Management Discussion and Analysis

2006 saw a recovery of momentum in semiconductor industry. In the beginning of the year, the Company benefited from a relatively robust communications industry whereas computer and consumer products remained dormant. However, the momentum subsided in the second half year of 2006. The phenomenon was attributable to the inventory adjustments and the seasonality of demand along the supply chain of the semiconductor industry and its end-users. Notwithstanding the fact that the market growth within the industry was slower than expected, the Company attained a significant growth in revenue in 2006.

COMPARISON BETWEEN 2005 AND 2006 ENDING 31 DECEMBER

Sales

The sales of the Company increased by 45.5% from RMB931.6 million in 2005 to RMB1,355.2 million in 2006, reaping the rewards of the higher utilisation of overall production capacity from 61% to 77% and the increase in wafer shipments. The Company's throughput of 8-inch equivalent wafers increased from 321,271 pieces for the year ended 31 December 2005 to 451,156 pieces for the year ended 31 December 2006 and correspondingly the Company's wafer shipments of 8-inch equivalent wafer increased by 39.0%, from 325,940 pieces to 453,214 pieces.

Cost of sales and gross profit

The cost of sales increased by 41.1% from RMB860.6 million in 2005 to RMB1,214.3 million in 2006. This was mainly attributable to the substantial increase in sales which demanded higher production volumes and hence resulted in the increase in manufacturing costs and allocation of depreciation of the 8-inch production facilities. The gross profit grew approximately twofold in value, from RMB71.0 million in 2005 to RMB140.9 million in 2006 and correspondingly the Company's gross margin rose from 7.6% to 10.4%. The increase in gross profit and margin was attributable to the Company's improvement in line yield and utilisation rate of 8-inch production facilities, which generated more sales in 2006.

Operating expenses and operating income

Selling and marketing expenses increased by 21.6%, from RMB7.4 million in 2005 to RMB9.0 million in 2006 because the Company strengthened its staff force in the Sales and Marketing Department.

General and administrative expenses slightly declined by 2.2%, from RMB77.6 million for the year ended 31 December 2005 to RMB75.9 million for the year ended 31 December 2006.

Research and development costs declined by 57.3%, from RMB74.9 million in 2005 to RMB32.0 million in 2006. This was primarily attributable to the fact that the Company had accumulated a wealth of know-how and experience in 8-inch manufacturing processes, which enabled it to launch a higher volume of production in 2006.

In summary, the Company's operating expenses decreased by 26.9%, from RMB159.9 million in 2005 to RMB116.9 million in 2006.

The financial performance of the Company's operating activities was encouraging. It recorded an operating profit of RMB24.0 million in 2006, compared to an operating loss of RMB89.0 million in the previous year. Likewise, the Company's operating margin of 1.8% indicated that the Company had made a satisfactory effort in 2006 in improving its operating activities and production facilities which used to bring about a negative margin of 9.6% in 2005.

Other income and finance Cost

Other income slightly reduced by 1.3%, from RMB37.4 million in 2005 to RMB36.9 million in 2006. In 2006, the Company's other income comprised interest income, exchange gain from Renminbi appreciation, scrap sales and compensation from a supplier. In 2005, the Company's other income derived from technology service in addition to interest, exchange gain, refund of value-added tax and the fair value gain of interest rate swap.

The Company's finance cost increased by 73.4%, from RMB33.4 million in 2005 to RMB57.9 million in 2006. The substantial increase in finance cost was attributable to the drawdowns under the US$100 million club term loan facility which took place since 31 March 2005 and amounted to US$92 million in 2006.

Net income

Collectively, the Company recorded a net income of RMB3.9 million for the year ended 31 December 2006, compared to a net loss of RMB75.0 million for the year ended 31 December 2005.

Liquidity and capital resources

The Company's cash and cash equivalents were RMB397.0 million as at 31 December 2006, compared to RMB105.9 million as at 31 December 2005. The Company's net cash inflow from operating activities showed an increase of 476.4% , from RMB56.0 million for the year ended 31 December 2005 to RMB322.8 million for the year ended 31 December 2006.

The Company's net cash outflow from investing activities was primarily attributable to the continuing investment in property, plant and equipment, and construction in progress. These expenditures amounted to RMB209.2 million for the year ended 31 December 2006, compared to RMB793.7 million for the year ended 31 December 2005. Most of the capital expenditure incurred in 2006 was allocated to the production facilities and equipment for 8-inch wafers.

