

REPORT OF THE DIRECTORS

REPORT OF THE DIRECTORS

The Board of directors ("Board") of the Company is pleased to announce the audited consolidated results of the Company and its subsidiaries ("Group") for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The Company is an investment holding company. The activities of the principal subsidiaries are set out in the financial statements on pages 72 to 73. The Group is a vertically integrated manufacturing services provider for handset industry worldwide. It provides a full range of manufacturing services to its customers in connection with the production of handsets.

RESULTS AND DIVIDENDS

The results of the Group for the year ended 31 December 2005 are set out in the financial statements on page 23. The Board does not recommend the payment of any dividends in respect of the year ended 31 December 2005.

RESERVES

Movements in reserves of the Group during the year are set out on page 25.

DISTRIBUTABLE RESERVES

As at 31 December 2005, the Company's reserves available for distribution amounted to US\$688,955,000.

SHARE CAPITAL

Details of the movements in the share capital during the year are set out in note 25 to the financial statements.

FINANCIAL SUMMARY

A financial summary of the results and the balance sheet of the Group for the last five financial years are set out on page 74.

PROPERTY, PLANT AND EQUIPMENT

Details of movements in property, plant and equipment of the Group during the year are set out in note 15 to the financial statements.

BANK LOANS

Details of bank loans are set out in note 24 to the financial statements.

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DIRECTORS

The directors of the Company during the year and up to the date of this report are:

Executive Directors

CHIN Wai Leung, Samuel
DAI Feng Shuh

Non-executive Directors

CHANG Ban Ja, Jimmy
GOU Hsiao Ling
LEE Jin Ming
LU Fang Ming

Independent non-executive Directors

LAU Siu Ki
Edward Fredrick PENSEL
MAO Yu Lang

Having received written confirmation from each of the independent non-executive directors of their independence pursuant to rule 3.13 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules"), the Company considers each independent non-executive director to be independent.

Pursuant to article 112 of the articles of the association of the Company ("Articles"), one-third of the directors for the time being (or, if their number is not three or a multiple of three, then the number nearest to, but not exceeding one-third) shall retire from office by rotation at each annual general meeting of the Company provided that every director shall be subject to retirement by rotation at least once every three years. In accordance with article 112 of the Articles, Messrs. Chin Wai Leung, Samuel and Chang Ban Ja, Jimmy and Miss Gou Hsiao Ling will retire from office by rotation at the annual general meeting and, being eligible, will offer themselves for re-election.

SERVICE CONTRACTS

None of the directors of the Company has entered into a service contract with the Company which does not expire or which is not determinable by the Company within one year without payment of compensations, other than statutory compensations.

DIRECTORS' INTERESTS IN CONTRACTS

No contracts of significance in relation to the Group's business to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of or at any time during the year.

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DISCLOSURE OF INTERESTS

Directors' Interests and Short Positions in Shares, Underlying Shares and Debentures

As at 31 December 2005, the interests and short positions, if any, of each director and chief executive of the Company in the shares, underlying shares and debentures of the Company and any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which were required to be notified to the Company and The Stock Exchange of Hong Kong Limited ("Stock Exchange") pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which the directors and chief executives were taken or deemed to have under such provisions of the SFO) or which were required to be and are recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO or as otherwise required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code") adopted by the Company were as follows:

Name of director	Name of corporation	Capacity/ Nature of interest	Total number of ordinary shares	Approximate percentage of interest in the Company/ associated corporations
Chin Wai Leung, Samuel	Company	Personal Interest	24,221,275	0.348%
	Hon Hai	Personal Interest	82,892	0.002%
Dai Feng Shuh	Company	Personal Interest	24,221,275	0.348%
	Hon Hai	Personal Interest	367,530	0.009%
Chang Ban Ja, Jimmy	Hon Hai	Personal Interest	1,745,892	0.043%
Lee Jin Ming	Hon Hai	Personal Interest	927,830	0.023%
Lu Fang Ming	Hon Hai	Personal Interest	1,200,596	0.029%
Mao Yu Lang	Hon Hai	Personal Interest	552,399	0.013%

Save as disclosed above, none of the directors or the chief executives of the Company had, as at 31 December 2005, any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which would have to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which the directors and chief executives were taken or deemed to have under such provisions of the SFO) or which were recorded in the register required to be kept by the Company under Section 352 of the SFO or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code.

