## 1. CORPORATE INFORMATION

Advanced Semiconductor Manufacturing Corporation Limited (the "Company") was initially established in the People's Republic of China (the "PRC") on 4 October 1988 as a Sino-foreign joint venture company with limited liability under the Law of the PRC on Joint Ventures Using Chinese and Foreign Investment with a tenure of operation of 30 years from 4 October 1988 to 3 October 2019.

On 2 March 2004, the Company was re-registered as a foreign invested joint stock company with limited liability by the issuance of 1,109,080,000 fully paid shares with a nominal value of RMB1.00 each to the then shareholders. The tenure of operation of the Company was revised to infinite. On 7 April 2006, the Company's H shares were successfully listed on the Hong Kong Stock Exchange.

The registered office and principal place of business of the Company is located at 385 Hongcao Road, Shanghai 200233, the PRC.

The Company is principally engaged in the manufacture and sale of 5-inch, 6-inch and 8-inch wafers.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *Basis of preparation*

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"), which comprise standards and interpretations approved by the International Accounting Standards Board, and International Accounting Standards and Interpretations of the Standing Interpretation Committee approved by the International Accounting Standards Committee that remain in effect and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except as disclosed in this summary of significant accounting policies.

In 2006 the Company adopted the following amended and newly released IFRSs, which are generally effective for accounting periods beginning on or after 1 January 2006 that are relevant to its operations.

| | |
|---|---|
| IAS 39 | Financial Instruments: Recognition and Measurement (amended in 2005) |
| IFRIC-Int 4 | Determining whether an arrangement contains a lease (issued in 2005) |

The adoption of the above standards has no material impact on the results and financial position of the Company.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### *Impact of issued but not yet effective IFRSs*

The Company has not applied the following new and revised IFRSs, and IFRIC interpretations that have been issued but are not yet effective in these financial statements.

| | |
|---|---|
| IAS 1 Amendment | Capital Disclosures |
| IFRS 7 | Financial Instruments: Disclosures |
| IFRS 8 | Operating Segments |
| IFRIC-Int 10 | Interim Financial Reporting and Impairment |

The IAS 1 Amendment will affect the disclosures about qualitative information of the Company's objectives, policies and processes for managing capital; quantitative data about what the Company regards as capital; and compliance with any capital requirements and the consequences of any non-compliance.

IFRS 7 requires disclosures relating to financial instruments and incorporates many of the disclosure requirements of IAS 32.

IFRS 8 will affect the disclosures about the Company's operating segments, the Company's products and services, the geographical areas in which it operates, and its major customers.

IFRIC-Int 10 addresses the interaction between the requirements of IAS 34, Interim Financial Reporting and the recognition of impairment losses on goodwill under IAS 36, Impairment of Assets and certain financial assets under IAS 39, Financial Instruments: Recognition and Measurement. IFRIC-Int 10 requires that an entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost.

IAS 1 Amendment and IFRS 7 are effective for annual periods beginning on or after 1 January 2007. IFRS 8 supersedes IAS14, and is effective for periods beginning on or after 1 January 2009. IFRIC-Int 10 is effective for the annual period beginning on or after 1 November 2006.

Except as stated above, the Company expects that the adoption of the pronouncements listed above will not have any significant impact on the Company's financial statements in the period of initial application.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### *Property, plant and equipment and depreciation*

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and impairment losses.

The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment, the expenditure is capitalised as an additional cost of that asset.

Depreciation is calculated on the straight-line basis to write off the cost of each item of property, plant and equipment to its residual value over its estimated useful life. The estimated useful lives of the property, plant and equipment are as follows:

| | |
|---|---|
| Buildings | 30 years |
| Plant and machinery | 5~10 years |
| Office equipment | 5 years |
| Motor vehicles | 5 years |

Residual values, useful lives and the depreciation method are reviewed, and adjusted if appropriate, at each balance sheet date.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the income statement in the year the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### *Impairment of non-financial assets*

The Company assesses at each reporting date whether there is an indication that an asset may be impaired. Where an indication of impairment exists, or when annual impairment testing for an asset is required, the assets' recoverable amount is estimated.