The Company's net cash inflow from financing activities amounted to RMB186.7 million in 2006, compared to RMB797.3 million in 2005. In 2005, the Company financed its activities by bank loans. During 2006, the Company, in addition to financing its activities by bank loans, successfully raised funds through its IPO and was listed on the HKEx on 7 April 2006.

The US$100 million club term-loan facility dated 31 March 2005 was secured by a pledge on the Company's property, plant and equipment, construction in progress and land lease prepayments. The facility will expire on 31 March 2010. As at 31 December 2006, the balance of the Company's borrowings drawn under the loan facility was RMB741.7 million, of which RMB286.4 million will fall due in 2007. As at 31 December 2006, the Company was in compliance with the financial covenants stipulated by the terms of the US$100 million club term loan facility.

As at 31 December 2006, the Company's current ratio was 1.45 when compared to 0.31 as at 31 December 2005. The Company's debt to equity ratio improved from 91.5% as at 31 December 2005 to 19.0% as at 31 December 2006.

Employees

As at 31 December 2006, the Company had 1,856 employees; remuneration and employment benefits were provided for and paid in accordance with PRC law and regulations.

Interest rate risk

The Company's interest-bearing loans and borrowings are subject to the interest rate fluctuation of LIBOR plus a margin. As the majority of the Company's debts are long-term borrowings, its profitability is exposed to interest rate risk arising from the fluctuations of LIBOR. Of the US$92 million the Company drawn down under the US$100 million club term-loan facility, the Company has entered into an interest rate swap to hedge the interest rate fluctuations on the loan amount of US$25 million.

Renminbi fluctuation risks

Renminbi is the Company's financial and reporting currency as it is the legal currency of the PRC, the primary economic environment in which the Company carries on business. The Company has large amounts of revenue and expenses denominated in foreign currencies. In the event that the Company's Renminbi revenue is insufficient to cover its Renminbi expenditure, it will convert foreign currency to Renminbi to meet the difference, leading to possible exchange loss with a negative effect on cash flow. The Company currently does not hedge against Renminbi appreciation risk.

Capital commitment

As at 31 December 2006, the Company had capital commitments for property, plant and equipment amounting to RMB52.8 million, of which RMB6.6 million was contracted but not provided for, while the remaining balance of RMB46.2 million was authorized but not contracted for.

OPERATING RESULTS FOR THE THREE MONTHS ENDED 31 DECEMBER 2006

Sales for the three months ended 31 December 2006 was RMB350.9 million, compared to RMB350.5 million for the three months ended 30 September 2006.

Gross profit decreased from RMB39.6 million for the three months ended 30 September 2006 to negative RMB5.1 million for the three months ended 31 December 2006. Gross margin for the three months ended 31 December 2006 was negative 1.5%, compared to 11.3% for the three months ended 30 September 2006. The decline in gross margin was attributable to the increase in manufacturing costs mainly because of increases in the price of silicon in 2006. In addition, the Company continued to ramp up its 8-inch production. Other factors included the change of product mix and inventory provision.

Operating expenses were recorded at RMB32.3 million for the three months ended 31 December 2006, an increase of 37.4%, compared to RMB23.5 million for the third quarter of 2006. The increase in operating expenses was mainly attributable to the increase in research and development cost.

The non-operating income for the three months ended 31 December 2006 was RMB6.2 million, compared to the non-operating expense of RMB5.8 million for the third quarter of 2006. This was mainly due to the significant increase in other income. The other income for the three months ended 31 December 2006 recorded at was RMB19.5 million, compared to RMB6.4 million for the third quarter, because there were larger foreign exchange gain from Renminbi appreciation, scrap sales, and compensation from a supplier. Finance costs increased by 8.3%, from RMB12.3 million for the three months ended 30 September 2006 to RMB13.3 million for the three months ended 31 December 2006, which was mainly attributable to higher interest expense.

Collectively, the Company recorded a net loss of RMB27.6 million for the three months ended 31 December 2006, compared to net income of RMB9.4 million for the three months ended 30 September 2006.

1. Revenue Analysis

By Application	4Q06	3Q06	4Q05
Communications	32%	32%	34%
Computer	33%	33%	33%
Consumer	35%	35%	33%

For the three months ended 31 December 2006, sales from communications, computer and consumer products accounted for 32%, 33% and 35% of total revenue respectively, which were in line with the prior quarter's.

