
OLEDs Asia 2005, Intertech Conferences	Seoul	18–20 April
SID 2005	Boston	24–26 May
International Symposium on Consumer Electronics 2005	Macau	14–16 June
The 5th International Meeting on Information Display and Exhibition	Seoul	20–23 July
The 3rd China International IC Industry Exhibition	Beijing	24–26 August
electronicAsia 2005	Hong Kong	13–16 October

New products and customers

The Group had 27 new products altogether go to production in 2005, an increase of roughly 70% against the previous year. Most of them were mobile phone related display ICs, supplied to module makers and eventually used by global mobile phone brand names and other portable applications. To promote its latest products and technologies, the Group participated in a number of exhibitions and conferences worldwide in 2005.

In recognition of the Group's product quality and customer services, the Group received 4 awards from its customers in 2005.

Backed by its extensive sales network and all-round customer services, the Group further enlarged its customer base. For instance, the number of module makers whose business with the Group worth more than US\$10 million increased from 5 in 2004 to 8 in 2005. At present, the Group serves more than 70 module makers globally.



1. Twenty-seven new IC products went into production in 2005, supplied directly to module makers and eventually used by global mobile phone brand names and in other portable applications.
2. The Group has a high caliber and experienced design team. It ensures the delivery of high performance ICs that exceed customers' expectation. The picture shows the large display ICs being evaluated at the display panel.
3. The Group's efforts in R&D will ultimately allow it to capture more business opportunities and stay ahead of technology frontiers. The picture shows a mobile display IC being verified.

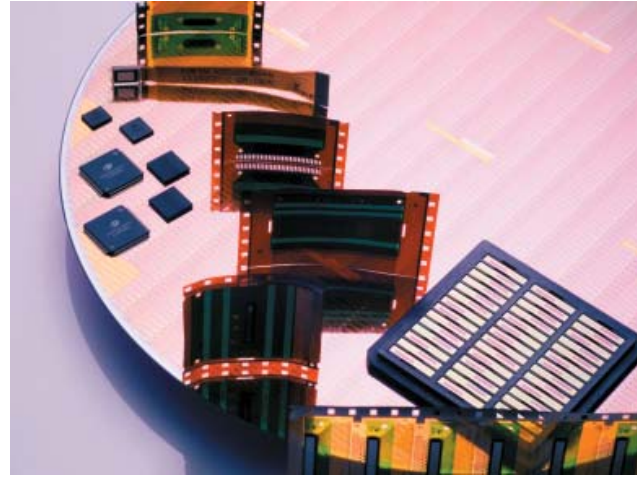
The Group believes that all major global mobile phone brand names are using or have started to use the Group's display ICs. In the non-mobile phone area, the Group also introduced a number of key products that won industry awards. For instance, the Group's microdisplay controller IC (part number SSD1502) won the Grand Award and Gold Award in the annual HKEIA Award for Outstanding Innovation and Technology Products. Additionally, the Group produced a high performance OLED display IC (part number SSD1339) that also received the EDN China Innovation Award 2005.

Research and development

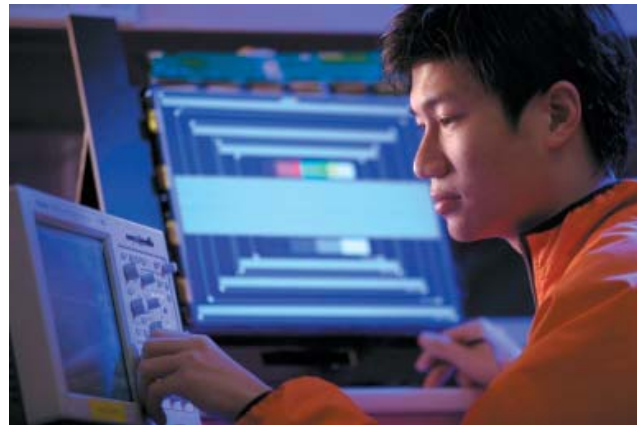
Research and development capability is one of the Group's core competences. The Group's management team regularly keeps track of the Group's research output and its customers' new requirements in connection with product features or specifications. The Group's ultimate research effort is to make the ICs that exceed customers' expectations and deliver performance unmatched even by its closest rivals.

In the past twelve months, the research and development costs amounted to roughly US\$18 million. The number of employees in research and development increased to more than 190 as at 31 December 2005. The headcount increase is part of the Group's focused business expansions as the Group captures more business opportunity from customers and has to stay ahead of competition with its innovative products for tomorrow's applications.

