Notes to the Financial Statements

1 General information

Solomon Systech (International) Limited (the "Company") and its subsidiaries (together "the Group") are fabless semiconductor companies specializing in the design, development and sales of proprietary integrated circuits.

The Company was incorporated in the Cayman Islands on 21 November 2003 as an exempted Company with limited liability under the Companies Law, Cap.22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands (the "Cayman Companies Law"). The address of its registered office is P.O. Box 309GT, Ugland House, South Church Street, George Town, Grand Cayman, Cayman Islands and the address of its principal office in Hong Kong is 6/F., No.3 Science Park East Avenue, Hong Kong Science Park, Shatin, New Territories, Hong Kong.

The Company has been listed on the main board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 8 April 2004.

These consolidated financial statements are presented in US dollars, unless otherwise stated. These consolidated financial statements have been approved for issue by the Board of Directors on 13 March 2006.

2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Company have been prepared in accordance with Hong Kong Financial Reporting Standards (HKFRS). The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and financial assets at fair value through profit or loss.

The preparation of financial statements in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

2 Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

In 2005, the Group adopted the new/revised standards and interpretation of HKFRS below, which are relevant to its operations. The 2004 comparatives have been amended as required, in accordance with the relevant requirements.

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 12	Income Taxes
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 28	Investments in Associates
HKAS 32	Financial Instruments: Disclosures and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS-Int 12	Scope of HKAS-Int 12 Consolidation - Special Purpose Entities
HKAS-Int 15	Operating Leases - Incentives
HKAS-Int 21	Income Taxes – Recovery of Revalued Non-Depreciated Assets
HKFRS 2	Share-based Payments

The adoption of new/revised HKASs 1, 2, 7, 8, 10, 12, 14, 16, 17, 18, 19, 21, 24, 27, 28, 33, 36, 38 and HKAS-Ints 15 and 21 did not result in substantial changes to the Group's accounting policies. In summary:

— HKAS 1 resulted in differences in the presentation of share of net after-tax results of associates and other disclosures.

— HKASs 2, 7, 8, 10, 12, 14, 16, 17, 18, 19, 27, 28, 33 and HKAS-Ints 15 and 21 had no material effect on the Group's policies.

— HKAS 21 had no material effect on the Group's policy. The functional currency of each of the consolidated entities has been re-evaluated based on the guidance to the revised standard. All the Group entities have the same functional currency as the presentation currency for respective entity financial statements.

— HKAS 24 has affected the identification of related parties and some other related-party disclosures.

The adoption of HKASs 32 and 39 has resulted in a change in the accounting policy relating to the classification of financial assets at fair value through profit or loss and available-for-sale financial assets. It has also resulted in the recognition of derivative financial instruments at fair value and the change in the recognition and measurement of hedging activities.

2 Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

The adoption of HKFRS 2 has resulted in a change in the accounting policy for share-based payments. Until 31 December 2004, the provision of shares and share options to employees and directors did not result in an expense in the profit and loss account. Effective on 1 January 2005, the Group expenses the cost of shares and share options in the profit and loss account. As a transitional provision, the cost of share options granted after 7 November 2002 and had not yet vested on 1 January 2005 was expensed retrospectively in the profit and loss account of the respective periods (Note 2.14).

The adoption of HKAS 36 and HKAS 38 has resulted in a change in the accounting policy for goodwill. There is no material impact on the financial statements for the year 2005 as both the goodwill and intangible assets of the Group have been fully amortised as at 31 December 2004.

Effect of adopting new/revised HKAS, HKAS-Int and HKFRS

The adoption of HKAS-Int 12 has resulted in a change in the accounting policy for the consolidation of a special purpose entity ("SPE"). A SPE should be consolidated when the substance of the relationship between the Group and the SPE indicates that the SPE is controlled by the Group.

All changes in the accounting policies have been made in accordance with the transition provisions in the respective standards, wherever applicable. All standards adopted by the Group require retrospective application other than:

— HKAS 16 – the initial measurement of an item of property, plant and equipment acquired in an exchange of assets transaction is accounted at fair value prospectively only to future transactions;

— HKAS 21 – prospective accounting for goodwill and fair value adjustments as part of foreign operations;

— HKAS 39 – does not permit to recognise, derecognise and measure financial assets and liabilities in accordance with this standard on a retrospective basis. The Group applied the previous SSAP 24 "Accounting for investments in securities" to investments in securities for the 2004 comparative information. The adjustments required for the accounting differences between SSAP 24 and HKAS 39 are determined and recognised at 1 January 2005.

— HKAS-Int 15 – does not require the recognition of incentives for leases beginning before 1 January 2005; and

— HKFRS 2 – only retrospective applicable for all equity instruments granted after 7 November 2002 and not vested at 1 January 2005. As a transitional provision, the cost of shares or options granted after 7 November 2002 and have not vested on 1 January 2005 was expensed retrospectively in the consolidated profit and loss account of the respective years.

The following are the impact upon the adoption of HKFRS 2 Share-based Payments:

	2005 US$'000	2004 US$'000
Increase in equity compensation reserve	**3,135**	1,616
Increase in share premium	**1,624**	—
Decrease in retained earnings	**4,759**	1,616

	2005 US$'000	2004 US$'000
Increase in research and development costs	**1,627**	210
Increase in selling and distribution expenses	**720**	17
Increase in administrative expenses	**796**	1,006
Decrease in basic earnings per share (US cents)	**(0.13)**	(0.05)
Decrease in diluted earnings per share (US cents)	**(0.13)**	(0.05)

2 Summary of significant accounting policies (continued)

2.1 Basis of preparation (continued)

The following are the impact upon adoption of HKAS-Int 12 Consolidation – Special Purpose Entities:

	2005 US$'000	2004 US$'000
Increase in cash and cash equivalents	**1,186**	447
Increase in accrued charges and other payables	—	246
Increase in own shares held	**605**	1,338
Increase in retained earnings	**1,791**	1,539

	2005 US$'000	2004 US$'000
Increase in other gain-net	**17**	1
Increase in basic earnings per share (US cents)	**0.08**	0.20
(Decrease)/Increase in diluted earnings per share (US cents)	**(0.04)**	0.07

2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all its subsidiaries made up to 31 December.

(a) Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the profit and loss account (see Note 2.6).

Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted by the Company on the basis of dividend received and receivable.