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Substantial Shareholders' Interests and Short Positions in Shares and Underlying Shares

So far as is known to any director of the Company, as at 31 December 2005, shareholders (other than the directors or the chief executives of the Company) who had interests and short positions in the shares and underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or which were recorded in the register required to be kept by the Company under Section 336 of the SFO were as follows:

Name	Capacity/ Nature of interest	Total number of ordinary shares	Approximate percentage of interest in the Company
Foxconn (Far East) Limited	Beneficial owner	5,081,034,525	73.07%
Hon Hai Precision Industry Company Limited ⁽¹⁾	Interest of a controlled corporation	5,081,034,525	73.07%

Note:

- (1) Foxconn (Far East) Limited is a direct wholly-owned subsidiary of Hon Hai Precision Industry Company Limited ("Hon Hai"), therefore, Hon Hai is deemed or taken to be interested in the 5,081,034,525 shares which are beneficially owned by Foxconn (Far East) Limited for the purposes of the SFO.

Save as disclosed above, as at 31 December 2005, the Company had not been notified by any persons (other than the directors or the chief executives of the Company) who had interests or short positions in the shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or which were recorded in the register required to be kept by the Company under Section 336 of the SFO.

CONTINUING CONNECTED TRANSACTIONS

During the year, the Company and its subsidiaries ("Group") entered into the following continuing connected transactions with Hon Hai, the Company's ultimate controlling shareholder, its subsidiaries or associates ("Hon Hai Group"):

1. Product sales transactions between the Group and the Hon Hai Group (Note 1);
2. Lease transactions between the Group and the Hon Hai Group (Note 2);
3. General services transactions between the Group and the Hon Hai Group (Note 3);
4. Research and development services transactions between the Group and the Hon Hai Group (Note 4);
5. Subcontracting transactions between the Group and the Hon Hai Group (Note 5);

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6. **Equipment sales and purchase transactions between the Group and the Hon Hai Group (Note 6); and**
7. **Materials and components supply transactions between the Group and the Hon Hai Group (Note 7).**

Notes

1. This refers to the sales of certain products to the Hon Hai Group pursuant to the framework product sales agreement dated 18 January 2005 and a supplemental agreement dated 28 February 2006. The total consideration for the year ended 31 December 2005 was US\$74.944 million.
2. This refers to the properties leased from the Hon Hai Group pursuant to the framework lease agreement dated 18 January 2005 and a supplemental agreement dated 12 January 2006. The total consideration for the year ended 31 December 2005 was US\$1.751 million.
3. This refers to the provision of utilities, support and other general services by the Hon Hai Group to the Group pursuant to the general services agreement dated 18 January 2005 and a supplemental agreement dated 12 January 2006. The total consideration for the year ended 31 December 2005 was US\$14.956 million.
4. This refers to the provision of research and development services by the Hon Hai Group to the Group pursuant to the research and development agreement dated 19 January 2005 and a supplemental agreement dated 12 January 2006. The total consideration for the year ended 31 December 2005 was US\$2.492 million.
5. This refers to subcontracting services providing to and provided by the Hon Hai Group pursuant to the framework subcontracting (income) agreement dated 18 January 2005 and a supplemental agreement dated 12 January 2006 and the framework subcontracting (expense) agreement dated 18 January 2005 and a supplemental agreement dated 12 January 2006. The total consideration for the year ended 31 December 2005 for subcontracting income and subcontracting expense was US\$3.228 million and US\$16.843 million respectively.
6. This refers to equipments purchased from and sold to the Hon Hai Group pursuant to the framework equipment purchase agreement dated 18 January 2005 and a supplemental agreement dated 12 January 2006 and the framework equipment sales agreement dated 18 January 2005 and a supplemental agreement dated 12 January 2006. The total consideration for the year ended 31 December 2005 for equipment purchase and equipment sale was US\$17.398 million and US\$8.839 million respectively.
7. This refers to the supply of materials and components by the Hon Hai Group pursuant to the framework materials and component agreement dated 19 January 2005 and a supplemental agreement dated 28 February 2006. The total consideration for the year ended 31 December 2005 was US\$444.457 million.