The recoverable amount is calculated as the higher of the asset's or cash-generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time, value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. An impairment loss is charged to the income statement in the period in which it arises.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. A previously recognised impairment loss of an asset other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset, but not to an amount higher than the carrying amount that would have been determined (net of any depreciation/ amortisation) had no impairment loss been recognised for the asset in prior years. A reversal of such impairment loss is credited to the income statement in the period in which it arises.

### *Construction in progress ("CIP")*

Construction in progress represents buildings, plant and machinery and other fixed assets under construction or installation, which is stated at cost less accumulated impairment losses, and is not depreciated. Cost comprises the direct costs of purchase, construction, installation and testing and capitalised borrowing costs on related borrowed funds during the period of construction or installation. Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

### *Land lease prepayments*

Land lease prepayments are stated at cost less accumulated amortisation and impairment losses. Land lease prepayments are amortised using the straight-line basis over the unexpired period of the rights.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### *Intangible assets*

Intangible assets are stated at cost less accumulated depreciation and impairment losses. The useful lives of intangible assets are assessed to be finite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each balance sheet date.

Amortisation is calculated on the straight-line basis to write off the cost of each item of intangible assets to its residual value over its estimated useful life. The estimated useful lives of the intangible assets are as follows:

| | |
|---|---|
| Computer software | 2~10 years |

### *Income tax*

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences, except where the deferred tax liability arises from goodwill or the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax assets and unused tax losses can be utilised, except where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### *Inventories*

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, cost comprises direct materials, direct labour, and an appropriate proportion of overheads. Net realisable value is based on the estimated selling price in the ordinary course of business less all further costs expected to be incurred to completion and disposal.

### *Financial assets*

Financial assets within the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus directly attributable transaction costs. The Company does not have available-for-sale financial assets at 31 December 2006.

All regular way purchases and sales of financial assets are recognised on the trade date, that is the date that the Company commits to purchase or sell the assets. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

*Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss includes financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit and loss.

Financial assets are classified as held for trading if they are acquired for the purpose of sale in the near term. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments or a financial guarantee contract. Gains or losses on investments held for trading are recognised in profit and loss.

Financial assets may be designated upon initial recognition as at fair value through profit or loss if the following criteria are met: (a) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis; (b) the assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or (c) the financial asset contains an embedded derivative that would need to be separately recorded.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are subsequently carried at amortised cost using the effective interest method. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### *Financial assets* (Continued)

*Held-to-maturity investments*

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Company has the positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortised cost. Amortised cost is computed as the amount initially recognised minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initially recognised amount and the maturity amount. Gains and losses are recognised in the income statement when the investments are derecognised or impaired, as well as through the amortisation process.

### *Impairment of financial assets*

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

*Assets carried at amortised cost*

If there is objective evidence that an impairment loss on loans and receivables or held- to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through the use of an allowance account. The amount of the loss shall be recognised in the income statement.

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment and for which an impairment loss is recognised in income statement to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

In relation to trade receivables, an allowance for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### *Cash and cash equivalents*

Cash and cash equivalents comprise cash on hand, demand deposits and short term, highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value and are not restricted as to use.

For the purpose of the cash flow statement and the balance sheet, cash and cash equivalents consist of cash on hand and deposits in banks.

### *Related parties*

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

### *Interest-bearing borrowings*

Interest-bearing borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing borrowings are subsequently measured at amortised cost using the effective interest method. This cost is computed as the amount initially recognised minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initially recognised amount and the maturity amount. Amortised cost is calculated by taking into account any transaction costs, and any discount or premium on settlement.

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

### *Borrowing costs*

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e., assets that necessarily take a substantial period of time to get ready for their intended use, are capitalised as a part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs capitalised.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### *Provisions*

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

### *Foreign currency transactions*

The functional and presentation currency of the Company is Renminbi ("RMB").