2 Summary of significant accounting policies (continued)

2.2 *Consolidation* (continued)

(b) Associated company

An associated company is an entity over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investment in an associated company is accounted for by the equity method of accounting and is initially recognized at cost.

The Group's share of its associated company post-acquisition profits or losses is recognized in the profit and loss account, and its share of post-acquisition movements in reserves is recognized in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associated company equals or exceeds its interest in the associated company, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associated company.

Unrealized gains on transactions between the Group and its associated company are eliminated to the extent of the Group's interest in the associated company. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of the associated company have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investment in an associated company is stated at cost less provision for impairment losses. The results of an associated company are accounted for by the Company on the basis of dividend received and receivable.

(c) Special purpose entity

A special purpose entity is an entity over which the Group has the power to govern the financial and operating policies. A special purpose entity is fully consolidated from the date on which control is transferred to the Group and it is deconsolidated from the date that control ceases.

2.3 *Segment reporting*

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

2.4 *Foreign currency translation*

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in US dollars, which is the Company's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the profit and loss account, except when deferred in equity as qualifying cash flow hedges or qualifying net investment hedges.

Translation differences on non-monetary items, such as equity instruments held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation difference on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the fair value reserve in equity.

2 Summary of significant accounting policies (continued)

2.4 *Foreign currency translation* (continued)

(c) Group companies

The results and financial position of all the group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each profit and loss account are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognized as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognized in the profit and loss account as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

2.5 *Property, plant and equipment*

All property, plant and equipment are stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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

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

Leasehold improvements	20% or over the unexpired lease period, whichever is shorter
Furniture, fixtures and office equipment	33.33%
Machinery and laboratory equipment	12.50% to 33.33%
Motor vehicles	33.33%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.7).

2 Summary of significant accounting policies (continued)

2.6 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associated company at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associated companies is included in investments in associated companies. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing.

(b) Patents and intellectual property

Patents and intellectual property are shown at historical cost. Patents and intellectual property have a definite useful life and are carried at cost less accumulated amortization. Amortization is calculated using the straight-line method to allocate the cost of trademarks and licences over their estimated useful lives of five years.

2.7 Impairment of assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

2.8 Investments

Prior to 1 January 2005, investment securities are stated at cost less any provision for impairment losses.

The carrying amounts of individual investments are reviewed at each balance sheet date to assess whether the fair values have declined below the carrying amounts. When a decline other than temporary has occurred, the carrying amount of such securities will be reduced to its fair value. The impairment loss is recognised as an expense in the profit and loss account. This impairment loss is written back to profit and loss when the circumstances and events that led to the write-downs or write-offs cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

Subsequent to the adoption of the HKAS39 from 1 January 2005:

The Group classifies its investments in the following categories: financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

(a) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realised within 12 months of the balance sheet date.

2 Summary of significant accounting policies (continued)

2.8 Investments (continued)

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are included in trade and other receivables in the balance sheet.

(c) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Purchases and sales of investments are recognised on trade-date — the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method. Realised and unrealised gains and losses arising from changes in the fair value of the "financial assets at fair value through profit or loss" category are included in the profit and loss account in the period in which they arise. Unrealised gains and losses arising from changes in the fair value of non-monetary securities classified as available-for-sale are recognized in equity. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments are included in the profit and loss account as gains or losses from investment securities.

The fair values of unlisted securities are determined by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models refined to reflect the issuer's specific circumstances.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the profit and loss account – is removed from equity and recognized in the profit and loss account. Impairment losses recognised in the profit and loss account on equity instruments are not reversed through the profit and loss account.

2 Summary of significant accounting policies (continued)

2.9 Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprises raw materials and subcontracting charges. It excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

2.10 Trade and other receivables

Trade and other receivables are recognized initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognized in the profit and loss account.

2.11 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and fixed deposits with maturity within 3 months or less.

2.12 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deductions, net of tax, from the proceeds.

2.13 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associated companies, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2 Summary of significant accounting policies (continued)

2.14 Employee benefits

(a) Pension obligations

The Group participates in several defined contribution plans, under which the Group pays fixed contributions into separate entities.

The Group has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense when they are due and are reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions.

(b) Equity compensation

The Group operates several equity-settled, share-based compensation plans. The fair value of the employee services received in exchange for the grant of the shares or share options is recognized as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the shares or share options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). At each balance sheet date, the Group revises its estimates of the number of shares or share options that are expected to become exercisable. It recognizes the impact of the revision of original estimates, if any, in the profit and loss account, and a corresponding adjustment to equity over the remaining vesting period.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

Under the Share Award Plan, directors and employees of the Group are entitled to receive shares in the Company. The shares, held under trust by HSBC International Trustee Limited for the benefit of the directors and employees, have been created by capitalising the Company's retained earnings to pay up consideration at nominal value in full prior to the listing of the Company in the Stock Exchange. Detail of outstanding shares can be referred to Note 23(c) to the financial statements on page 90.

The Company also adopted the Share Option Scheme under which options may be granted to subscribe for the Company's shares. Please refer to Note 23(b) on page 90 for detail of the option plans.

(c) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are not recognised until the time of leave.

(d) Profit-sharing and bonus plans

The Group recognizes a liability and an expense for bonuses and profit-sharing, based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognizes a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

2.15 Provisions

Provisions for restructuring costs and legal claims are recognized when: the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognized for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

2 Summary of significant accounting policies (continued)

2.16 Revenue recognition

Revenue comprises the fair value for the sale of products net of discounts and after eliminating sales within the Group. Revenue is recognized as follows:

(a) Sales of products

Sales of products are recognized on the transfer of risks and rewards of ownership, which generally coincides with the time of shipment/delivery.

(b) Interest income

Interest income is recognized on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognized either as cash is collected or on a cost – recovery basis as conditions warrant.

2.17 Leases (as the lessee)

(a) Operating lease

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are expensed in the profit and loss account on a straight-line basis over the period of the lease.

(b) Finance lease

Leases of assets where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in current and non-current borrowings. The interest element of the finance cost is recognized in the profit and loss account over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

2.18 Government grants

Grants from the government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognized in the profit and loss account over the period necessary to match them with the costs that they are intended to compensate.

2.19 Research and development

Research expenditure is expensed as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognized as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility, and costs can be measured reliably. Other development expenditures are expensed as incurred. Development costs previously recognized as an expense are not recognized as an asset in a subsequent period. Development costs with a finite useful life that have been capitalized are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit, not exceeding five years.

