



# Report of the Directors

The Board hereby presents the report of the Directors and the audited accounts of the Group for the year ended 31 December 2005 to the shareholders.

## Principal operations

The Group is principally engaged in the production and sales of CPTs and CPT components.

## Results and financial status

The annual results of the Group for the year ended 31 December 2005 and its financial status as at the same day prepared in accordance with accounting principles generally accepted in Hong Kong ("HK GAAP") are set out on page 67 to page 133 of this annual report.

## Dividend

The Company's original dividend policy will remain unchanged. In light of the operating loss in 2005, the Board resolved not to distribute any final dividend.

## Five year financial summary

A summary of the published results and assets, liabilities and minority interests of the Group for the last five years, as extracted from the audited financial statements and adjusted (in applicable), is set out in page 134 of this annual report. This summary does not form a part of the audited financial statements.

## Property, plant and equipment

Details of the movement of property, plant and equipment of the Group in the year are set out in note 5 to the financial statements.

## Share capital

Details of the changes in the Company's share capital, together with the reasons therefore, are set out in note 15 to the financial statements.

### Purchase, redemption and sale of shares of the Company

Neither has the Company nor any of its subsidiaries purchased, redeemed or sold any of its shares during the year.

### Reserves

Details of the movement of reserves of the Company and of the Group during the year are set out in note 16 to the financial statements.

### Major customers and suppliers

The percentage of purchase from and sales to the major suppliers and customers of the Group is set out as follows:

#### Purchase

- largest supplier 5%
- five largest suppliers 14%

#### Sales

- largest customer 18%
- five largest customers 55%

None of the directors, their respective associates or any shareholder who, as far as the directors are aware, holds 5% or more of the Company equity interests had any interest in the above-mentioned major suppliers and customers.

### Directors and Supervisors

The particulars of Directors and Supervisors during the year and up to the date of this report are set out in page 25 to 31 of this annual report.

## Re-election of Directors and Supervisors

The existing Directors and Supervisors of the Company were elected at the general meeting held on 9 September 2004, with a term of 3 years. In August 2005, Chairman Mr. Ma Jinqun resigned due to his retirement. Mr. Niu Xingan was accordingly nominated as executive director candidate by the Board and Mr. Zhang Zhankui was nominated by the Supervisory Committee as supervisor candidate, subject to the approval by the forthcoming general meeting. Other Directors and Supervisors will remain in office.

## Remuneration of Directors and the five highest paid individuals

Details of the remuneration of directors and the five highest paid individuals of the Group are set out in note 26 to the financial statements.

## Management contracts

Save for the contracts in relation to connected transactions as stated in this report, 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.

## Share Appreciation Rights Plan

Pursuant to the Share Appreciation Rights Plan of the Company (details of which were set out in the Company's prospectus dated 8 December 2004), the following Directors, Supervisor and senior management members were granted share appreciation rights by the Company as follows:

Name	Number of Share Appreciation Rights (Shares)	Note
Xing Daoqin	800,000	Director
Tao Kui	800,000	Director
Guo Mengquan	600,000	Director
Zhang Shaowen	600,000	Director
Yun Dajun	600,000	Director
Zhang Weichuan	320,000	Supervisor
Zhang Chunqing	400,000	Senior Management
Ng Yuk Keung	400,000	Senior Management
Wang Ximin	400,000	Senior Management
Zhang Junhua	320,000	Senior Management
Li Miao	320,000	Senior Management

### **Directors' and Supervisors' equity interest**

Save as to the interests mentioned in the section headed "Share Appreciation Rights Plan" above, as at 31 December 2005, none of the Directors, Supervisors or senior management members of the Company had any interest or short position in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")) which shall be recorded in the register of members required to be kept by the Company pursuant to section 352 of the SFO, or which was otherwise required to be notified to the Company or the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies. During the year, none of the directors, supervisors or senior management members of the Company or their spouses or children under the age of 18 held the right to purchase the share capital or debentures of the Company, neither did they exercise such right.

### **Directors' and Supervisors' interests in contracts**

At end of the year and any time during the year, save for the service contract in relation to the Company's business, none of the Company, its holding companies or subsidiaries or of the Group entered into any material contract in which the Director or Supervisor of the Company held, either directly or indirectly, any significant interest.