By Geography	4Q06	3Q06	4Q05
USA	43%	50%	51%
Europe	27%	28%	24%
Asia Pacific	30%	22%	25%

For the three months ended 31 December 2006, sales to the USA accounted for 43% of total revenue, compared to 50% in the previous quarter. The sales to Asia Pacific increased by eight percentage points sequentially.

By Customer Type	4Q06	3Q06	4Q05
IDM	37%	43%	35%
Fabless	63%	57%	65%

For the three months ended 31 December 2006, sales to IDM and fabless customers accounted for 37% and 63% of total revenue respectively.

2. Utilisation and Capacity (8" equivalent)

	4Q06	3Q06	4Q05
Utilisation	77%	71%	59%
Capacity (wafers in thousand)	154	154	154

Note:

1. The capacity utilisation rate represents the percentage of the actual number of processing steps (measured by the number of masks used) for the number of semiconductor wafers shipped in the reporting period divided by the total number of processing steps a fab is capable to produce during the corresponding period.

2. The Company estimated the capacities of its 5-inch, 6-inch and 8-inch on the basis of 9, 10 and 22 mask steps per wafer respectively and 5-inch and 6-inch wafers were converted to 8-inch equivalent wafers by dividing their wafer numbers using 2.56 and 1.78 respectively.

Overall capacity utilisation for the three month ended 31 December 2006 improved by six percentage points sequentially to 77%.

The capacity for the three months ended 31 December 2006 was 154,000 8-inch equivalent wafers, which was the same as that of both the previous quarter and that of the fourth quarter of 2005.

3. Receivable/Inventory Turnover

	4Q06	3Q06	4Q05
Trade & Notes Receivables Turnover (days)	44	45	55
Inventory Turnover (days)	67	71	62

Receivable turnover for the three months ended 31 December 2006 was 44 days as compared to 45 days in the third quarter of 2006.

Inventory turnover decreased from 71 days for three months ended 30 September 2006 to 67 days for the three months ended 31 December 2006.

4. Capital Expenditure

	4Q06	3Q06	4Q05
(Amount: RMB'000)			
Capex	11,107	8,049	59,853

The amount of capital expenditure for the three months ended 31 December 2006 was RMB11.1 million, which was mainly expended on the improvement of overall production efficiency, flexibility, and technology development of 8-inch fab.

INTENDED CHANGE OF THE USE OF PROCEEDS FROM THE IPO

Since April 2006, the Company's management has been actively reviewing the plans set out in the Prospectus for the use of the remaining proceeds of the IPO following the application of approximately US$47 million in the repayment of borrowings. It has been the Board's intention to apply the balance in further expansion of the Company's 8-inch production facilities, as stated in the Prospectus. However, the Board is also mindful of its responsibility to shareholders to ensure that the Company's value be preserved and enhanced. The business environment in the semiconductor industry has deteriorated since the fourth quarter of 2006, although it is expected that the weak business cycle may come to an end in the second half of 2007. Under these circumstances, the Board believes that it is not now the right time to apply the remaining proceeds from the IPO in the expansion of the 8-inch production facilities. The Board has therefore decided that the most suitable application of these funds at the present time is in the reduction of the Company's long-term debt in order to reduce its current finance costs. The Board intends that, as and when it is appropriate to incur the capital expenditure required to expand the 8-inch production facilities, the Company will utilise its borrowing capacity released by the debt repayment now planned.

PROSPECTS AND FUTURE PLANS

The analog semiconductor industry is expected to follow the trend of moderate growth of the semiconductor industry and will benefit from China's on-going support for high-tech industries under the "Eleventh Five-Year Plan" in 2007. However, the Company will continue to encounter difficulty in inventory correction and seasonality, coupled with increasing competition in certain product segments in which the Company is currently engaged.

In view of these challenges, the Company aims at consolidating its competitive advantage and further improving the overall efficiency of its 8-inch fab by means of the following strategies:

- improve product quality and line yield;
- attain higher utilisation rate;
- increase throughput and acquire more orders from the existing and new customers;
- control manufacturing costs and overhead;
- seek cost savings from second source suppliers with no compromise in quality;
- maintain assets and facilities to prolong their economic lives;
- seek cooperation with existing and new customers for the development of advanced process technology.

In 2006, the Company made progressive improvement in its operations and financial performance, compared to 2005. In 2007, the markets in which we operate are highly competitive and challenging but should present opportunities to the Company to maintain its growth. Under these circumstances, the management of the Company will further strive to deliver the best solution to its customers with quality, flexibility and price competitiveness.