2.20 Dividend distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

3 Financial risk management

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value, interest risk and price risk), credit risk, liquidity risk and cash flow interest rate risk.

(a) Market risk

Foreign exchange risk

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar. Revenue and majority of the cost of sales are US dollar basis. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities and net investments in foreign operations.

(b) Credit risk

Customers of the Group are mainly well-known distributors with sound financial background. In addition, the Group has policies in place to ensure that sales of products are made to customers within appropriate credit history or limits.

(c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Group aims to maintain flexibility in funding by keeping committed credit lines available.

(d) Cash flow and fair value interest rate risk

The Group has no significant interest-bearing assets or liabilities except for bank balances. In view that majority of these bank balances are under short maturity terms, the cash flow and fair value interest rate risk is considered to be low.

3.2 Fair value estimation

The fair value of financial assets at fair value through profit or loss is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price.

The nominal value less estimated credit adjustments of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

4 Critical accounting estimates and judgements

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

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

(a) Income taxes

The Group is subject to income taxes in several jurisdictions. Significant judgment is required in determining the worldwide provision for income taxes. There are transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

(b) Equity compensation

In determining the total expenses for the Group's equity compensation plans, the Group estimates the number of options/shares that are expected to become exercisable/vested at the date of grant. At each balance sheet date before the options/shares that are become fully exercisable/vested, the Group will revise the total expenses where the number of options/shares that are expected to become exercisable/vested are different to previously estimated.

(c) Property, plant and equipment and depreciation

The Group determines the estimated useful lives and related depreciation charges for the Group's property, plant and equipment. Management will revise the depreciation charge where useful lives are different to previously estimated, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

5 Segment information – Group

(a) Primary reporting format – business segment

At 31 December 2005, the Group is principally engaged in the research, design, development and distribution of integrated circuits ("IC").

The Group has been operating in one single business segment, i.e. the research, design, development and distribution of ICs. Sales amounted to US$394,089,000 and US$308,238,000 for the years ended 31 December 2005 and 2004 respectively.

(b) Secondary reporting format – geographical segments

The Group mainly operates in Hong Kong SAR ("Hong Kong"). The Group's sales are mainly made to customers in places/countries within Taiwan, Hong Kong and Japan.

(i) Sales

	2005 US$'000	2004 US$'000
Taiwan	**158,324**	121,791
Hong Kong	**125,195**	97,579
Japan	**85,887**	62,873
Korea	**21,467**	11,425
Singapore	**1,046**	8,690
Mainland China ("China")	**511**	4,123
United States of America ("U.S.A.")	**94**	400
Others	**1,565**	1,357
	394,089	308,238

Sales are allocated based on the places/countries in which customers are located.

5 Segment information – Group (continued)

(b) *Secondary reporting format – geographical segments* (continued)

(ii) Total assets

	2005 US$'000	Restated 2004 US$'000
Hong Kong	230,519	208,633
Taiwan	32,723	35,080
Others	7,028	6,423
	270,270	250,136

Total assets are allocated based on where the assets are located. Others comprises China, Japan, Singapore and U.S.A.

(iii) Capital expenditures

	2005 US$'000	2004 US$'000
Hong Kong	5,378	2,965
China	267	1,456
Taiwan	341	3,312
Others	219	262
	6,205	7,995

Capital expenditures are allocated based on where the assets are located.

6 Other gain – net – Group

	2005 US$'000	Restated 2004 US$'000
Interest income	4,485	461

7 Expenses by nature – Group

Expenses included in cost of sales, research and development costs, selling and distribution expenses and administrative expenses are analysed as follows:

	2005 US$'000	Restated 2004 US$'000
Loss on disposal of property, plant and equipment	12	—
Auditors' remuneration	123	108
Depreciation of owned property, plant and equipment	4,660	3,932
Depreciation of leased property, plant and equipment	9	5
Operating leases for land and buildings	778	490
Amortisation of patents and intellectual property included in research and development costs (Note 15)	—	675
Amortisation of goodwill included in administrative expenses (Note 15)	—	291
Employee benefit expenses (Note 8)	16,412	12,042
Net exchange losses	127	156
(Write-back of provision)/Provision for doubtful debts	(1,782)	1,174
(Write-back of provision)/Provision for obsolete or slow moving inventories	(65)	4,232

8 Employee benefit expenses – Group

(a) Employee benefit expenses

	2005 US$'000	Restated 2004 US$'000
Wages and salaries	8,702	6,068
Discretionary bonus	4,023	3,781
Equity compensation	2,245	1,174
Pension costs - defined contribution plans [1]	440	313
Other staff benefits	1,002	706
	16,412	12,042

[1] Forfeited contribution to the defined contribution plans will be utilized to reduce future contributions. During the year, there is no material contribution being forfeited.

8 Employee benefit expenses – Group (continued)

(b) Directors' emoluments

The remuneration of every director including the equity compensation charged to the profit and loss account per HKFRS 2 is set out below:

For the year ended 31 December 2005										
Name of Director	Fees US$'000	Salary US$'000	Discretionary Bonuses(i) US$'000	Inducement fees US$'000	Other benefits(ii) US$'000	Employer's contribution to pension scheme US$'000	Compensation for loss of office as director US$'000	Subtotal US$'000	Equity compensation(iii) US$'000	Total US$'000
Leung Kwong Wai	—	226	529	—	51	10	—	816	443	1,259
Huang Hsing Hua	—	115	122	—	12	5	—	254	76	330
Lai Woon Ching	—	129	122	—	2	6	—	259	82	341
Lo Wai Ming	—	125	122	—	2	6	—	255	84	339
Lam Pak Lee	19	—	—	—	—	—	—	19	44	63
Chang Ching Yi, Steven	19	—	—	—	—	—	—	19	44	63
Wong Yuet Leung, Frankie	19	—	—	—	—	—	—	19	28	47
Choy Kwok Hung, Patrick	23	—	—	—	—	—	—	23	28	51
Kao Kuen, Charles	23	—	—	—	—	—	—	23	28	51
Sun, Patrick	23	—	—	—	—	—	—	23	41	64
Total	126	595	895	—	67	27	—	1,710	898	2,608

