

Report of the Directors

The directors have pleasure in submitting their annual report together with the audited financial statements for the year ended 31 December 2005.

Principal Place of Business

Varitronix International Limited ("the Company") is a company incorporated in Bermuda and has its registered office at Clarendon House, 2 Church Street, Hamilton HM11, Bermuda and principal place of business at 9th Floor, Liven House, 61-63 King Yip Street, Kwun Tong, Kowloon, Hong Kong.

Principal Activities

The principal activity of the Company is investment holding. The principal activities of the Group are the design, manufacture and sale of liquid crystal displays and related products.

The analysis of the principal activities and geographical locations of the operations of the Company and its subsidiaries during the financial year are set out in note 27 on the financial statements.

Subsidiaries

Particulars of the Company's subsidiaries at 31 December 2005 are set out in note 15 on the financial statements.

Financial Statements

The loss of the Group for the year ended 31 December 2005 and the state of the Company's and the Group's affairs at that date are set out in the financial statements on pages 28 to 68.

Dividends

An interim dividend of 10.0 cents per share was paid on 10 November 2005 (2004: interim dividend 10.0 cents per share). The directors now recommend the payment of a final dividend of 28.0 cents per share (2004: 28.0 cents per share).

Share Capital

Details of the movements in share capital of the Company during the year are set out in note 26 on the financial statements. Shares were issued on exercise of share options and as a result of scrip dividends.

Charitable Donations

Charitable donations made by the Group during the year amounted to HK\$196,377 (2004: HK\$48,734).

Fixed Assets

Movements in fixed assets during the year are set out in note 12 on the financial statements.

Reserves

Details of movements in reserves of the Group and the Company during the year are set out in note 26 on the financial statements.

Report of the Directors

Directors

The Directors during the financial year and up to the date of this report were:

Executive Directors:

Dr Chang Chu Cheng, <i>Chairman</i>	
Johnson Ko Chun Shun, <i>Chairman</i>	(appointed on 15 June 2005)
Tony Tsoi Tong Hoo	
Cecil Ho Te Hwai	
Dr Yan Sze Kwan	(resigned on 30 August 2005)
Chung Shun Ming	(resigned on 30 August 2005)
Kwok Siu Kwan	(resigned on 30 August 2005)

Independent Non-executive Directors:

Professor Charles Kao Kuen	(resigned on 21 July 2005)
Anthony Lui Chi Shing	(resigned on 21 July 2005)
Dr William Lo Wing Yan	
Yuen Kin	
Hou Ziqiang	

In accordance with the Bye-laws of the Company, Dr Chang Chu Cheng, Johnson Ko Chun Shun and Dr William Lo Wing Yan shall retire from office by rotation and are eligible for re-election at the forthcoming annual general meeting.

Directors' Interests in Shares

The Directors of the Company who held office at 31 December 2005 had the following interests in the shares of the Company and its subsidiaries (within the meaning of the Securities and Futures Ordinance ("SFO")) at that date as recorded in the register of directors' and chief executives' interests and share positions required to be kept under Section 352 of the SFO:

(a) Interests in the Company

	Shares of HK\$0.25 each			% of the issued share capital
	Personal interests	Corporate interests	Total	
Dr Chang Chu Cheng	22,598	6,203,716 <i>(note (a))</i>	6,226,314	1.93
Mr Johnson Ko Chun Shun	–	42,912,000 <i>(note (b))</i>	42,912,000	13.31

Notes:

- A family trust of Dr Chang Chu Cheng and his wife, Madam Iling Sieh, was the beneficial owner of the issued share capital of Colville Group Limited which held 6,203,716 shares of the Company.
- Rockstead Technology Limited and Omnicorp Limited, both wholly-owned by Mr Johnson Ko Chun Shun, held 32,212,000 shares and 10,700,000 shares of the Company respectively.

(b) Interests in subsidiaries

	Non-voting deferred shares of HK\$1,000 each in Varitronix Limited	Non-voting deferred shares of HK\$100 each in Polysources Properties Limited
Dr Chang Chu Cheng	960	78

Notes:

- (a) Dr Chang Chu Cheng held the above non-voting deferred shares as beneficial owner.
- (b) Dr Chang Chu Cheng was also interested in 4 non-voting deferred shares in Polysources Properties Limited which were held by a non-voting deferred shareholder of Polysources Properties Limited in trust for all non-voting deferred shareholders of Polysources Properties Limited.

Directors' Service Contracts

Dr Chang Chu Cheng and Messrs Johnson Ko Chun Shun, Tony Tsoi Tong Hoo and Cecil Ho Te Hwai have entered into management agreements with the Company which may be terminated by either party to the agreements at three months' notice.

Non-executive Directors are appointed for a period up to 31 December 2006 or such other date as agreed by the Non-executive Directors and the Company.

No Director proposed for re-election at the forthcoming annual general meeting has an unexpired service contract which is not determinable by the Company or any of its subsidiaries within one year without payment of compensation, other than normal statutory obligations.