### **Interests and short positions of Directors, Supervisors and Senior Management**

Save as to the interests mentioned in the section headed "Share Appreciation Rights Plan" above, as at 31 December 2005, none of the Directors, Supervisors, chief executive or senior management members of the Company or their respective associates had any interest or short position in the shares, underlying shares and/or debentures (as the case may be) of the Company and / or any of its associated corporations (within the meaning of Part XV of the SFO) which was required to be notified to the Company and the Stock Exchange pursuant to the provisions of Divisions 7 and 8 of Part XV of the SFO (including interest and short positions which any such directors, supervisors, chief executive or senior management member was taken or deemed to have under such provisions of the SFO), or which was otherwise required to be entered in the register of interests to be kept by the Company pursuant to section 352 of the SFO, or which was 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 (the "Model Code") as set out in Appendix 10 to the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules") in force as at 31 December 2005.

### Interests and short positions of substantial shareholders and other persons

So far as the Directors are aware, each of the following persons, not being a Director, Supervisor, chief executive or member of the Company's senior management, had an interest or short position in the Company's shares or underlying shares (as the case may be) as at 31 December 2005 and as entered in the register of interests to be kept pursuant to section 336 of the SFO:

IRICO Group Corporation had interests in 1,455,880,000 Domestic Shares of the Company (representing 100% of the Domestic Share capital), whereas HKSCC Nominees Limited had interests in 484,027,990 H Shares of the Company (representing 99.74% of the H Share capital).

*Notes:*

As at 31 December 2005, based on the information available to Directors and so far as the Directors are aware, HKSCC Nominees Limited held 484,027,990 H Shares, among which:

J. P. Morgan Chase & Co. through its controlled corporations had interests in 35,464,000 H Shares of the Company (representing approximately 7.31% of the H Share capital).

Pictet Asset Management on behalf of Pictet Funds Asian Equities had direct interests in 33,742,000 H Shares of the Company (representing approximately 6.95% of the H Share capital).

Derby Steven P., Goldfarb Lawrence and Lamar Steven M. through their controlled corporations had interests in 49,554,000 H Shares of the Company (representing approximately 10.21% of the H Share capital).

Morgan Stanley through its controlled corporations had interests in 83,980,000 H Shares of the Company (representing approximately 17.30% of the H Share capital) and a short position in 73,000,000 H Shares of the Company (representing approximately 15.04% of the H Share capital).

### Designated deposit and overdue time deposit

As of 31 December 2005, the Group had no designated deposits in any financial institutions in the PRC. All of the Group's bank deposits are lodged in commercial banks in the PRC, and are in compliance with the relevant laws and regulations.

## Employees

As at 31 December 2005, the Group had 18,289 employees with various talents, of whom approximately 3.2% were management and administrative personnel, 5.9% were technological personnel, 0.6% were accounting and audit personnel, 0.6% were sales and marketing personnel, and 86.7% were production employees. The employment and remuneration policy of the Company remained the same as set out in the Company's prospectus dated 8 December 2004. With full enthusiasm in work, the Group's employees are committed to ensure the high quality and reliability of products and services.

## Connected transactions

For the year ended 31 December 2005, there were various continuing connected transactions between the Group and IRICO Group Corporation, Xian Guangxin Electronic Co., Ltd. ("Xian Guangxin"), IRICO Display Technology Co., Ltd. ("IRICO Display"), Xianyang IRICO Electronics Shadow Mask Co., Ltd. ("IRICO Shadow Mask"), Shaanxi IRICO Phosphor Material Co., Ltd. ("IRICO Phosphor"), Xianyang Cailian Packaging Material Company Limited ("Xianyang Cailian"), details of which are set out in the Company's prospectus dated 8 December 2004.

Pursuant to Rule 14A.42(3) of the Listing Rules, the Stock Exchange has granted to the Company a waiver from strict compliance with the otherwise applicable announcement and / or independent shareholders' approval requirements in connection with these continuing connected transactions (the "Waiver").

