Notes to the Condensed Consolidated Interim Financial Statements

1. General information

Solomon Systech (International) Limited (the "Company") and its subsidiaries (collectively referred to as "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 condensed consolidated interim financial statements ("Interim Financial Statements") are presented in US dollars, unless otherwise stated. These Interim Financial Statements have been approved for issue by the Board of Directors on 3 August 2006.

2. Basis of preparation and accounting policies

These unaudited Interim Financial Statements are prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34, "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA").

These Interim Financial Statements should be read in conjunction with the 2005 annual report.

3. Changes in accounting policies

The accounting policies adopted are consistent with those of the consolidated financial statements for the year ended 31 December 2005.

The following new standards, amendments to standards and interpretations which are relevant to the Group's operations are mandatory for financial year ending 31 December 2006.

HKAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures
HKAS 21 (Amendment)	The Effects of Changes in Foreign Exchange Rates
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intagroup Transactions
HKAS 39 (Amendment)	The Fair Value Option
HKAS 39 & HKFRS 4 (Amendment)	Financial Guarantee Contracts
HK(IFRIC)-Int 4	Determining whether an Arrangement contains A Lease

The adoption of new/revised HKAS 19 (Amendment), 21 (Amendment), 39 (Amendment), HKFRS 4 (Amendment) and HK(IFRIC)-Int 4 did not result in substantial changes to the Group's accounting policies.

The following new standards, amendments to standards and interpretations relevant to the Group's operations have been issued but are not effective for 2006 and have not been early adopted:

HKAS 1 (Amendment)	Capital Disclosures
HKFRS 7	Financial Instruments : Disclosures
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economics
HK(IFRIC)-Int 8	Scope of HKFRS 2
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives

4. Financial risk management

4.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: foreign exchange risk, credit risk, liquidity risk, and cash flow and interest rate risk.

(a) 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 based. 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 with 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 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.

4.2 Fair value estimation

The available-for-sale financial assets are stated at fair value. 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.

5. Critical accounting estimates and judgments

Estimates and judgments 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.

5. Critical accounting estimates and judgments (continued)

(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 that 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 that previously estimated, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

6. Segmental Information

(a) Primary reporting format - business segment

At 30 June 2006, 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$149,415,000 and US$185,713,000 for the six months ended 30 June 2006 and 2005 respectively.

(b) Secondary reporting format - geographical segments

The Group mainly operates in the 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

	Unaudited Six months ended 30 June	
	2006 US$'000	2005 US$'000
Taiwan	**11,437**	71,186
Hong Kong	**113,034**	58,920
Japan	**16,641**	45,224
Korea	**2,446**	8,559
Mainland China ("China")	**3,577**	363
Singapore	**1,408**	206
United States of America ("U.S.A.")	**221**	20
Others	**651**	1,235
	149,415	185,713

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

6. Segmental Information (continued)

(b) Secondary reporting format - geographical segments (continued)

(ii) Total assets

	Unaudited 30 June 2006 US$'000	Audited 31 December 2005 US$'000
Hong Kong	**181,296**	230,519
Taiwan	**39,697**	32,723
Others	**9,210**	7,028
	230,203	270,270

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

(iii) Capital Expenditures

	Unaudited Six months ended 30 June	
	2006 US$'000	2005 US$'000
Hong Kong	**2,618**	1,159
China	**1,154**	30
Taiwan	**16**	105
Others	**19**	209
	3,807	1,503

Capital expenditure is allocated based on where the assets are located.