For the year ended 31 December 2004										
Name of Director	Fees US$'000	Salary US$'000	Discretionary Bonuses(i) US$'000	Inducement fees US$'000	Other benefits(ii) US$'000	Employer's contribution to pension scheme US$'000	Compensation for loss of office as director US$'000	Subtotal US$'000	Equity compensation(iii) US$'000	Total US$'000
Leung Kwong Wai	—	221	387	—	51	10	—	669	204	873
Huang Hsing Hua	—	114	136	—	11	4	—	265	21	286
Lai Woon Ching	—	127	136	—	1	6	—	270	42	312
Lo Wai Ming	—	120	136	—	2	6	—	264	51	315
Lam Pak Lee	16	—	—	—	—	—	—	16	28	44
Chang Ching Yi, Steven	23	—	—	—	—	—	—	23	28	51
Wong Yuet Leung, Frankie	18	—	—	—	—	—	—	18	17	35
Choy Kwok Hung, Patrick	20	—	—	—	—	—	—	20	17	37
Kao Kuen, Charles	19	—	—	—	—	—	—	19	17	36
Sun, Patrick	20	—	—	—	—	—	—	20	17	37
Total	116	582	795	—	65	26	—	1,584	442	2,026

Notes:

(i) Discretionary bonus was determined by the Remuneration Committee of the Group after taking into account of the Group's profit for the year and individual employee's performance.

(ii) Other benefits include leave pay, insurance premium and other allowances.

(iii) This represents the amount charged to profit and loss account per requirement under HKFRS 2.

8 Employee benefit expenses – Group (continued)

(c) *Equity Compensation to Directors*

More detail for the Equity Compensation Scheme can be referred to Note 23 to the financial statements. Detail of the share options and shares granted to each of the directors and their corresponding fair value are listed as below:

Name of Director	2005 No. of Share Options Granted [1] (in thousand)	2005 Fair Value of the share option at Grant Date [3] US$'000	2005 No. of Shares Granted [2] (in thousand)	2005 Fair Value of the share at Grant Date [3] US$'000	2004 No. of Share Options Granted [4] (in thousand)	2004 Fair Value at Grant Date [6] US$'000	2004 No. of Shares Grant [5] (in thousand)	2004 Fair Value at Grant Date [7] US$'000
Leung Kwong Wai	800	66	2,600	886	800	38	26,400	5,941
Huang Hsing Hua	300	25	420	143	300	14	5,700	1,283
Lai Woon Ching	300	25	420	143	300	14	7,400	1,665
Lo Wai Ming	300	25	420	143	300	14	12,000	2,701
Lam Pak Lee	800	66	—	—	800	38	—	—
Chang Ching Yi, Steven	800	66	—	—	800	38	—	—
Wong Yuet Leung, Frankie	500	41	—	—	500	24	—	—
Choy Kwok Hung, Patrick	500	41	—	—	500	24	—	—
Kao Kuen, Charles	500	41	—	—	500	24	—	—
Sun, Patrick	800	66	—	—	500	24	—	—
Total	5,600	462	3,860	1,315	5,300	252	51,500	11,590

1 5,600,000 share options were granted to the Directors of the Group on 14 June 2005 under the Share Option Scheme. The share options can be exercised commencing from 1 July 2006.

2 3,860,000 shares from the Share Award Plan of the Company were granted to the Executive Directors of the Company on 7 June 2005. 1,544,000 shares (40% of the total) will be vested on 7 June 2006 and 2,316,000 shares (60% of the total) will be vested on 7 June 2007.

3 These represent the full fair value at grant date to be amortized in accordance to the vesting term of the Schemes and may differ from the total charge to the profit and loss account of the corresponding year.

4 5,300,000 share options were granted to the Directors of the Group on 19 March 2004 under the Pre-IPO Share Option Scheme. The share options were all exercised in 2005.

5 26,400,000 shares from the Pre-IPO Loyalty Plan and 25,100,000 from the Pre-IPO Share Reward Plan of the Company totalling 51,500,000 shares were granted to the Executive Directors of the Company on 19 March 2004. The shares from the Pre-IPO Loyalty Plan were vested on 1 April 2004 and the shares granted under the Pre-IPO Share Reward Plan were vested on 31 December 2004.

6 The share options were granted on 19 March 2004, a date prior to the Listing Date of the Company in the Stock Exchange and prior to the inception of HKFRS 2. The fair value of the share option was determined retrospectively with IPO Offer Price as one of the key significant inputs to the Black-Scholes model in 2005. This represented the full fair value which had been restated and amortized in the 2004 and 2005 financial statements respectively.

7 The Shares were granted on 19 March 2004, a date prior to the Listing Date of the Company in the Stock Exchange and prior to the inception of HKFRS 2. The fair value of the shares was determined retrospectively with IPO Offer Price. Shares under both the Pre-IPO Loyalty Plan and the Pre-IPO Share Reward Plan were vested prior to 1 January 2005 and HKFRS 2 is not applicable (see note 2.1 to the financial statements). The fair values stated here are purely for information only and are not required to reflect in the profit and loss account of 2005 and 2004.

8 Employee benefit expenses – Group (continued)

(d) *Five highest paid individuals*

The five individuals whose emoluments were the highest in the Group during the year include three (2004: four) directors whose emoluments are reflected in the analysis above. The amount of emolument paid and payable to the remaining two (2004: one) individual during the year is as follows:

	2005 US$'000	Restated 2004 US$'000
Number of individuals (excluding directors)	2	1
Basic salaries and other benefits	225	115
Discretionary bonus	154	102
Employer's contribution to pension scheme	10	5
	389	222
Equity compensation[1]	334	46
	723	268

The emoluments fell within the following bands:

	Number of individuals	
	2005	Restated 2004
US$350,001 - US$400,000	1	—
US$300,001 - US$350,000	1	—
US$250,001 - US$300,000	—	1
	2	1

[1] This represents the amount charged to profit and loss account per HKFRS 2 requirement.

Remarks

— None of the Directors of the Company waived any emoluments during the year.

— During the year, no emoluments have been paid to the Directors of the Company or the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office (2004: Nil).

9 Finance costs – Group

	2005 US$'000	2004 US$'000
Interest element of finance leases	2	2

10 Taxation – Group

Hong Kong profits tax has been provided at the rate of 17.5% (2004: 17.5%) on the estimated assessable profits for the year. No provision for income tax has been provided for subsidiaries operating outside Hong Kong as they did not generate any assessable profits in the respective jurisdictions during the year (2004: Nil).