Foreign currency transactions are initially recorded using the functional currency rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the balance sheet date. All differences are recognised in the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

### *Leases*

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

(a) There is a change in contractual terms, other than a renewal or extension of the arrangement;

(b) A renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term;

(c) There is a change in the determination of whether fulfilment is dependant on a specified asset; or

(d) There is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios a), c) or d) and at the date of renewal or extension period for scenario b).

*Company as a lessee*

Operating lease payments are recognised as an expense in the income statement on a straight line basis over the lease term.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### *Revenue recognition*

Revenue is recognised when it is probable that the economic benefits will flow to the Company and when the revenue can be measured reliably, on the following bases:

(a) from the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer, provided that the Company maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;

(b) from the rendering of services, when the services have been rendered; and

(c) interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable.

Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, and other taxes or duty.

### *Research and development costs*

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an individual project is recognised only when the Company can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the ability of resources to complete and the availability to measure reliably the expenditure during the development.

Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure capitalised is amortised over the period of expected future sales from the related project.

### *Government grants*

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, the fair value is credited to a deferred income account and is released to the income statement over the expected useful life of the relevant asset by equal annual instalments.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### *Retirement benefits*

Obligatory retirement benefits in the form of contributions under a defined contribution retirement plan administered by local government agencies are charged to the income statement as incurred.

### *Accommodation benefits*

Contributions to an accommodation fund administered by the Provident Fund Management Centre are charged to the income statement as incurred.

## 3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATION

### *Judgements*

In the process of applying the Company's accounting policies, management has made the following judgements, apart from those involving estimations, which have the most significant effect on the amounts recognised in the financial statements:

*(a) Impairment of assets*

In determining if an asset is impaired or the event previously causing the impairment no longer exists, management has to exercise judgement in the area of asset impairment, particularly in assessing

(i) whether an event has occurred that may affect asset value or such event affecting the asset value has not been in existence;

(ii) whether the carrying value of an asset can be supported by the net present value of future cash flows which are estimated based upon the continuing use of the asset or derecognition; and

(iii) the appropriate key assumptions to be applied in preparing cash flow projections including whether these cash flow projections are discounted using an appropriate rate.

*(b) Deferred tax assets*

Deferred tax is provided using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax assets are recognised for unused tax losses carried forward to the extent it is probable that future taxable profits will be available against which the unused tax losses can be utilised, based on all available evidence. Recognition primarily involves judgement regarding the future performance of the Company in which the deferred tax asset has been recognised. A variety of other factors are also evaluated in considering whether there is convincing evidence that it is probable that some portion or all of the deferred tax assets will ultimately be realised, such as the existence of taxable temporary differences, tax planning strategies and the periods in which estimated tax losses can be utilised.

## 3. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATION *(Continued)*

### *Judgements* *(Continued)*

*(c) Provision for obsolete and slow-moving inventories*

The Company's inventories are stated at the lower of cost and net realisable value. The Company makes provisions based on estimates of the realisable value with reference to the age and conditions of the inventories, together with the economic circumstances on the marketability of such inventories. Inventories will be reviewed annually for obsolescence provisions, if appropriate.

### *Estimation uncertainty*

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of the assets and liabilities within the next financial year are discussed below:

*(a) Impairment test of assets*

Management determines whether an asset is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units. Estimating the value in use requires management to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the level of impairment, including the discount rates or the growth rate assumptions in the cash flow projections, could materially affect the net present value used in the impairment test.

*(b) Deferred tax assets*

The carrying amount of deferred tax assets and related financial models and budgets are reviewed by management at each balance sheet date. To the extent that there is insufficient convincing evidence that sufficient taxable profits will be available within the utilisation periods to allow the utilisation of the tax losses carried forward, the asset balance will be reduced and charged to the income statement.

