

Report of the Directors

The directors present their first report and the audited financial statements of the Company for the year ended 31 December 2006.

PRINCIPAL ACTIVITIES

The principal activity of the Company is the manufacture and sale of semiconductor products. There were no significant changes in the nature of the Company's principal activities during the year.

SEGMENT INFORMATION

The Company's revenue and profit for the year ended 31 December 2006 were mainly derived from the manufacture and sale of semiconductor wafers. The Company has only one business segment. The principal assets employed by the Company are located in Shanghai, the PRC. Therefore, no segment information based on the geographical location of the Company's assets is presented.

RESULTS AND DIVIDENDS

The Company's profit for the year ended 31 December 2006 and the state of affairs of the Company at that date are set out in the financial statements on pages 47 and 48.

The Board of directors does not recommend the payment of dividend to the ordinary equity holders of the Company for the year ended 31 December 2006.

USE OF PROCEEDS FROM THE COMPANY'S INITIAL PUBLIC OFFERING

Details of the use of proceeds from the Company's initial public offering (the "IPO") are disclosed as follows:

Net proceeds from the IPO, after deducting relevant listing expenses, amounted to approximately RMB630.47 million.

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During the year ended 31 December 2006, net proceeds from the IPO were applied in accordance with the plans set out in the prospectus of the Company dated 27 March 2006 (the "Prospectus") as follows:

	Year ended 31 Dec 2006	
	Application of proceeds as planned in the prospectus	Actual application of proceeds
	RMB' million	RMB' million
Bank loan repayment	280.70	366.75
Equipment refinement for 8 inch	256.51	—
Total	537.21	366.75
Actual proceeds received	630.47	630.47
Additional funds raised/proceeds not yet utilised	93.26	263.72

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.

SUMMARY FINANCIAL INFORMATION

A summary of the published results and assets and liabilities of the Company for the last four financial years, as extracted from the audited financial statements, is set out on page 32. This summary does not form part of the audited financial statements.

PROPERTY, PLANT AND EQUIPMENT

Details of movements in the property, plant and equipment of the Company during the year are set out in note 12 to the financial statements.

SHARE CAPITAL

Details of movements in the Company's share capital during the year are set out in note 24 to the financial statements.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Articles of association or the laws of People's Republic of China which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

The Company did not purchase, redeem or sell any of the Company's listed securities during the year.

RESERVES

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

DISTRIBUTABLE RESERVES

In accordance with the Company's Articles of Association, the Company is permitted to distribute dividends based on the lower of the Company's distributable reserves determined under the PRC GAAP and the International Financial Reporting Standards ("IFRSs").

As at 31 December 2006, the Company's reserves available for distribution determined under the PRC GAAP is RMB38,904,000.

CHARITABLE DONATION

The Company made charitable contributions totaling HK\$500,000 to the Community Chest of Hong Kong for its corporate and employee contribution programme in April 2006.

MAJOR CUSTOMERS AND SUPPLIERS

In the year under review, sales to the Company's five largest customers accounted for 56% of the total sales for the year and sales to the largest customer included therein amounted to 18%. Purchases from the Company's five largest suppliers accounted for 42% of the total purchases for the year and purchases from the largest supplier accounted for 22%.

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 Company's issued share capital had any beneficial interest in the Company's five largest customers.

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DIRECTORS

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

Executive directors:

Mr. Tony Yuhai Liu
Ms. Cheng Jianyu

Non-executive directors:

Mr. Ruan Yanhua
Mr. Zhu Jian
Mr. Anthony Lear (retirement on 1 March 2007)
Mr. Petrus Antonius Maria Van Bommel (appointment with effect from 15 March 2006)
Mr. Ajit Manocha (appointment with effect from 2 March 2007)
Mr. Zhu Peiyi
Mr. Zhou Weiping (retirement on 1 March 2007)
Mr. Xiao Yongji (appointment with effect from 2 March 2007)

Independent Non-executive Directors:

Mr. James Arthur Watkins
Mr. Thaddeus Thomas Beczak
Mr. Shen Weijia

The Company has received annual confirmations of independence from Mr. James Arthur Watkins, Mr. Thaddeus Thomas Beczak and Mr. Shen Weijia on 28 February 2007 and considers them to be independent.

CHANGES IN THE BOARD BETWEEN THE BALANCE SHEET DATE AND DATE OF REPORT

Subsequent to the balance sheet date, the above-mentioned directors for the first session of the Board of Directors of the Company served terms until 1 March 2007. Mr. Tony Yuhai LIU, Ms. CHENG Jianyu, Mr. Thaddeus Thomas BECZAK, Mr. James Arthur WATKINS, Mr. SHEN Weijia, Mr. RUAN Yanhua, Mr. ZHU Jian, Mr. Petrus Antonius Maria VAN BOMMEL, Mr. Ajit MANOCHA, Mr. ZHU Peiyi and Mr. XIAO Yongji were elected as Directors of the second session (from 2 March 2007 to 1 March 2010) of the Board of Directors of the Company at the Company's extraordinary general meeting held on 29 January 2007.