## Connected transactions *(continued)*

For the year ended 31 December 2005, the approved annual cap and the actual revenue or expenditure in respect of each continuing connected transactions are set out below:

<b>Item</b>	<b>Approved annual cap for 2005 RMB'000</b>	<b>Actual revenue or expenditure for 2005 RMB'000</b>
Supply of fuel, coal, industrial chemicals products and raw materials to IRICO Group Corporation	90,250	54,589
Supply of parts and raw materials to IRICO Display, IRICO Phosphor and IRICO Shadow Mask	666,221	655,490
Purchase of foam plastics, gloves, wood brackets and raw materials from IRICO Group Corporation	224,654	133,800
Purchase of phosphor and shadow mask from IRICO Phosphor and IRICO Shadow Mask	206,793	129,990
Purchase of materials from Xianyang Cailian	62,049	58,958
Utilities obtained from IRICO Group Corporation	572,827	444,582
Social and ancillary services obtained from IRICO Group Corporation		
(a) Schools	10,236	9,278
(b) Social welfare facilities	2,814	2,786
(c) Security services	800	—
(d) Environmental hyginene and landscaping services	1,200	1,200
Rental payable to IRICO Group Corporation	40,739	30,206
Land use rights leasing fees payable to IRICO Group Corporation	4,218	4,218
Equipment leasing fees payable to Xian Guangxin	1,500	750
Trademark licensing fees payable to IRICO Group Corporation	6,450	3,902

## Connected transactions *(continued)*

The independent non-executive Directors had reviewed these continuing connected transactions and confirmed to the Board that these transactions have been entered into:

- (1) in the ordinary and usual course of business of the Group;
- (2) either on normal commercial terms or, if there are not sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Company than terms available to or from (as appropriate) independent third parties; 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.

The auditors of the Company had provided a letter to the Directors of the Company confirming that the continuing connected transactions:

- (1) had received the approval by the Board of the Company;
- (2) were in accordance with the pricing policies of the Company;
- (3) had been entered into in accordance with the relevant agreements governing these transactions; and
- (4) had not exceeded the caps set out in the Waiver.

In respect of these continuing connected transactions, the Company confirmed that it had complied with the relevant requirements set out in the Waiver and Chapter 14A of the Listing Rules.

## Bank loans

As at 31 December 2005, details of bank loans of the Group are set out in note 22 to the financial statements.

## Pre-emptive right

There are no provisions for pre-emptive rights under the Company's articles of association or relevant laws and regulations which could oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

## Subsidiaries

Details of the subsidiaries of the Company are set out in note 8 to the financial statements.

## External guarantee

The Group does not have any external guarantee during the year ended 31 December 2005.



### Provision for Impairment of Property, Plant and Equipment

In 2005, drastic changes occurred in the CPT industry. In particular, the severe adverse impact of flat screen display device on the traditional CPT industry was far beyond the expectation of the Company and many analyst organisations. In light of this, the Board appointed an independent professional valuer to evaluate the value of the production facilities and construction in progress. A provision for impairment of property, plant and equipment of the Group amounting to approximately RMB567,659,000 was made for 2005, of which a provision for diminution of value amounting to approximately RMB320,325,000 was made for K line planned for production of super large screen high definition flat CPTs, and provisions for diminution of value for other production lines amounted to approximately RMB247,334,000.

Globally, investments in TFT-LCD reached US\$12.7 billion in 2005, hitting a new record. The subsequent production capacity imposed tremendous pressure on the traditional CRT television market. With several high generation LCD production lines in the world gradually commencing production, large and super-large screen CRT television sets stood more severely hit than medium and small CRT television sets. According to Stanford Company's report in the first quarter of 2006, during the first quarter of 2005, the global average price of 30"-34" LCD television sets fell 15.7% from the previous quarter, dropping below the sweet spot of US\$2000 (such decrease in price took place at least one year in advance than was forecasted by Stanford Company two years ago). The price decrease stimulated strong global demand for LCD television sets of such sizes. Under such stimulation, global sales of 30"-34" LCD television sets in the first quarter of 2005 reached almost 60% of the sales in the full year of 2004. Such sales far exceeded the forecast made by Stanford Company just a quarter before.