*(c) Provision for slow-moving inventories*

Provision for slow-moving inventories is made based on the age and estimated net realisable value of inventories. The assessment of the provision amount required involves management judgements and estimates. Where the actual outcome or expectation in future is different from the original estimate, such differences will have an impact on the carrying value of the inventories and provision charge/write-back in the period in which such estimate has been changed.

*(d) Provision for doubtful debts*

Provision for doubtful debts is made based on assessment of the recoverability of the trade receivables and other receivables. The identification of doubtful debts requires management judgements and estimates. Where the actual outcome or expectation in future is different from the original estimate, such differences will have an impact on the carrying value of the receivables and doubtful debt expenses/write-back in the period in which such estimate has been changed.

## 4. SEGMENT INFORMATION

The Company's revenue and profit were mainly derived from the sale of 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.

The Company's revenue is attributed to geographical areas based on the location of customers. Revenue regarding geographical segments based on the location of customers is presented as follows:

| | **2006 RMB'000** | 2005 RMB'000 |
|---|---|---|
| United States of America | **696,869** | 542,143 |
| Europe | **347,337** | 169,556 |
| Asia | **310,987** | 219,884 |
| | **1,355,193** | 931,583 |

## 5. REVENUE AND OTHER INCOME

| | **2006 RMB'000** | 2005 RMB'000 |
|---|---|---|
| **Revenue** | | |
| Sale of goods | **1,354,399** | 929,711 |
| Others | **794** | 1,872 |
| | **1,355,193** | 931,583 |
| **Other income** | | |
| Interest income | **11,104** | 393 |
| Government subsidies: | | |
| Refund of Value-added Tax ("VAT") | **—** | 7,314 |
| Technology service income | **—** | 4,656 |
| Scrap sales | **7,622** | — |
| Compensation received | **4,801** | — |
| Net foreign exchange gains and others | **13,579** | 22,194 |
| Fair value (loss)/gain on interest rate swap | **(224)** | 2,840 |
| | **36,882** | 37,397 |
| | **1,392,075** | 968,980 |

## 6. PROFIT/(LOSS) BEFORE INCOME TAX

Profit/(loss) before income tax is arrived at after charging/(crediting):

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Staff costs (including Directors', supervisors' and senior executives' emoluments as set out in note 7): | | |
| Retirement benefits (note 8) | | |
| - defined contribution fund | **13,180** | 9,679 |
| Accommodation benefits (note 8) | | |
| - defined contribution fund | **4,055** | 3,057 |
| Salaries and other staff costs | **146,377** | 126,396 |
| | **163,612** | 139,132 |
| Interest on bank loans | **58,153** | 38,977 |
| Less: Interest capitalised | **(231)** | (5,550) |
| Finance costs | **57,922** | 33,427 |
| *Average interest rate capitalised* | ***4.93%*** | *4.93%* |
| Depreciation | **382,801** | 284,888 |
| Amortisation of intangible assets | **3,491** | — |
| Amortisation of land lease prepayments | **769** | 769 |
| Auditors' remuneration | **2,400** | 1,000 |
| Loss on disposal of property, plant and equipment | **1,392** | 2,068 |
| (Reversal of)/provision of impairment loss on construction in progress | **(1,299)** | 2,337 |
| Reversal of allowance for bad and doubtful debts | **(22)** | — |
| Foreign exchange losses | **—** | 1,730 |
| Construction in progress written off | **10** | — |
| Provision for inventories | **13,186** | 7,056 |

## 7. DIRECTORS', SUPERVISORS' AND SENIOR EXECUTIVES' EMOLUMENTS

Details of directors' and supervisors' emoluments are as follows:

| | **2006**<br>**RMB'000** | 2005<br>RMB'000 |
|---|---|---|
| Fees | **3,122** | 3,187 |
| Other emoluments for executive directors and supervisors: | | |
| - Basic salaries and other benefits | **4,736** | 4,788 |
| - Non-discretionary bonuses paid and payable | **590** | 630 |
| - Retirement contributions | **36** | 33 |
| | **5,362** | 5,451 |
| | **8,484** | 8,638 |

### *(a) Independent non-executive directors*

The fees paid to independent non-executive directors during the year were as follows:

| | **2006**<br>**RMB'000** | 2005<br>RMB'000 |
|---|---|---|
| James Arthur Watkins | **250** | 238 |
| Thaddeus Thomas Beczak | **250** | 238 |
| Shen Weijia | **250** | 238 |
| | **750** | 714 |

There were no other emoluments payables to the independent non-executive directors during the year.