Directors' Interests in Contracts

Apart from the foregoing, no contract of significance to which the Company, or any of its subsidiaries was a party, in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Share Option Schemes

The Company had a Share Option Scheme for the employees of the Group which was adopted on 6 June 1991, subsequently amended on 8 June 1999 and expired on 5 June 2001. A second Share Option Scheme of the Company was adopted on 22 June 2001 and terminated on 12 May 2003.

A third Share Option Scheme of the Company was adopted on 12 May 2003 as an incentive to the Group's employees and business associates. This Scheme shall be valid and effective for a period of ten years ending on 11 May 2013, after which no further options will be granted. The maximum number of shares in respect of which options may be granted under the third Share Option Scheme and any other Share Option Schemes of the Company may not exceed 10 percent of the issued share capital of the Company at the date of approval of the third Share Option Scheme. The maximum entitlement of each participant in the total number of shares issued and to be issued upon exercise of options granted under the third Share Option Scheme and any other Share Option Scheme of the Company in any 12-month period shall not exceed 1% of the total number of shares in issue.

The total number of shares available for issue under the Share Option Schemes at 31 December 2005 represents 6.59% (2004: 5.71%) of the issued share capital of the Company at that date. Further details of the Share Option Schemes are set out in note 25 on the financial statements.

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	Date granted	Number of options at 1 January 2005	Granted during the year	Options cancelled during the year	Options exercised during the year	Number of options at 31 December 2005	Exercisable period	Price per share to be paid on exercise of option HK\$	Market value per share at date of grant of options HK\$	Weighted average market value per share on exercise of options HK\$
Directors										
Chang Chu Cheng	30 October 2002	1,000,000	–	–	–	1,000,000	31 October 2002 to 30 October 2012	4.605	4.35	N/A
	21 December 2004	300,000	–	–	–	300,000	21 December 2004 to 20 December 2014	7.450	7.45	N/A
	19 December 2005	–	3,000,000	–	–	3,000,000	19 December 2005 to 18 December 2015	5.73	5.65	N/A
Johnson Ko Chun Shun	19 December 2005	–	3,000,000	–	–	3,000,000	19 December 2005 to 18 December 2015	5.73	5.65	N/A
Tony Tsoi Tong Hoo	22 July 2005	–	3,000,000	–	–	3,000,000	22 July 2005 to 21 July 2015	6.60	6.55	N/A
Cecil Ho Te Hwai	19 December 2005	–	3,000,000	–	–	3,000,000	19 December 2005 to 18 December 2015	5.73	5.65	N/A
Yan Sze Kwan (resigned on 30 August 2005)	30 October 2002	1,000,000	–	–	–	1,000,000	31 October 2002 to 30 October 2012	4.605	4.35	N/A
	21 December 2004	3,000,000	–	–	–	3,000,000	21 December 2004 to 20 December 2014	7.45	7.45	N/A
Chun Shun Ming (resigned on 30 August 2005)	30 October 2002	1,000,000	–	(1,000,000)	–	–	31 October 2002 to 30 October 2012	4.605	4.35	5.90
	21 December 2004	3,000,000	–	(3,000,000)	–	–	21 December 2004 to 20 December 2014	7.45	7.45	N/A
Kwok Siu Kwan (resigned on 30 August 2005)	9 June 1999	150,000	–	(150,000)	–	–	9 July 1999 to 8 July 2009	10.90	15.00	N/A
	30 October 2002	1,000,000	–	–	(1,000,000)	–	31 October 2002 to 30 October 2012	4.605	4.35	5.90
	21 December 2004	3,000,000	–	(3,000,000)	–	–	21 December 2004 to 20 December 2014	7.45	7.45	N/A
Employees										
	9 June 1999	430,250	–	(72,500)	–	357,750	9 July 1999 to 8 July 2009	10.90	15.00	N/A
	1 June 2000	688,000	–	(119,000)	–	569,000	1 July 2000 to 30 June 2010	11.30	13.40	N/A
	30 August 2001	265,000	–	(6,000)	(119,000)	140,000	30 August 2001 to 29 August 2011	3.06	3.68	8.46
	13 September 2002	199,000	–	–	(45,500)	153,500	13 September 2002 to 12 September 2012	3.905	3.85	7.05
	6 October 2003	433,000	–	(76,500)	(55,000)	301,500	6 October 2003 to 5 October 2013	7.35	7.35	8.28
	20 December 2004	2,596,000	–	(131,000)	(36,500)	2,428,500	20 December 2004 to 19 December 2014	7.50	7.50	8.17
		<u>18,061,250</u>	<u>12,000,000</u>	<u>(6,555,000)</u>	<u>(2,256,000)</u>	<u>21,250,250</u>				

Apart from the foregoing, at no time during the year was the Company or any of its subsidiaries a party to any arrangement to enable the Directors or any of their spouses or children under eighteen years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

Substantial Interests in the Share Capital of the Company

The register of interests in shares and short positions maintained under Section 336 of the SFO Ordinance shows that at 31 December 2005, other than the interests disclosed above in respect of Mr Johnson Ko Chun Shun and Rockstead Technology Limited, the following individual company had an interest of 5% or more in the issued share capital of the Company:

Name of shareholder	Capacity	Number of shares	% of the issued share capital
Mr Cheah Cheng Hye	Interest of a controlled corporation (<i>note</i>)	22,467,974	6.97
Value Partners Limited	Beneficial owner (<i>note</i>)	22,467,974	6.97

Note:

Mr Cheah Cheng Hye was deemed (by virtue of the SFO) to be interested in 22,467,974 shares. These shares were held by Value Partners Limited, which was owned as to 32.77% by Mr Cheah Cheng Hye.