	2005 US$'000	2004 US$'000
Current taxation:		
Hong Kong profits tax	15,869	13,385
Overseas profits tax	(17)	—
Over provisions in prior years	(635)	(186)
Deferred taxation (Note 28)	545	(558)
Taxation charge	15,762	12,641

The tax on the Group's profit before tax differs from theoretical amount that would arise using the taxation rate of Hong Kong, the Group's principal place of operation, as follows:

	2005 US$'000	Restated 2004 US$'000
Profit before tax	92,016	70,576
Tax calculated at a taxation rate of 17.5% (2004: 17.5%)	16,103	12,351
Income not subject to tax	(1,779)	(89)
Expenses not deductible for taxation purposes	1,773	287
Tax losses not recognised	300	278
Over provisions in prior years	(635)	(186)
Taxation expense	15,762	12,641

11 Profit attributable to shareholders of the Company

The profit attributable to shareholders of the Company is dealt with in the financial statements of the Company to extent of profit of US$67,675,000 (2004 restated: US$50,541,000).

12 Dividends

		2005 US$'000	Restated 2004 US$'000
(a)	Interim dividend declared and paid by the Company during the year:		
	2004 first interim, attributable to the result of 2003, paid, of HK$0.066 (approximately 0.85 US cents) per ordinary share	—	16,039
	2004 second interim, paid, of HK$0.026 (approximately 0.34 US cents) per ordinary share	—	8,393
	2005 interim, paid, of HK$0.04 (approximately 0.51 US cents) per ordinary share (Note (i))	12,912	—
	Less: Company's share of dividends paid on the shares held by a special purpose entity of the Group	(242)	(424)
		12,670	24,008
(b)	Final dividend attributed to the year:		
	2004 final dividend, paid, of HK$0.12 (approximately 1.54 US cents) per ordinary share (Note (ii))		38,655
	2005 final dividend, proposed, of HK$0.15 (approximately 1.93 US cents) per ordinary share (Note (iii))	48,540	
	Less: Company's share of dividends paid on the shares held by a special purpose entity of the Group	—	(749)
		48,540	37,906
	Dividend attributed to the year	61,452	63,087

Notes:

(i) On 7 September 2005, the Directors declared an interim dividend of HK$0.04 (approximately 0.51 US cents) per ordinary share . The interim dividend was paid on 7 October 2005.

(ii) On 9 March 2005, the Directors proposed a final dividend of HK$0.12 (approximately 1.54 US cents) per ordinary share. The final dividend was paid on 22 April 2005.

(iii) At a meeting held on 13 March 2006, the Directors proposed a final dividend of HK$0.15 (approximately 1.93 US cents) per ordinary share. This proposed dividend is not reflected as a dividend payable in these financial statements, but will be reflected as an appropriation of retained earnings for the year ending 31 December 2006.

13 Earnings per share

The calculation of basic and diluted earnings per share is based on the Group's profit attributable to shareholders of US$76,254,000 (2004 restated: US$57,935,000).

The basic earnings per share is based on the weighted average of 2,445,135,773 (2004 restated: 2,204,501,037) ordinary shares in issue excluding own shares held during the year.

Diluted earnings per share information is based on 2,473,217,108 (2004 restated: 2,320,846,751) ordinary shares which is 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. A calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares as calculated is compared with the number of shares that would have been issued assuming the exercise of the share options.

	2005	Restated 2004
Weighted average number of ordinary shares in issue	**2,445,135,773**	2,204,501,037
Adjustments for – allocated own shares	**27,052,538**	116,134,638
– share options	**1,028,797**	211,076
Weighted average number of ordinary shares for diluted earnings per share	**2,473,217,108**	2,320,846,751

14 Property, plant and equipment – Group

	Leasehold improvements US$'000	Furniture, fixtures and office equipment US$'000	Machinery and laboratory equipment US$'000	Motor vehicles US$'000	Total US$'000
At 1 January 2004					
Cost	1,566	3,837	3,321	127	8,851
Accumulated depreciation	(439)	(2,182)	(705)	(35)	(3,361)
Net book amount	1,127	1,655	2,616	92	5,490
For year ended 31 December 2004					
Opening net book amount	1,127	1,655	2,616	92	5,490
Additions	135	2,162	5,672	26	7,995
Depreciation	(292)	(2,039)	(1,555)	(51)	(3,937)
Closing net book amount	970	1,778	6,733	67	9,548
At 31 December 2004					
Cost	1,384	5,954	9,025	153	16,516
Accumulated depreciation	(414)	(4,176)	(2,292)	(86)	(6,968)
Net book amount	970	1,778	6,733	67	9,548
For year ended 31 December 2005					
Opening net book amount	970	1,778	6,733	67	9,548
Exchange differences	—	5	6	—	11
Additions	535	4,011	1,659	—	6,205
Disposals	—	(18)	—	—	(18)
Depreciation	(406)	(1,784)	(2,428)	(51)	(4,669)
Closing net book amount	1,099	3,992	5,970	16	11,077
At 31 December 2005					
Cost	1,919	9,884	10,690	153	22,646
Accumulated depreciation	(820)	(5,892)	(4,720)	(137)	(11,569)
Net book amount	1,099	3,992	5,970	16	11,077

Depreciation expense of US$2,366,000 (2004: US$2,406,000) has been expensed in cost of sales, US$398,000 (2004: US$675,000) in research and development costs and US$1,905,000 (2004: US$856,000) in administrative expenses.

15 Intangible assets – Group

	Patents and Intellectual property US$'000	Goodwill US$'000	Total US$'000
At 1 January 2004			
Cost	4,500	933	5,433
Accumulated amortisation	(3,825)	(642)	(4,467)
Net book amount	675	291	966
For year ended 31 December 2004			
Opening net book amount	675	291	966
Amortisation expense	(675)	(291)	(966)
Closing net book amount	—	—	—
At 31 December 2005			
Cost	4,500	933	5,433
Accumulated amortisation	(4,500)	(933)	(5,433)
Net book amount	—	—	—

16 Investments in subsidiaries

(a) Investments in subsidiaries

	Company	
	2005 **US$'000**	2004 US$'000
Investment in unlisted shares, at cost	**50,078**	50,016

(b) Amounts due from/(to) subsidiaries

The amounts due from/(to) subsidiaries are interest-free and have no fixed terms of repayment.