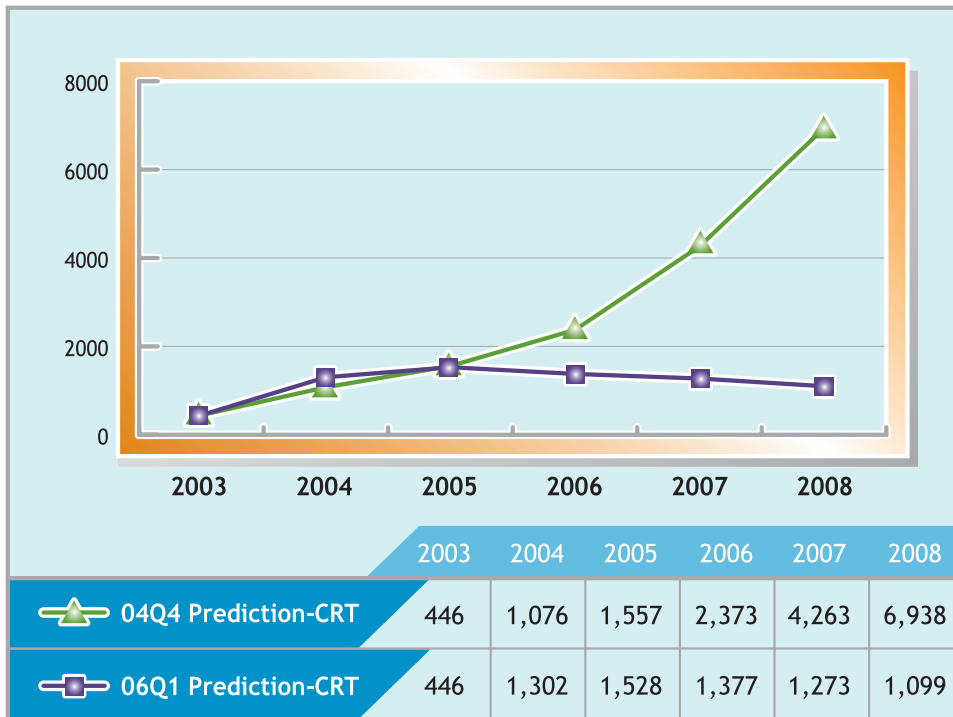
With the continuous price decrease of LCD television sets, in the fourth quarter of 2005, the ratio of the selling prices of LCD television sets of the above sizes to those of 32" 16:9 flat screen CRT television sets fell near the significant psychological threshold ratio of 2:1. The replacement effect coming from LCD television sets in the above size range became obvious. In 2005, sales of 30"-34" LCD television sets in the United States exceeded, for the first time, those of CRT flat screen television sets of such sizes. In Japan, the ratio between the two even climbed to 4.23:1.

In China, the replacement effect of flat screen television sets on CRT television sets, especially on super-large screen CRT television sets, was also far beyond the general expectation of the Company and organizations preparing industry forecast. According to the latest forecast by Stanford Company in the first quarter of 2006, the steady growing trend of the 30"-34" flat screen CRT television market in China is experiencing fundamental reversing changes. Not only has Stanford Company made fundamental revisions to its forecast regarding 30"-34" CRT and LCD television sets, but similar revisions have been made by Displaysearch, another organization in America preparing industry forecast.

The Company is of the opinion that, based on the trend of change in the television set industry in 2005, the speed at which LCD television sets are replacing CRT television sets in domestic and foreign markets, especially super-large screen CRT television sets larger than 30", has far exceeded the general prediction by the Company and the whole industry. Under the continuous threat from FPD television sets, the trend of the super large CRT television set market has experienced fundamental reversing changes that are beyond the control of the CRT industry.