7. Expenses by nature

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

	Unaudited Six months ended 30 June	
	2006 **US$'000**	2005 US$'000
Depreciation of owned property, plant and equipment	**2,689**	1,982
Depreciation of leased property, plant and equipment	**6**	3
Operating leases for land and buildings	**414**	357
Employee benefit expenses		
Equity compensation	**3,026**	811
Non-equity compensation portion	**7,469**	7,296
Net exchange (gains)/losses	**(17)**	57
Provision/(write-back of provision) for doubtful debts	**7**	(494)
Provision for obsolete inventories	**1,271**	1,575

8. Taxation

Hong Kong profits tax has been provided at the rate of 17.5% (2005: 17.5%) on the estimated assessable profits for the period. Taxation on overseas profits has been calculated on the estimated assessable profit for the period at the rates of taxation prevailing in the countries in which the Group operates. (2005: Nil)

	Unaudited Six months ended 30 June	
	2006 **US$'000**	2005 US$'000
Current taxation:		
Hong Kong profits tax	**3,536**	8,117
Overseas profits tax	**7**	–
Deferred taxation	**169**	369
Taxation	**3,712**	8,486

9. Dividends

	Unaudited Six months ended 30 June	
	2006 US$'000	2005 US$'000
(a) Dividend attributable to the previous year, approved and paid during the period:		
2004 final dividend, paid, of HK$0.12 (approximately 1.54 US cents) per ordinary share	**–**	38,655
2005 final dividend, paid, of HK$0.15 (approximately 1.93 US cents) per ordinary share (Note (i))	**48,540**	–
Less: Company's share of dividends paid on the shares held by a special purpose entity of the Group	**(753)**	(749)
	47,787	37,906
(b) Dividend attributable to the year:		
2005 interim, paid, of HK$0.04 (approximately 0.51 US cents) per ordinary share	**–**	12,912
2006 interim, declared, of HK$0.02 (approximately 0.26 US cents) per ordinary share (Note (ii))	**6,472**	–
	6,472	12,912
Less : Company's share of dividends paid on the shares held by a special purpose entity of the Group	**–**	(242)
	6,472	12,670

Notes:

(i) On 13 March 2006, the Directors proposed a final dividend of HK$0.15 (approximately 1.93 US cents) per ordinary share. The final dividend was paid on 12 May 2006.

(ii) On 3 August, 2006, the Director declared an interim dividend of HK$0.02 (approximately 0.26 US cents) per ordinary share which will be payable on 18 September 2006 to shareholders whose names appear on the register of members on 31 August, 2006. The interim dividend is not reflected as a dividend payable in the Interim Financial Statements, but will be reflected as an appropriation of retained earnings for the year ended 31 December 2006.

10. Earnings per share

The calculation of basic and diluted earnings per share is based on the Group's profit attributable to shareholders of US$17,892,000 (2005: US$36,304,000).

The basic earnings per share is based on the weighted average of 2,464,909,041 (2005: 2,426,719,229) ordinary shares in issue excluding own shares held during the period.

Diluted earnings per share information is based on 2,489,441,986 (2005: 2,428,155,857) ordinary shares which is the adjusted weighted average number of ordinary shares outstanding assuming the conversion of all share options outstanding but excluding unallocated own shares held during the period. 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.

	Unaudited Six months ended 30 June	
	2006	2005
Weighted average number of ordinary shares in issue	**2,464,909,041**	2,426,719,229
Adjustments for – allocated own share	**23,476,265**	–
– share option	**1,056,680**	1,436,628
Weighted average number of ordinary shares for diluted earnings per share	**2,489,441,986**	2,428,155,857

11. Available-for-sale financial assets

	Unaudited 30 June	Audited 31 December
	2006 US$'000	2005 US$'000
Unlisted shares, at cost	**4,186**	284
Less: Provision for impairment loss	**(284)**	(284)
	3,902	–

There was no disposal of or impairment provision on available-for-sale financial assets for the six months ended 30 June 2006. All the available-for-sale financial assets are unlisted equity securities.