Pursuant to the PRC company law and the Company's Articles of Association, directors shall be elected by the Company's general meetings each for a term of three years and upon expiry of their term, may offer themselves for re-election.

DIRECTORS' AND SENIOR MANAGEMENT'S BIOGRAPHIES

Biographical details of the directors of the Company and the senior management of the Company are set out on pages 11 to 20 of the annual report.

DIRECTORS' SERVICE CONTRACTS

Each of the directors of the Company has entered into a service contract with the Company with effect from the date of appointment of the respective director, for a term of no more than three years.

None of the directors of the Company has entered into any service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

DIRECTORS' REMUNERATION

The directors' fees are subject to shareholders' approval at general meetings. Other emoluments are determined by the Company's board of directors with reference to directors' duties, responsibilities and performance and the results of the Company.

DIRECTORS' INTEREST IN CONTRACTS

No director had a material interest, either directly or indirectly, in any contract of significance to the business of the Company to which the Company was a party during the year.

DIRECTORS', SUPERVISORS', AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS

As at 31 December 2006, none of the directors or supervisors or the chief executive of the Company had any interests or short positions in the shares, underlying shares or debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register maintained under section 352 of the SFO or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "HKEx") pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") in the Rules Governing the Listing of Securities on the HKEx (the "Listing Rules").

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS

As at 31 December 2006, the interests and short positions of the following persons (other than directors, supervisors and the chief executive) in the shares or underlying shares of the Company were recorded in the register kept by the Company pursuant to section 336 of the SFO.

Name of shareholders	Class of shares	Number of shares	Capacity	Percentage in the relevant class of issued share capital	Percentage in total issued share capital
Koninklijke Philips Electronics N.V.	H shares	408,806,888 (Long position) (Note 1)	Beneficial owner	36.13%	26.65%
Shanghai Chemical Industrial Park Development Co., Ltd	H shares	254,866,584 (Long position) (Note 2)	Beneficial owner	22.53%	16.61%
Fidelity International Limited	H shares	92,250,000	Investment manager	8.15%	6.01%
JPMorgan Chase & Co.	H shares	68,725,958 (Long Position) 68,725,958 (Lending pool) (Note 3)	Custodian corporation/ approved lending	6.07%	4.48%
Schroder Investment Management (Hong Kong) Limited	H shares	67,896,000 (Long position)	Investment manager	6%	4.43%
The Capital Group Companies, Inc	H shares	57,024,000 (Long position) (Note 4)	Investment manager	5.04%	3.72%
China Orient Asset Management Corporation	Domestic shares	172,648,520 (Long position)	Beneficial owner	46.71%	11.25%
Shanghai Chemical Industrial Park Development Co., Ltd	Domestic shares	110,908,000 (Long position) (Note 5)	Beneficial owner	30.01%	7.23%
Shanghai Belling Co. Ltd	Domestic shares	86,064,608 (Long position)	Beneficial owner	23.28%	5.61%

Notes:

1. All of these 408,806,888 H shares (long position) are deemed corporate interests indirectly held through Philips Electronics China B.V..
2. All of these 254,866,584 H shares (long position) are deemed corporate interests indirectly held through Shanghai Chemical Industrial Park Investment Enterprise Company Limited and SCIP (HK) Limited.
3. All of these 68,725,958 H shares (long position) are deemed corporate interests indirectly held through JPMorgan Chase Bank, N.A..
4. All of these 57,024,000 H shares (long position) are deemed corporate interests indirectly held through Capital Research and Management Company.
5. All of these 110,908,000 (long position) are deemed corporate interests indirectly held through Shanghai Chemical Industrial Park Investment Enterprise Company Limited.

SHARE OPTION SCHEME

As at 31 December 2006, the Company had no share option scheme within the meaning of Chapter 17 of the Listing Rules.

DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE H SHARES

Save as disclosed above, during the year ended 31 December 2006, none of the directors or supervisors or the chief executive of the Company was granted options to subscribe for H Shares of the Company. During the year ended 31 December 2006, none of the directors or supervisors or the chief executive nor their spouses or minor children had any right to acquire H Shares in the Company or had exercised any such right.