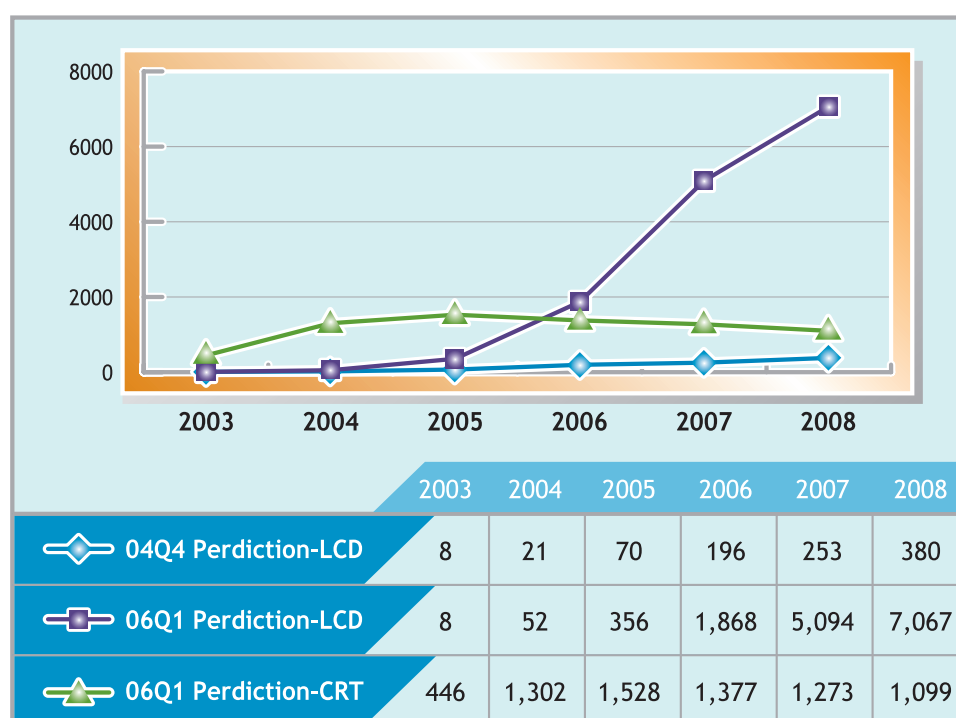
## Provision for Impairment of Property, Plant and Equipment *(continued)*

Forecast, and revisions to forecast, regarding the 30"-34" CRT television set market in China by Stanford Company in 4th Quarter of 2004 and 1st Quarter of 2006 ('000 sets)



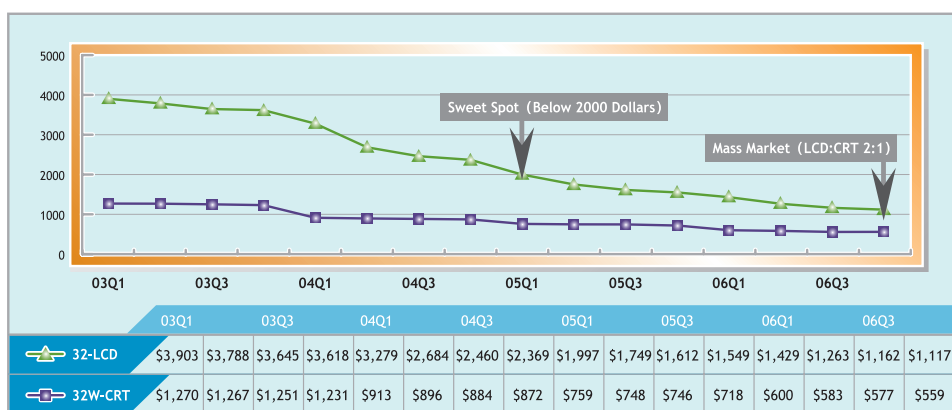
### Provision for Impairment of Property, Plant and Equipment (continued)

Forecast, and revisions to forecast, regarding the 30"-34" LCD television set market in China by Stanford Company in 4th Quarter of 2004 and 1st Quarter of 2006 ('000 sets)



## Provision for Impairment of Property, Plant and Equipment (continued)

Trend of change in prices of 32" LCD and 32" 16:9 flat CRT television sets in the global market (US Dollars)



Source: Stanford Company, report on global TV market in 2006Q1, and amounts of each quarter in 2006 are predicting data.