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Pursuant to Rule 14A.38 of the Listing Rules, the Board of Directors engaged the auditors of the Company to perform certain agreed upon procedures in respect of the transactions of the Group to assist the Directors to evaluate whether the transactions:

1. have received the approval from the Board of Directors;
2. were in accordance with the pricing policies of the Company where the transactions involve provision of goods and services by the Company;
3. have been entered into in accordance with the agreements governing the transactions; and
4. have not exceeded the caps disclosed in the relevant announcements.

The auditors of the Company have performed procedures in respect of the transactions in accordance with Hong Kong Standard on Related Services 4400 *Engagements to Perform Agreed Upon Procedures Regarding Financial Information*.

The auditors have reported their factual findings on these procedures to the Board of Director. The independent non-executive directors of the Company have reviewed the transactions and the findings and confirmed that the transactions are:

1. in the ordinary and usual course of business of the Company;
2. on normal commercial terms; and
3. in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

SHARE OPTION SCHEME AND SHARE SCHEME

A share option scheme ("Option Scheme") and a share scheme ("Share Scheme") were adopted by the Company on 12 January 2005.

Option Scheme

On 25 July 2005, the Company granted options to employees under the Option Scheme as below:

Outstanding at beginning of year	Date of grant during year	Granted during year	Vesting period	Exercise price	Exercised during year	Lapsed during year	Expired during year	Outstanding at end of year
0	25 July 2005	435,599,000	each year on 25 July from 2006 to 2011	HK\$6.06	0	309,000	0	435,290,000
0		435,599,000			0	309,000	0	435,290,000

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The closing price of the shares of the Company immediately before 25 July 2005, the date on which the options were granted, was HK\$5.75.

Summary of Principal Terms of the Option Scheme

The purpose of the Option Scheme is to attract skilled and experienced personnel, to incentivize them to remain with the Group and to give effect to the Group's customer-focused corporate culture, and to motivate them to strive for the future development and expansion of the Group, by providing them with opportunities to acquire equity interests in the Company.

Subject to the terms of the Option Scheme, the Board may, at its absolute discretion, offer any employees, management members and directors of the Company, or any of its subsidiaries, and third party service providers including employees of Hon Hai and its subsidiaries, options to subscribe for shares on the terms set out in the Option Scheme.

The total number of shares in respect of which options may be granted under the Option Scheme shall be 683,940,002 shares, representing approximately 9.83% of the issued share capital of the Company as at the date of this annual report.

The total number of shares issued and to be issued upon exercise of options granted and to be granted to each grantee in any 12-month period up to the date of the latest grant shall not exceed 1% of the issued share capital of the Company from time to time.

The period within which the options must be exercised will be specified by the Board at the time of grant, and must expire no later than 10 years from the effective date of the Share Option Scheme. An offer of grant of an option must be accepted being a date not more than 30 days after the date of the offer. The amount payable on acceptance of an offer is HK\$1.00.

The subscription price for shares shall be not less than the highest of: (i) the closing price of the shares as stated in the Stock Exchange's daily quotations sheet on the date of grant, which must be a business day; and (ii) the average closing price of the shares as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the shares.