(c) Particulars of subsidiaries

The following is a list of the principal subsidiaries at 31 December 2005:

Name	Place of incorporation and kind of legal entity	Principal activities and place of operation	Particulars of issued share capital and debt securities	Interest held
Directly held:				
Solomon Systech Limited ("SSL")	Hong Kong, limited liability company ("LLC")	Research, design and distribution of integrated circuits, Hong Kong	188,585,271 Ordinary shares of HK$1 each	100%
Ample Pacific Limited ("Ample")	British Virgin Islands, LLC	Investment holding, Hong Kong	50,000 ordinary shares of US$1 each	100%
Cornway International Limited ("Cornway")	British Virgin Islands, LLC	Investment holding, Hong Kong	50,000 ordinary shares of US$1 each	100%
Pac-Pacific Limited ("Pac-Pacific")	Hong Kong, LLC	Investment holding, Hong Kong	2 ordinary shares of HK$1 each	100%
Mentor Ventures Limited ("Mentor")	British Virgin Islands, LLC	Investment holding, Hong Kong	50,000 ordinary shares of US$1 each	100%
Indirectly held:				
Systech Technology China Limited ("STCL")	Hong Kong, LLC	Investment holding, Hong Kong	10,000 ordinary shares of HK$1 each	100%
Solomon Systech Inc. ("SSI")	U.S.A., LLC	Market research, U.S.A.	20,000 ordinary shares of US$1 each	100%
Solomon Systech (Shenzhen) Limited ("SSSZ")	China, LLC	Research, design and distribution of integrated circuits, China	HK$8,000,000 registered and paid up capital	100%
Solomon Systech Japan Company Limited ("SSJCL")	Japan, LLC	Market research, Japan	10,000 ordinary shares of JPY1,000 each	100%
Solomon Systech Pte. Ltd. ("SSPL")	The Republic of Singapore, LLC	Research, design and distribution of integrated circuits, Singapore	480,000 ordinary shares of SGD1 each	100%
Jing Guang Semiconductors (Dongguan) Limited ("JGDG")	China, LLC	Manufacturing of integrated circuits, China	US$5,500,000 registered capital (US$850,000 paid up)	100%
Solomon Systech Taiwan Limited ("SST")	Republic of China ("Taiwan") LLC	Market research, Taiwan	5,000,000 ordinary shares of TWD10 each	100%

17 Investment in an associated company – Group

	2005 US$'000	2004 US$'000
At 1 January	1,119	—
Increase in interest in an associated company	—	1,313
Amortisation of goodwill	—	(24)
Share of associated company's results	(216)	(170)
At 31 December	903	1,119

The Group's interest in its associated company was as follows:

Name	Place of incorporation and operation	Principal activities	Particulars of issued shares held	As at 31 December 2005 Assets	As at 31 December 2005 Liabilities	For the year ended 31 December 2005 Revenue	For the year ended 31 December 2005 Loss	Interest held indirectly
				US$'000	US$'000	US$'000	US$'000	
WE3 Technology Company Limited	Hong Kong	Research, design, development and distribution of handsets solutions	3,500,000 ordinary shares of HK$1 each	3,914	134	1,520	1,075	20%

18 Available-for-sale financial assets – Group

	2005 US$'000	2004 US$'000
Unlisted shares, at cost	284	284
Less: Provision for impairment loss	(284)	(284)
	—	—

19 Inventories – Group

	2005 US$'000	2004 US$'000
Finished goods	4,576	16,949
Raw materials and work in progress	36,847	30,785
	41,423	47,734
Less: Provision for obsolete or slow moving inventories	(5,211)	(5,276)
	36,212	42,458

The cost of inventories that is recognised as expense and included in cost of sales amounted to US$278,529,000 (2004: US$206,144,000).

20 Trade and other receivables – Group

	2005 US$'000	2004 US$'000
Trade receivables	56,146	58,676
Less: Provision for impairment of receivables	(33)	(1,814)
Trade receivables - net	56,113	56,862
Prepayments and other receivables	3,106	1,304
	59,219	58,166

The Group's sales to corporate customers are normally entered into on credit terms of 30 days. The ageing analysis of trade and bills receivables is as follows:

	2005 US$'000	2004 US$'000
0 - 30 days	53,997	56,772
31 - 60 days	1,843	—
61 - 90 days	273	53
91 - 120 days	—	—
121 - 365 days	—	37
	56,113	56,862

21 Cash and cash equivalents and short-term fixed deposits

	Group		Company	
	2005	2004	**2005**	2004
	US$'000	US$'000	**US$'000**	US$'000
Cash at bank and in hand	**8,160**	124,715	**165**	88,240
Short-term bank deposits[1]	**111,319**	1,000	**65,214**	—
Cash and cash equivalents	**119,479**	125,715	**65,379**	88,240
Short-term fixed deposits[2]	**37,000**	—	**32,000**	—
	156,479	125,715	**97,379**	88,240

1 The effective interest rate on short-term bank deposits was 4.0% (2004: 1.8%); these deposits have an average maturity of 26 days. (2004: 21 days)

2 The effective interest rate on short-term fixed deposits was 3.5% (2004: N/A); these deposits have an average maturity of 231 days. (2004: N/A)

22 Share capital

	2005		2004	
	No. of shares	**US$'000**	No. of shares	US$'000
Authorised:				
Ordinary shares of HK$0.10 each	**5,000,000,000**	**64,433**	5,000,000,000	64,433
Issued and fully paid:				
At 1 January	**2,504,854,351**	**32,279**	1,885,852,711	24,302
Capitalisation of retained earnings for issue of new shares	—	—	189,000,000	2,436
New issue of shares	—	—	430,001,640	5,541
Exercise of share options (Note 23 (a))	**6,300,000**	**81**	—	—
At 31 December	**2,511,154,351**	**32,360**	2,504,854,351	32,279

23 Equity Compensation Scheme

(a) *The Pre-IPO Share Option Scheme*

The Company adopted the Pre-IPO Share Option Scheme (the "Pre-IPO Scheme") at an extraordinary general meeting held on 25 February 2004 and a meeting of the Board on 19 March 2004. The purpose of the Pre-IPO Scheme is to recognise the contribution of certain directors and members of the Group to the growth of the Group and/or to the listing of the Company's shares on the Stock Exchange.