Forecast, and revisions to forecast, regarding the 30"-34" television set market in China for year 2006 by Displaysearch (Unit: '000 set)

	2004 Q4 Prediction	2006 Q1 Prediction
2008 LCD 30-34"	1,278.4K	5,531.7K
2008 CRT 30-34"	5,711.4K	1,021.8K

Source: Displaysearch in America

In light of the significant adverse changes in the market of 32" - 36" super-large screen high definition flat CPTs originally planned for production by K Line, and having regard to the fact that the 36" 16:9 CPTs have completely lost its market and that there is only a small market for 32" and 34" CPTs, to minimise losses, the Company has suspended production in K line. After taking into account conditions regarding market, costs and adjustments of product mix, the Group will to the largest extent possible use K line's production capacity for the development of appropriate products.

### Material litigation

Baystar Capital II, LP et al. v. Core-Pacific Yamaichi International (HK) Ltd. et al., Case No 05 1091 ABC (CWx) (filed in the United States District Court for the Central District of California) (the “Baystar Litigation”). On or about 11st February 2005, BayStar Capital Management, LLC and BaystarCapital II, LP (hereinafter collectively referred to as “Baystar”), a holder of the Company’s H shares, commenced a litigation against Core-Pacific Yamaichi International (H.K.) Limited, et.al (hereinafter referred to as “CPYI”), one of the underwriters that offered the Company’s H shares to investors in the United States pursuant to Rule 144A of the Securities Act of the USA. Baystar alleges that it entered into a strategic business development agreement with CPYI, pursuant to which CPYI acted as an investment consultant to Baystar in the greater China area. Baystar claims that CPYI breached the agreement and its fiduciary duties to Baystar. In addition, Baystar alleges that CPYI made material misrepresentations and omissions to Baystar, in violation of United States federal and state securities laws and the common law. Baystar has alleged no claims against the Company.

On or about 20th May 2005, CPYI commenced a third-party lawsuit against the Company and the lead underwriter of the Company, as part of the Baystar Litigation. CPYI seeks contractual and common law indemnification and / or contribution from the Company in the event that CPYI is found liable to Baystar. A copy of the third-party complaint was served on Law Debenture Society on or about 11th June 2005. The Company has retained Jones Day to represent the Company in the litigation. On 18th August 2005, Jones Day filed a motion to dismiss the third-party complaint in its entirety. On 13th October 2005, the Court granted in part and denied in part the motion to dismiss. Thereafter, on 7th November 2005, the Company filed an answer to CPYI’s claims, denying all liability. Pre-trial discovery has commenced and is currently underway. Under the discovery schedule presently in effect, all discovery is to be completed by 1st June 2006. The final pre-trial motion is scheduled for 16th October 2006 and trial is set for 31st October 2006.

On 21st April 2006, the Company filed a motion for summary judgment, seeking dismissal of the Third-Party Complaint in its entirety, because no party has identified a single material misrepresentation or omission made by the Company in the Offering Circular. The Company anticipates that the motion will be briefed and submitted to the Court on or about 15th May 2006. The Company denies that CPYI’s claims have any merit and will defend itself vigorously.

### Code on Corporate Governance Practices

The Board has reviewed the documents regarding the Company’s adoption of relevant corporate governance, and is of the opinion that they have met the principles and code provisions set out in the Code on Corporate Governance Practices in the Listing Rules.

The Directors are not aware of any information that would reasonably reflect the non-compliance of the Company or any of the Directors with the Code. The Board considers that the Company has fully complied with the principles and code provisions set out in the Code.

## Model Code

The Company has adopted the Model Code set out in Appendix 10 to the Listing Rules as the code of conduct regarding securities transactions by the Directors (the "Model Code"). Having made specific enquiry of all Directors, the Company has confirmed that all Directors have complied with the requirements set out in the Model Code.

## Public float

Based on the information that is publicly available to the Company and within the knowledge of the Directors, as at the date of this report, there is sufficient public float of more than 25% of the Company's issued shares as required under Rule 34A in Appendix 16 to the Listing Rules.

## Auditors

The financial statements have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

By order of the Board

**Xing Daoqin**

*Chairman*

Xianyang, the PRC  
24 April 2006