## 7. DIRECTORS', SUPERVISORS' AND SENIOR EXECUTIVES' EMOLUMENTS *(Continued)*

### *(b) Executive directors and non-executive directors*

| | Fees RMB'000 | Basic salaries and other benefits RMB'000 | Performance related bonuses RMB'000 | Retirement contributions RMB'000 | Total remuneration RMB'000 |
|---|---|---|---|---|---|
| **2006** | | | | | |
| **Executive directors:** | | | | | |
| Mr. Tony Yuhai Liu | — | 2,787 | 390 | — | 3,177 |
| Ms. Cheng Jianyu | — | 1,416 | 168 | 18 | 1,602 |
| | — | 4,203 | 558 | 18 | 4,779 |
| **Non-executive directors:** | | | | | |
| Mr. Ruan Yanhua | 201 | — | — | — | 201 |
| Mr. Zhu Jian | 201 | — | — | — | 201 |
| Mr. Anthony Lear | 201 | — | — | — | 201 |
| Mr. Mang Wai Kin | — | — | — | — | — |
| Mr. Zhu Peiyi | 201 | — | — | — | 201 |
| Mr. Ma Mai | — | — | — | — | — |
| Mr. Zhou Weiping | 201 | — | — | — | 201 |
| Mr. Petrus Antonius Maria Van Bommel | 161 | — | — | — | 161 |
| | 1,166 | — | — | — | 1,166 |
| **Supervisors:** | | | | | |
| Mr. Shen Qitang | 201 | — | — | — | 201 |
| Mr. Yang Yanhui | 201 | — | — | — | 201 |
| Mr. Zhang Yueh | 201 | — | — | — | 201 |
| Mr. Ajit Manocha | 201 | — | — | — | 201 |
| Ms. Wang Xiangqun | 201 | — | — | — | 201 |
| Mr. Huang Jihua | 201 | — | — | — | 201 |
| Mr. Xu Songneng | — | 533 | 32 | 18 | 583 |
| | 1,206 | 533 | 32 | 18 | 1,789 |
| | 2,372 | 4,736 | 590 | 36 | 7,734 |

## 7. DIRECTORS', SUPERVISORS' AND SENIOR EXECUTIVES' EMOLUMENTS *(Continued)*

### *(b) Executive directors and non-executive directors (Continued)*

| | Fees | Basic salaries and other benefits | Performance related bonuses | Retirement contributions | Total remuneration |
|---|---|---|---|---|---|
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| **2005** | | | | | |
| **Executive directors:** | | | | | |
| Mr. Tony Yuhai Liu | — | 2,881 | 404 | — | 3,285 |
| Ms. Cheng Jianyu | — | 1,435 | 168 | 16 | 1,619 |
| | — | 4,316 | 572 | 16 | 4,904 |
| **Non-executive directors:** | | | | | |
| Mr. Ruan Yanhua | 208 | — | — | — | 208 |
| Mr. Zhu Jian | 208 | — | — | — | 208 |
| Mr. Anthony Lear | 208 | — | — | — | 208 |
| Mr. Mang Wai Kin | 208 | — | — | — | 208 |
| Mr. Zhu Peiyi | 208 | — | — | — | 208 |
| Mr. Ma Mai | 35 | — | — | — | 35 |
| Mr. Zhou Weiping | 150 | — | — | — | 150 |
| Mr. Petrus Antonius Maria Van Bommel | — | — | — | — | — |
| | 1,225 | — | — | — | 1,225 |
| **Supervisors:** | | | | | |
| Mr. Shen Qitang | 208 | — | — | — | 208 |
| Mr. Yang Yanhui | 208 | — | — | — | 208 |
| Mr. Zhang Yueh | 208 | — | — | — | 208 |
| Mr. Ajit Manocha | 208 | — | — | — | 208 |
| Ms. Wang Xiangqun | 208 | — | — | — | 208 |
| Mr. Huang Jihua | 208 | — | — | — | 208 |
| Mr. Xu Songneng | — | 472 | 58 | 17 | 547 |
| | 1,248 | 472 | 58 | 17 | 1,795 |
| | 2,473 | 4,788 | 630 | 33 | 7,924 |