On 19 March 2004, options to subscribe for an aggregate of 6,300,000 new Shares of the Company at the IPO Offer Price were offered by the Company to directors and senior management of the Group at a nominal consideration of HK$1.0 payable by each grantee. No further options can be offered under the Pre-IPO Scheme after the Listing Date. These options may be exercised at any time commencing 9 April 2005 to 8 April 2009, at the exercise price of HK$1.75 per share.

Movements in the number of share options under the Pre-IPO Share Option Scheme and their related exercise price are as follows:

	2005		2004	
	Exercise price in HK$ per share	**No. of options (thousands)**	Exercise price in HK$ per share	No. of options (thousands)
At 1 January	**1.75**	**6,300**		—
Granted		**—**	1.75	6,300
Exercised	**1.75**	**6,300**		—
At 31 December		**—**		6,300

All share options were exercised during the year and there was no share option outstanding under the Pre-IPO Share Option Scheme as at 31 December 2005.

The share options were granted on 19 March 2004, a date prior to the listing of the Company in the Stock Exchange and prior to the inception of the HKFRS 2. The fair value of options granted was not included in the preparation of financial statements for the year ended 31 December 2004.

In 2005, the fair value of the share options granted in 2004 under the Pre-IPO Option Scheme determined retrospectively using the Black-Scholes valuation model was US$297,000 (2004: N/A). The 2004 comparative figure was restated and the impact of HKFRS 2 was highlighted under Note 2 to the financial statements on page 61.

The significant inputs into the model were share price of HK$1.75, the IPO Offer Price in lieu of the market price at grant date (2004: N/A), exercise price shown above, expected life of options of 2 years (2004: N/A), expected dividend paid out rate of 2.63% (2004: N/A) and annual risk-free interest rate of 2.389% (2004: N/A). The annualised volatility of 40% is based on statistical analysis of daily share prices from 8 April 2004 to 29 March 2005. In view of the short listing history, the volatility was adjusted by reference to other listed companies in same industry.

23 Equity Compensation Scheme (continued)

(b) The Share Option Scheme

The Company also adopted the Share Option Scheme at an extraordinary general meeting held on 25 February 2004 and a meeting of the Board on 19 March 2004 under which options may be granted to subscribe for the Company's shares. Participants of the Scheme shall include directors (including executive directors, non-executive directors and independent non-executive directors) and employees of any member of the Group and any advisers, consultants, distributors contractors, contract manufactures, suppliers, agents customers, business partners, joint venture business partners, service providers of any member of the Group who the Board considers have contributed or will contribute to the Group ("the Participants"). The purpose of the Share Option Scheme is to provide Participants with opportunity to acquire proprietary interests in the Company and its Shares for the benefits of the Company with a flexible mean of either retaining, incentivising, rewarding, remunerating, compensating and/or providing benefits to Participants. The terms of the Scheme are in accordance with the provisions of the Chapter 17 of the Rules governing the Listing of Securities on the Stock Exchange.

On 14 June 2005, options to subscribe for 6,100,000 shares of the Company were offered by the Company to directors and senior management of the Group at a nominal consideration of HK$1.0 payable by each grantee. These options may be exercised at any time commencing 1 July 2006 to 30 June 2008, at the exercise price of HK$2.695 per share.

Movements in the number of share options outstanding and their related exercise price are as follows:

	2005		2004	
	Exercise price in HK$ per share	No. of options (thousands)	Exercise price in HK$ per share	No. of options (thousands)
At 1 January		—		—
Granted	2.695	6,100		—
At 31 December	2.695	6,100		—

The fair value of options granted during the period determined using the Black-Scholes valuation model was US$503,000 (2004: N/A). The significant inputs into the model were share price of HK$2.675 (2004: N/A) at the grant date, exercise price shown above, expected life of options of 2 years (2004: N/A), expected dividend paid out rate of 8.34% (2004: N/A) and annual risk-free interest rate of 3.086% (2004: N/A). The volatility of 58.47% measured at the standard deviation of expected share price returns is based on statistical analysis of daily share prices from 8 April 2004, the Listing Date to 14 June 2005, the option grant date.

23 Equity Compensation Scheme (continued)

(b) *The Share Option Scheme* (continued)

Share options outstanding at the end of the year have the following expiry date and exercise prices:

Expiry date - 1 July	Exercise price HK$ per share	No. of options 2005 (thousands)	No. of options 2004 (thousands)
2008	2.695	**6,100**	—

(c) *The Share Award Plan*

The Share Award Plan was adopted by the Company at an extraordinary general meeting held on 25 February 2004 and the Board on 19 March 2004 with an initial pool of 46,223,520 shares held by HSBC International Trustee Limited ("HSBC Trust") as Trustee for the benefit of the directors and employees.

Under the terms and condition as specified under the Share Award Plan, 40% of the shares will be vested 1 year from the grant date and the remaining 60% will be vested 2 years from the grant date. At 31 December 2005, a net 18,912,000 shares were reserved for named employees leaving a balance of 28,143,520 for future grant to directors and employees in 2006 and beyond.

Shares held by HSBC Trust as Trustee under the Share Award Plan	No. of shares
At 1 January 2005	46,223,520
Forfeited shares transferred from the employee share reward plan of Solomon Systech Limited	950,000
Forfeited shares transferred from the Pre-IPO Share Reward Plan[1]	1,350,000
Shares vested during the year	(1,468,000)
At 31 December 2005	47,055,520

The following is a summary of the shares granted, vested and forfeited during the year:

	Cumulative total	No. of shares 2005	No. of shares 2004
Granted during the year	20,460,000	**16,790,000**	3,670,000
Vesting of the 40% of shares granted in 2004 during 2005	(1,468,000)	**(1,468,000)**	—
Forfeiture of shares granted during the year	(80,000)	**(80,000)**	—
	18,912,000	**15,242,000**	3,670,000

The Group has followed the new HKFRS 2 in the financial statements for the year ended 31 December 2005 to account for the equity compensation expenses at appropriate market price at the date of grant.

[1] During the year, the 1,350,000 unvested shares were transferred from the Pre-IPO Share Reward Plan which was terminated under a Termination Deed dated 9 March 2005.