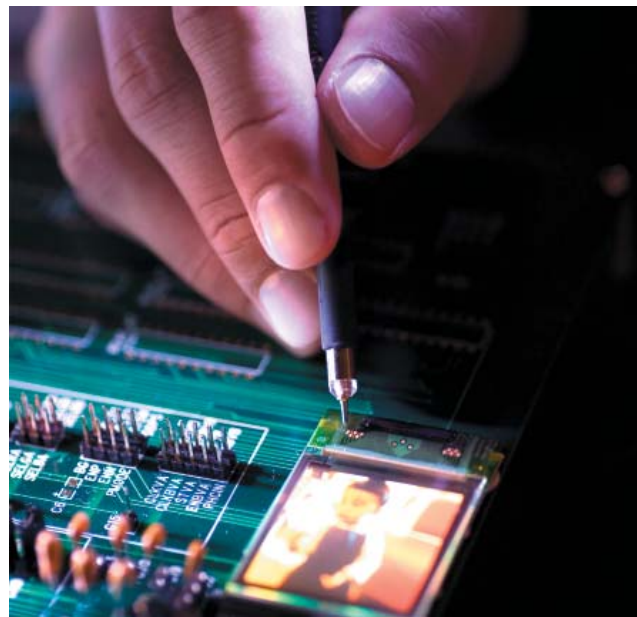
The Group's existing and future products are supported by 3 technology centers, namely Hong Kong, Shenzhen and Singapore. The research



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Management Discussion and Analysis (continued)

and development team in Hong Kong provides a full range of product developments, while the Shenzhen operation takes on special projects and the Singapore operation focuses on multimedia ICs and IP development.

In terms of wafers technology under development, the Group's products employ a range of fine technologies from 0.13 μ m to 0.6 μ m, depending on the cost-performance measure along with specific customer's requirements. Lastly, the Group filed 3 patents and published 5 technical articles in 2005.

Prospects

Display Panel Area

Mobile display

The Group has a firm grip on the mobile display area globally. Its market share and position are meaningful to the players in the whole value chain of mobile display area. Going forward, the Group will carry on certain strategic directions in respect of different display technologies.

In 2006, the Group expects the unit shipment growth of monochrome STN display will be flat. Color STN display ICs for the coming year will experience a growth comparable to that of the market, which is forecast to be moderate double-digit. In respect of m-TFT display ICs, the Group's focus will be on 3-4 top brand name customers. As such, the growth of m-TFT display ICs is expected to be outperforming the market. With reference to OLED display ICs, the most attention-grabbing application will be the main display of mobile phone using OLED display. Given its 40% plus global market share in OLED display IC area, the Group will definitely benefit

from the high growth of OLED-driven consumer electronic products such as mobile phones, MP3, MP4, mini-disc players and other large volume applications.

Large display

There were roughly 320,000 units of gate driver ICs shipped in 2005. In 2006, the Group aims to broaden its product offerings, and will ship both gate and source driver ICs for notebook computers, PC monitors as well as LCD TVs. Such driver ICs will initially accommodate display size of up to 32 inches. In fulfilling customer needs, the Group will ship more driver ICs for large display.

Right now, the total market size for large display driver ICs is more than US\$2.5 billion a year. This is a potentially large enough market for the Group to line up more resources with the purpose of gaining market share and achieving continuous revenue growth. Apart from Quanta Display Inc., the Group plans to acquire a few more customers in the region. As mentioned previously, the Group's dual intentions with regard to the large display area are (1) to bring in long-term revenue growth and (2) to make a foray into high-value ICs associated with LCD TV.

New display

This business area has yet to produce significant revenue to the Group. However, as an innovative technology company, the Group not only devotes R&D efforts to products with immediate market demand, but also develops future products that can create high volume demand. To date, there are certain products whose potential are on the rise, namely microdisplay ICs, flexible and bistable driver controller ICs.

1. To provide total display IC solutions, the Group entered the display system area and developed new IC products such as the image processor SSD1921.
2. Flexible or bistable displays can be applied in electronic paper applications such as label-tag, timepiece and e-book. The Group sees potentially great new demand for the new displays in different applications.
3. Microdisplay ICs, integrated into plug-and-play display modules, enable innovative applications such as mobile entertainment, cellular accessories and 3-D gaming.

The Group expects there will be various applications using microdisplay ICs. Such applications can be found in areas of mobile entertainment, cellular accessories and 3-D gaming, thanks to the large demand of portable multimedia players and the emergence of mobile TV phones. In 2005, the Group entered into a co-marketing and sales agreement for the China market with Kopin Corporation to promote "Video On-the-Go" technology. As for flexible or bistable displays, they may be used in ultra-thin portable or attachable devices, label-tag empowered by RF connectivity and others. The management believes in the potentially surging demand for new display applications, and will keep researching and expanding this business so as to stay ahead of competitors.

Display System Area

Display system area means those ICs that are either complementing display panel ICs or enriching the image, graphics or functionality of a display. Currently, display system ICs consist of graphics controller, image processor, mobile phone audio chipset, multi-format audio decoder, multimedia processor, timing controller and interface peripheral chipset.

The Group intends to speed up its products development with the right strategic alliance, business cooperation, product acquisition or licensing of core IP rights. During 2005, the Group licensed IP rights from Qualcomm Inc. on MDDI interface, which is a rapidly accepted display interface for CDMA platforms, and from a multinational technology company on processor and the associated software platform. With the development of this business, the Group will be more able to deliver total display IC solutions.



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