CONTINUING CONNECTED TRANSACTIONS

The Company was previously under the significant influence of Koninklijke Philips Electronics N.V. ("Royal Philips") through its wholly-owned subsidiary, Philips Electronics China B.V. On 3 August 2006, Royal Philips announced that it had signed an agreement with Kohlberg Kravis Roberts & Co., Sliver Lake Partners and AlInvest Partners N.V. (the "Consortium") whereby the Consortium will acquire an 80.1% stake in Philips' Semiconductors business, with Royal Philips retaining a 19.9% stake in this business. The shares in the Company currently held by Royal Philips through Philips Electronics China B.V. will be ultimately held by the stand-alone NXP B.V. (formerly known as "Philips Semiconductor International B.V."). However, such shares may not be transferred until the expiry of the existing shareholder's lock up period, i.e., one year after 7 April 2006 when the Company's shares were listed on the Hong Kong Stock Exchange and except with approval from the PRC Ministry of Commerce. Consequently, the Company was considered to be under significant influence of NXP B.V. controlled by the Consortium effective from 1 September 2006. The Companies controlled by or under the significant influence of Royal Philips and NXP B.V. are considered to be the Company's connected persons during the year.

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During the year ended 31 December 2006, the Company had the following continuing connected transactions, certain details of which are disclosed in compliance with the requirements of Chapter 14A of the Listing Rules:

- a. provision of IT services to the Company by the Company's connected persons amounting to RMB2,613,398.70 with details as follows:

	RMB
Philips International B.V.	2,012,161.20
NXP Semiconductors B.V.	601,237.50
	2,613,398.70

- b. purchase on normal commercial terms from the Company's connected person being Philips Communication System (Suzhou) Co., Ltd amounting to RMB1,016,140.00 (equivalent to HK\$984,125.48);
- c. transfer and Licensing of Information and Technology to the Company by the Company's connected persons being NXP B.V. amounting to RMB21,529,877.03. The information and technology transfer relationship between the NXP Group and the Company allows the Company to manufacture, sell and develop analog semiconductors of international standards of quality with competitive price; and
- d. sales of Philips Licensed Products and Identification Products by the Company to the NXP Group amounting to RMB245,450,275.53 with details as follows:

	2006 RMB
NXP Semiconductors Netherlands B.V. (CSN)	12,472,815.76
NXP Semiconductors France SAS (CSC)	595,332.83
NXP Semiconductors Germany GmbH	8,703,247.27
NXP Semiconductors Switzerland AG	23,046,019.19
NXP Semiconductors Taiwan Ltd	7,409,006.84
NXP Semiconductors Netherlands B.V. (AA)	18,788,147.45
NXP Semiconductors Netherlands B.V. (SA)	292,447.63
NXP Semiconductors France SAS (PM)	10,142,403.48
NXP Semiconductors USA, Inc. (MCA)	52,670,911.88
NXP Semiconductors USA, Inc. (BLC)	12,653,326.77
NXP Semiconductors Netherlands B.V. (ABL)	6,651,647.94
NXP Semiconductors Austria GmbH	2,012,014.98
NXP Semiconductors USA, Inc. (IP)	8,489,027.41
NXP Semiconductors Netherlands B.V. (CS)	81,408,667.30
NXP Semiconductor (Suzhou) Co., Ltd	115,258.80
	245,450,275.53

The directors consider that sales of Philips Licensed Products and Identification Products to the NXP Group form an important part of our sales strategy. Under the Philips Cooperation Agreement, NXP Semiconductors B.V. supports the Company in providing design services to authorized PRC-based manufacturers of national identification cards for Chinese citizens.

The independent non-executive directors of the Company have reviewed the continuing connected transactions set out above and have confirmed that these continuing connected transactions were entered into (i) in the ordinary and usual course of business of the Company; (ii) on normal commercial terms or on terms no less favourable to the Company than terms available to or from independent third parties; and (iii) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The transactions would normally be subject to the announcement and/or independent shareholders' approval requirements under R.14A.34/R.14A.35. In this regard, the HKEx has granted the Company a waiver from strict compliance with the announcement and/or the independent shareholders' approval requirements in relation to the transactions. For the year ended 31 December 2006, the total amount of the connected transactions and the approved caps are as follows:

Connected transactions	2006 Actual	Approved caps 2006 (disclosed in the Company's prospectus)
Provision of IT services	RMB2.6 million	RMB4.6 million
Transfer and licensing of information and technology	RMB21.5 million	RMB25 million
Sales of Philips licensed products and identification products	RMB245.5 million	RMB409.3 million

The connected transactions for the year ended 31 December 2006 are within the approved caps stipulated in the Company's prospectus.

DIRECTORS' INTERESTS IN A COMPETING BUSINESS

During the year and up to the date of this report, save as disclosed below, none of the directors of the Company had any interest in a business which competes or is likely to compete, either directly or indirectly, with the businesses of the Company.