Information on the Share Scheme

The Share Scheme is not subject to the provisions of Chapter 17 of the Listing Rules. The trustee for the Share Scheme may either subscribe for new shares at nominal value or purchase shares from the market in accordance with the terms of the Share Scheme.

At the forthcoming annual general meeting of the Company, an ordinary resolution will be proposed to grant a general mandate to the directors of the Company to allot and issue shares under the Share Scheme not exceeding 2% of the issued share capital of the Company as at the date of such meeting ("Scheme Mandate").

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As at 11 April 2006, the issued share capital of the Company comprised 6,958,056,025 shares of US\$0.04 each. Subject to the passing of the ordinary resolution approving the Scheme Mandate and on the basis that no further shares are issued or repurchased prior to the forthcoming annual general meeting, exercise in full of the proposed Scheme Mandate will result in 139,161,120 shares being allotted and issued under the Scheme Mandate. On the basis of the closing price of HK\$16.3 per share as at 11 April 2006 and the Scheme Mandate being exercised in full, the aggregate market value of the 139,161,120 shares to be allotted and issued pursuant thereto would be approximately HK\$2,268,326,256. The Company expects that the costs attributable to the grant of any shares under the Share Scheme will be accounted for by reference to the market value of such shares at the time of grant. The Company will give due consideration to any financial impact arising from the grant of shares under the Share Scheme before exercising the Scheme Mandate.

On 31 December 2005, the Company granted 3,273,000 award shares to 425 employees under the Share Scheme subject to lock-up periods of up to three years commencing from the date of grant, which will be vary from beneficiary to beneficiary.

Apart from the Option Scheme and the Share Scheme above, at no time during the year was the Company or any of its subsidiaries a party to any arrangement to enable the directors of the Company to acquire benefits by means of acquisitions of shares in, or debenture of, the Company or any other body corporate.

MAJOR CUSTOMERS AND SUPPLIERS

During the year, sales to the Group's five largest customers accounted for approximately 95% of the Group's total sales for the year and sales to the Group's largest customer amounted to approximately 58%. Purchases from the Group's five largest suppliers accounted for approximately 86% of the total purchases for the year and purchase from the Group's largest supplier amounted to approximately 76%.

None of the directors of the Company or any of their associates or any shareholders (which, to the best knowledge of the directors, own more than 5% of the issued share capital of the Company) had any interest in any of the Group's five largest customers and five largest suppliers.

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

SUFFICIENCY OF PUBLIC FLOAT

As at the latest practical date prior to the issue of this annual report, to the best knowledge of the directors and based on the information publicly available to the Company, there is sufficient public float as required by the Listing Rules.

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PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

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

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the memorandum and the articles of the association of the Company and the Companies Law of the Cayman Islands.

PENSION SCHEMES

Details of the Group's pension scheme and the basis of calculation are set out in note 35 to the financial statements.

AUDIT COMMITTEE

The Company has established an audit committee in accordance with the requirements of the Listing Rules and the Code on Corporate Governance Practices ("CCGP"). Its primary duties are to review and supervise the Company's financial reporting process and internal control system, nominate and monitor external auditors and provide advices and comments to the Board. The audit committee is comprised of three non-executive directors, two of whom are independent non-executive directors.

The audit committee has reviewed the audited financial statements of the Group for the year ended 31 December 2005.

CORPORATE GOVERNANCE

None of the directors of the Company is aware of information that would reasonably indicate that the Company is not, or was not for any part of the year covered by the annual report, in compliance with the CCGP as set out in Appendix 14 of the Listing Rules save as disclosed in the corporate governance report in this report.

AUDITORS

The financial statements have been audited by Deloitte Touche Tohmatsu who are due to retire and, being eligible, offer themselves for re-appointment as auditors of the Company.

On behalf of the Board

Chin Wai Leung, Samuel

Chairman and Chief Executive Officer

Hong Kong, 11 April 2006