Save as stated above, no other person is recorded in the register of substantial shareholders maintained under Section 336 of the SFO Ordinance as having an interest of 5% or more in the issued share capital of the Company as at 31 December 2005.

Pre-emptive Rights

There is no provision for pre-emptive rights under the Company's Bye-laws and the law in Bermuda.

Bank Loans, Overdrafts and Other Borrowings

Particulars of bank loans, overdrafts and other borrowings of the Group at 31 December 2005 are set out in notes 21 and 23 on the financial statements.

Properties

Particulars of the properties held by the Group are shown on pages 71 and 72 of the annual report.

Five Year Summary

A summary of the results and the assets and liabilities of the Group for the last five financial years is set out on pages 69 and 70 of the annual report.

Sufficiency of Public Float

Based on the information that is publicly available to the Company and within the knowledge of the Directors of the Company as at the date of this annual report, the Company has maintained the prescribed public float under the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited ("Listing Rules").

Major Customers and Suppliers

Revenue attributable to the five largest customers of the Group accounted for less than 50% of the total income of the Group for the year.

Purchases attributable to the five largest suppliers of the Group accounted for less than 29% of the value of the Group's total purchases for the year. At no time during the year have the Directors or any Shareholder of the Company (which to the knowledge of the Directors own more than 5% of the Company's issued share capital) had any interest in these major customers and suppliers.

Connected Transactions

- (1) On 8 November 2005, Varitronix Marketing (China) Limited ("Varitronix Marketing"), an indirect wholly-owned subsidiary of the Company, entered into an agreement with Tsinghua Holdings Corporation Limited ("Tsinghua Holdings"). Pursuant to the agreement, Varitronix Marketing conditionally agreed to acquire and Tsinghua Holdings conditionally agreed to sell its 49% equity interest in Varitronix Pengyuan Limited ("Varitronix Pengyuan"), a sino-foreign equity joint venture enterprise which was owned as to 51% by Varitronix Marketing and as to 49% by Tsinghua Holdings, at a total cash consideration of RMB40 million (equivalent to approximately HK\$38.5 million). Tsinghua Holdings is a connected person of the Company under the Listing Rules.

On the same day, the Company and Varitronix Marketing entered into an agreement with Harvest King Corporation Limited ("Harvest King"). Pursuant to the agreement, the Company conditionally agreed to transfer, through Varitronix (B.V.I.) Limited ("Varitronix BVI"), a wholly-owned subsidiary of the Company, to Harvest King 10% of the issued share capital of Great Boom Developments Limited ("Great Boom"), a wholly-owned subsidiary of Varitronix BVI, and in exchange Harvest King conditionally agreed to transfer its entire 20% equity interest in Beijing Varitronix Pengyuan Electronics Limited ("BVPEL"), a sino-foreign equity joint venture enterprise which was owned as to 42% by Varitronix Pengyuan, 38% by Varitronix Marketing and 20% by Harvest King to Varitronix Marketing. Harvest King is a connected person of the Company under the Listing Rules.

The Group has experienced strong competition in the mobile phone market in China. By eliminating all minority interests in Varitronix Pengyuan and BVPEL, the Group shall have greater flexibility in operating and the provision of financing to these subsidiaries.

- (2) Pursuant to a supplemental note entered into by the issuer, being an indirect wholly-owned subsidiary of the Company, and the holders of the convertible notes ("Noteholders") on 25 January 2006, the convertible notes were redeemed at 85% of their face value (HK\$26,520,000) on 27 January 2006. One of the Noteholders is the brother-in-law of an Executive Director of the Company. The other Noteholder is a director of an indirect wholly-owned subsidiary of the Company. The Noteholders are therefore connected persons of the Company under the Listing Rules. The Directors expect that, in addition to the saving of HK\$4,680,000 representing 15% of the aggregate outstanding principal of the convertible notes, the early repayment of the convertible notes will reduce net interest expense of the Group as the interest receivable from the bank is expected to be lower than the interest that would have been payable under the convertible notes. Details of the convertible notes are set out in note 23 on the financial statements.

Purchase, Sale or Redemption of the Company's Listed Securities

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities during the year ended 31 December 2005.

Confirmation of Independence

The Company has received from each of the Independent Non-executive Directors an annual confirmation of independence pursuant to Rule 3.13 of the Listing Rules and considers all the Independent Non-executive Directors to be independent.

Auditors

KPMG retire and, being eligible, offer themselves for reappointment. A resolution for the reappointment of KPMG as auditors of the Company is to be proposed at the forthcoming annual general meeting.

By order of the board

Tony Tsoi Tong Hoo

Director

Hong Kong, 10 April 2006