Mr. Ajit MANOCHA has been appointed as a non-executive director of the second session of the Board of directors with effect from 2 March 2007. He is currently executive vice president, chief manufacturing officer and a member of the Executive Management Team of the NXP group of companies (the "NXP Group"), the newly independent semiconductors group founded by Koninklijke Philips Electronics N.V. He is responsible for all divisional manufacturing and integral supply chain strategies including purchasing of the NXP Group. Mr. MANOCHA has also been a director of Systems on Silicon Manufacturing Company Pte Ltd ("SSMC") since 17 June 2003.

Mr. Petrus Antonius Maria VAN BOMMEL has been appointed as a non-executive director and vice chairman of the second session of the Board of directors with effect from 2 March 2007. He was a non-executive director of the first session of the Board of directors from 15 March 2006 to 1 March 2007. Mr. VAN BOMMEL is currently executive vice president, chief financial officer and a member of the Board of Management as well as the Executive Management Team of the NXP Group. He has been a director of SSMC since 12 June 2006.

Mr. Anthony LEAR was a non-executive director and vice chairman of the first session of the Board of directors from 2 March 2004 to 1 March 2007. He is currently senior vice president & regional executive of the NXP Group. He has been an alternate director of SSMC since 1 March 2004.

The NXP Group engages in, among other things, the development, design and manufacturing of semiconductor products. Fabs owned by the NXP Group currently dedicate their foundry capacity to the needs of the NXP Group. These fabs may compete with the Company as they supply wafers to the NXP Group, which has been one of the Company's top five customers for the year ended 31 December 2006. However, since they are dedicated to serve the NXP Group, they do not currently compete with the Company's sales to other customers.

SSMC is a captive foundry, established in 1998 as a joint venture by the NXP Group, Taiwan Semiconductor Manufacturing Company Limited and the Economic Development Board of Singapore (the later through its subsidiary, EDB Investment Ptd Ltd), for the purpose of constructing an IC foundry in Singapore. EDB Investments Ptd Ltd has since sold its entire shareholding to the NXP Group and Taiwan Semiconductor Manufacturing Company Ltd in late 2006. The Company understands that Taiwan Semiconductor Manufacturing Corporation and the NXP Group (and their respective subsidiaries) have committed to purchase specific percentages of its production capacity. As such, the Company does not believe SSMC directly competes with it.

Mr. XIAO Yongji has been appointed as a non-executive director of the second session of the Board of directors with effect from 2 March 2007. Mr. Xiao is currently a director and president of Shanghai Belling Co. Ltd. ("Shanghai Belling"). He is also a director of Shanghai Hua Hong NEC Electronics Co. Ltd. ("Hua Hong NEC"), a director of Hua Hong Semiconductor Co. Ltd., chairman of Hong Kong Hylink Limited and a director of Shanghai Hongri International Electronics Co. Ltd.

Shanghai Belling engages in the design and manufacture of integrated circuits, discrete part chips, pertinent modules and ancillary products of multi-media information systems, design and manufacture of electronic equipment and instruments, technical services and consultancy services. Shanghai Belling primarily manufactures its own IC products and can thus be classified as an IDM. Starting in 2005, Shanghai Belling allocated a portion of its excess processing capacity to provide foundry services to third-party customers, the majority being fabless semiconductor companies in the PRC. However, Shanghai Belling primarily offers its customers process technologies of higher linewidths that differ from the technical specifications required for most of the Company's customers' end products. As such, the Company has not experienced Shanghai Belling as, and does not believe it is, a significant direct competitor of the Company.

Hua Hong NEC engages in the design, development and manufacture of semiconductor wafers, utilizing 0.35, 0.25 and 0.18 micron logic and mixed-signal processing technologies. Their products are applied in a wide range of communications, consumer electronics and computing applications, such as identification cards, LCD drivers, power MOS, DRAM, MSRAM, FLASH, etc., which to some extent, overlap and therefore may compete with those of the Company.

Hua Hong Semiconductor Co. Ltd., Hong Kong Hylink Limited and Shanghai Hongri International Electronics Co. Ltd. mainly engage in the design and trading of semiconductor products. The Company has not experienced any of these three companies as a direct competitor.

CONTINGENT LIABILITIES

Details of the contingent liabilities of the Company are set out in note 29 to the financial statements.

AUDITORS

The financial statements have been audited by Ernst & Young. A resolution for their reappointment as auditors of the Company for the year ended 31 December 2007 will be proposed at the forthcoming annual general meeting.

PUBLIC FLOAT

On the basis of information that is publicly available to the Company and within the knowledge of the directors as at the date of this annual report, the Company has complied with the public float requirements of the Listing Rules.

By order of Board of Directors

Ruan Yanhua

Chairman

Shanghai, the PRC, 19 March 2007