The five highest paid individuals in the Company include two executive directors for the years ended 31 December 2005 and 2006, details of whose emoluments have been disclosed above.

## 7. DIRECTORS', SUPERVISORS' AND SENIOR EXECUTIVES' EMOLUMENTS *(Continued)*

### (b) *Executive directors and non-executive directors* *(Continued)*

The details of the emoluments of the remaining three highest paid individuals are as follows:

| | **2006**<br>**RMB'000** | 2005<br>RMB'000 |
|---|---|---|
| Basic salaries and other benefits | **3,552** | 3,629 |
| Non-discretionary bonuses paid and payable | **483** | 605 |
| Retirement contributions | **53** | 49 |
| | **4,088** | 4,283 |

The number of the three highest paid employees, whose remuneration fell within the following bands, is as follows:

| | **2006** | 2005 |
|---|---|---|
| HK$1,000,001 - HK$1,500,000 | **2** | 2 |
| HK$1,500,001 - HK$2,000,000 | **1** | 1 |
| | **3** | 3 |

During the years ended 31 December 2005 and 2006, no director or supervisor waived or agreed to waive any emolument and no emoluments were paid by the Company to the directors, supervisors or five highest paid employees of the Company as an inducement to join or upon joining the Company or as compensation for loss of office.

## 8. RETIREMENT BENEFITS AND ACCOMMODATION

### *Retirement benefits*

As stipulated by PRC law and regulations, the Company participates in a defined contribution retirement plan. All local Chinese employees are entitled to an annual pension equal to a fixed proportion of the average basic salary amount within the geographical area of their last employment at their retirement date. The Company is required to make contributions to the Labour and Social Security Bureau of the Shanghai Government at a rate of 22.5% of the employees' salaries and wages of the previous year, limited to a ceiling amount of three times of the previous year's average basic salaries within the geographical area where the local Chinese employees are under employment with the Company.

The Company has no obligation for the payment of pension benefits beyond the annual contributions to the Labour and Social Security Bureau of the Shanghai Government as set out above. The retirement benefits do not apply to expatriate employees.

### *Accommodation benefits*

According to the relevant rules and regulations of the PRC, the Company and each of its local Chinese employees are required to make contributions which are in proportion to the salaries and wages of the employees to an accommodation fund administered by the Provident Fund Management Center. There are no further obligations on the part of the Company except for such contributions to the accommodation fund. The accommodation benefits do not apply to expatriate employees.

## 9. INCOME TAX

No provision for Hong Kong profits tax has been made as the Company had no assessable profits arising in Hong Kong during the years ended 31 December 2005 and 2006.

The Company is located at Caohejing High-Tech Park of Shanghai, the PRC, and its applicable corporate income tax rate is 15%. In accordance with the prevailing tax laws in the PRC, the Company is entitled to full exemption from corporate income tax for the first and second profitable years (after offsetting accumulated tax losses, which can be carried forward for utilisation for a maximum period of five years), and a further 50% exemption for the succeeding three years.