24 Reserves - Group

(a) Group

	Share premium US$'000	Own shares held US$'000	Merger reserve US$'000	Exchange reserve US$'000	Equity compen-sation reserve US$'000	Retained earnings US$'000	Total US$'000
At 1 January 2004, as previously reported	—	—	2,082	(1)	—	23,533	25,614
Effect of changes in accounting policies	—	(755)	—	—	384	394	23
At 1 January 2004, as restated	—	(755)	2,082	(1)	384	23,927	25,637
Exchange differences	—	—	—	(40)	—	—	(40)
Capitalisation of retained earnings for issue of new shares	—	(1,530)	—	—	—	(906)	(2,436)
Issue of ordinary shares	91,431	—	—	—	—	—	91,431
Share issue expenses	(5,037)	—	—	—	—	—	(5,037)
Dividends paid, net of portion for own shares held	—	—	—	—	—	(24,008)	(24,008)
Profit for the year	—	—	—	—	—	57,935	57,935
Equity compensation	—	947	—	—	1,232	(1,160)	1,019
At 31 December 2004	86,394	(1,338)	2,082	(41)	1,616	55,788	144,501
At 1 January 2005, as previously reported	86,394	—	2,082	(41)	—	55,865	144,300
Effect of changes in accounting policies	—	(1,338)	—	—	1,616	(77)	201
At 1 January 2005, as restated	86,394	(1,338)	2,082	(41)	1,616	55,788	144,501
Exchange difference	—	—	—	17	—	—	17
Exercise of share options	1,337	—	—	—	—	—	1,337
Dividends paid, net of portion for own shares held	—	—	—	—	—	(50,599)	(50,599)
Profit for the year	—	—	—	—	—	76,254	76,254
Equity compensation	—	—	—	—	3,143	—	3,143
Equity compensation transferred to share premium	1,624	733	—	—	(1,624)	(733)	—
At 31 December 2005	89,355	(605)	2,082	(24)	3,135	80,710	174,653

24 Reserves - Group (continued)

(b) Company

	Share premium US$'000	Equity compensation reserve US$'000	Retained earnings US$'000	Total US$'000
At 1 January 2004, as previously reported	25,614	—	18,408	44,022
Effect of changes in accounting policies	—	384	—	384
At 1 January 2004, as restated	25,614	384	18,408	44,406
Capitalisation of retained earnings for issue of new shares	—	—	(2,436)	(2,436)
Issue of ordinary shares	91,431	—	—	91,431
Share issue expenses	(5,037)	—	—	(5,037)
Dividends paid	—	—	(24,399)	(24,399)
Profit for the year	—	—	50,541	50,541
Equity compensation	—	1,232	—	1,232
At 31 December 2004	112,008	1,616	42,114	155,738
At 1 January 2005, as previously reported	112,008	—	42,336	154,344
Effect of changes in accounting policies	—	1,616	(222)	1,394
At 1 January 2005, as restated	112,008	1,616	42,114	155,738
Exercise of share options	1,337	—	—	1,337
Dividends paid	—	—	(51,567)	(51,567)
Profit for the year	—	—	67,675	67,675
Equity compensation	—	3,143	—	3,143
Equity compensation transferred to share premium	1,624	(1,624)	—	—
At 31 December 2005	114,969	3,135	58,222	176,326

25 Banking facilities – Group

At 31 December 2005, the banking facilitates of the Group amounting to US$16,232,000 (2004: US$16,232,000) are secured by the pledge of bank deposits of US$130,000 (2004: US$2,130,000).

26 Trade and other payables – Group

	2005 US$'000	2004 US$'000
Trade payables	43,408	54,760
Accrued expenses	12,949	8,639
	56,357	63,399

At 31 December 2005, the ageing analysis of trade payables is as follows:

	2005 US$'000	2004 US$'000
0 - 30 days	42,650	53,618
31 - 60 days	728	624
61 - 90 days	30	375
91 - 120 days	—	36
121- 365 days	—	107
	43,408	54,760

27 Obligations under finance leases - Group

	2005 US$'000	2004 US$'000
Wholly repayable within five years	39	28
Current portion	(10)	(8)
	29	20

At 31 December 2005, the Group's finance lease liabilities were repayable as follows:

	2005 US$'000	2004 US$'000
Within one year	11	9
In the second to fifth year	33	24
	44	33
Future finance charges on finance leases	(5)	(5)
Present value of finance lease liabilities	39	28
The present value of finance lease liabilities is as follows:		
Within one year	10	8
In the second to fifth year	29	20
	39	28

28 Deferred taxation - Group

Deferred taxation is calculated in full on temporary differences under the liability method using a principal taxation rate of 17.5% (2004: 17.5%).

The movement on the deferred tax liabilities account is as follows:

	2005 US$'000	2004 US$'000
At 1 January	29	587
Deferred taxation charged/(credited) to consolidated profit and loss account (Note 10)	545	(558)
At 31 December	574	29

The components of deferred tax liabilities recognised in the consolidated balance sheet and the movements during the year are as follows:

	Accelerated Tax depreciation US$'000
At 1 January 2004	587
Credited to consolidated profit and loss account in 2004	(558)
At 31 December 2004 and 1 January 2005	29
Charged to consolidated profit and loss account in 2005	545
At 31 December 2005	574

29 Consolidated cash flow statement

(a) Reconciliation of operating profit to net cash inflow from operations

	2005 US$'000	Restated 2004 US$'000
Operating profit	92,234	70,772
Depreciation of property, plant and equipment	4,669	3,937
Amortisation of patents and intellectual property	—	675
Amortisation of goodwill	—	291
Provision for equity compensation	3,143	1,232
Loss on disposal of property, plant and equipment	12	—
Interest income	(4)	(395)
Operating profit before working capital changes	100,054	76,512
Increase in trade and other receivables	(1,053)	(36,458)
Decrease/(Increase) in inventories	6,246	(29,375)
(Decrease)/Increase in trade and other payables	(7,042)	35,798
Net cash inflow generated from operations	98,205	46,477

29 Consolidated cash flow statement (continued)

(b) Proceeds from sale of property, plant and equipment

	2005 US$'000	2004 US$'000
Net book amount (note 14)	18	—
Loss on sale of property, plant and equipment	(12)	—
Proceeds from sale of property, plant and equipment	6	—

30 Commitments – Group

Capital commitments

Capital expenditure for property, plant and equipment at the balance sheet date but not yet incurred is as follows:

	2005 US$'000	2004 US$'000
Contracted but not provided for	659	470

Operating lease commitments - where a Group is the lessee

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2005 US$'000	2004 US$'000
Not later than 1 year	670	651
Later than 1 year and not later than 5 years	1,419	2,029
	2,089	2,680

31 Approval of financial statements

The financial statements were approved by the board of Directors on 13 March 2006.