12. Trade and other receivables

	Unaudited 30 June 2006 US$'000	Audited 31 December 2005 US$'000
Trade receivables	**60,202**	56,146
Less: provision for impairment of receivables	**(40)**	(33)
Trade receivables - net	**60,162**	56,113
Prepayments and other receivables	**3,752**	3,106
	63,914	59,219

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

	Unaudited 30 June 2006 US$'000	Audited 31 December 2005 US$'000
0 - 30 days	**48,150**	53,997
31 - 60 days	**10,934**	1,843
61 - 90 days	**979**	273
91 - 120 days	**5**	—
121 - 365 days	**94**	—
	60,162	56,113

13. Trade and other payables

	Unaudited 30 June 2006 US$'000	Audited 31 December 2005 US$'000
Trade payables	**35,643**	43,408
Accrued expenses	**7,034**	12,949
	42,677	56,357

13. Trade and other payables (continued)

The ageing analysis of trade payables is as follows:

	Unaudited 30 June 2006 US$'000	Audited 31 December 2005 US$'000
0 - 30 days	**34,512**	42,650
31 - 60 days	**151**	728
61 - 90 days	**980**	30
	35,643	43,408

14. Share capital

	Ordinary shares of HK$0.1 each	
	No. of shares	**US$'000**
Authorised	5,000,000,000	64,433
Issued and fully paid:		
At 31 December 2005 and 30 June 2006	2,511,154,351	32,360

15. Equity compensation scheme

(a) The Pre-IPO Share Option Scheme

The Company has 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 or 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.

No option under the Pre-IPO Share Option Scheme lapsed, or was cancelled or exercised during the period.

(b) The Share Option Scheme

The Company adopted the Share Option Scheme (the "Scheme") 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 manufacturers, suppliers, agents, customers, business partners, joint venture business partners, service providers or any member of the Group who the Board considers have contributed or will contribute to the Group ("the Participants"). The purpose of the Scheme is to provide Participants with an 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 of Hong Kong Limited (the "Listing Rules").

On 28 June 2006, options to subscribe for 5,500,000 share 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 2007 to 30 June 2009, at the exercise price of HK$1.98 per share.

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

	Unaudited Six months ended 30 June	
	2006	2005
At beginning of the period	**6,100,000**	–
Granted	**5,500,000**	6,100,000
At end of the period	**11,600,000**	6,100,000

No option under the Share Option Scheme lapsed, or was cancelled or exercised during the period.

15. Equity compensation scheme (continued)

(c) The Share Award Plan

The Share Award Plan was adopted by the Company 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 30 June 2006, a net 27,596,000 shares were reserved for named employees leaving a balance of 13,083,520 for future grant to directors and employees in the second half of 2006 and beyond.

Shares held by HSBC Trust as Trustee under the Share Award Plan

	No. of shares
At 1 January 2006	47,055,520
Shares vested during the period	(6,376,000)
At 30 June 2006	40,679,520

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

		No. of shares	
	Cumulative total	**1 January to 30 June, 2006**	1 January to 31 December, 2005
Granted during the period	35,640,000	**15,180,000**	16,790,000
Vesting of the shares granted in previous periods	(7,844,000)	**(6,376,000)**	(1,468,000)
Forfeiture of shares granted during the period	(200,000)	**(120,000)**	(80,000)
	27,596,000	**8,684,000**	15,242,000

The Group has followed the HKFRS2 in the financial statements for the period ended 30 June 2006 to account for the equity compensation expenses at appropriate market price at the date of grant.

16. Own share held

Own shares held represents the 40,679,520 (as at 31 December 2005: 47,055,520) ordinary shares in the Company which were not yet granted or vested and were held by the trustees, the Special Purpose Entity, under the Share Award Plan.

17. Commitments

Capital commitments

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

	Unaudited 30 June 2006 US$'000	Audited 31 December 2005 US$'000
Contracted but not provided for	**99**	659

Operating lease commitments

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

	Unaudited 30 June 2006 US$'000	Audited 31 December 2005 US$'000
Not later than 1 year	**801**	670
Later than 1 year and not later than 5 years	**1,385**	1,419
Later than 5 years	**144**	—
	2,330	2,089