As an integrated circuits manufacturer capable of manufacturing wafers with line widths equal to or below 0.25 micron, and pursuant to an approval document of the relevant tax authorities dated 17 June 2004, the Company is entitled to a 50% reduction in corporate income tax for an additional five years from 2004 to 2008. Accordingly, the Company was subject to PRC corporate income tax at an applicable income tax rate of 7.5% for the years ended 31 December 2005 and 2006.

## 9. INCOME TAX *(Continued)*

Major components of income tax credit are as follows:

| | **2006 RMB'000** | 2005 RMB'000 |
|---|---|---|
| Provision for income tax in respect of profit for the year | **—** | — |
| Over provision of income tax in respect of prior years | **—** | (4,936) |
| | **—** | (4,936) |
| Deferred tax credit | **(974)** | (5,055) |
| Income tax credit | **(974)** | (9,991) |

A numerical reconciliation between net income tax credit and the profit/(loss) before income tax multiplied by the applicable tax rate is as follows:

| | **2006 RMB'000** | 2005 RMB'000 |
|---|---|---|
| Profit/ (loss) before income tax | **2,969** | (85,021) |
| Tax at applicable tax rate of 7.5% | **223** | (6,377) |
| Tax effect of: | | |
| - Expenses not deductible for tax purpose | **3** | 906 |
| - Additional deductible expenses for tax purpose | **(1,200)** | — |
| - Others | **—** | 416 |
| Over provision in prior year | **—** | (4,936) |
| Income tax credit, net | **(974)** | (9,991) |

The additional deductible expenses for tax purpose refer to additional 50% deduction for research and development costs according to PRC tax law.

## 10. DIVIDENDS

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 (31 December 2005: Nil).

## 11. EARNINGS/(LOSS) PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY

Basic earnings/(loss) per share is calculated by dividing the profit/(loss) attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares in issue during the periods.

| | **2006** | 2005 |
|---|---|---|
| Profit/(loss) attributable to ordinary equity holders of the Company (RMB'000) | **3,943** | (75,030) |
| Weighted average number of ordinary shares in issue ('000) | **1,421,800** | 1,109,080 |

Diluted earnings/(loss) per share has not been disclosed as there were no dilutive options and other potential dilutive ordinary shares in issue during the years ended 31 December 2005 and 2006.

## 12. PROPERTY, PLANT AND EQUIPMENT

| 31 December 2006: | Buildings RMB'000 | Plant and machinery RMB'000 | Office equipment RMB'000 | Motor vehicles RMB'000 | Total RMB'000 |
|---|---|---|---|---|---|
| **Cost:** | | | | | |
| At 1 January 2006 | 104,222 | 3,318,453 | 50,433 | 3,391 | 3,476,499 |
| Additions | 40 | 25,080 | 7,496 | 473 | 33,089 |
| Transferred from CIP | 53,932 | 278,974 | 14,562 | — | 347,468 |
| Disposals | (1,953) | (2,902) | (1,308) | (124) | (6,287) |
| At 31 December 2006 | 156,241 | 3,619,605 | 71,183 | 3,740 | 3,850,769 |
| **Accumulated depreciation:** | | | | | |
| At 1 January 2006 | 24,140 | 1,474,006 | 29,280 | 2,757 | 1,530,183 |
| Charge for the year | 4,903 | 369,548 | 8,104 | 246 | 382,801 |
| Disposals | (415) | (1,802) | (1,308) | (124) | (3,649) |
| At 31 December 2006 | 28,628 | 1,841,752 | 36,076 | 2,879 | 1,909,335 |
| **Net book value:** | | | | | |
| At 31 December 2006 | 127,613 | 1,777,853 | 35,107 | 861 | 1,941,434 |
| **31 December 2005:** | | | | | |
| **Cost:** | | | | | |
| At 1 January 2005 | 101,823 | 2,536,873 | 43,384 | 3,379 | 2,685,459 |
| Additions | — | 58,951 | 3,324 | 35 | 62,310 |
| Transferred from CIP | 2,399 | 734,876 | 4,974 | — | 742,249 |
| Disposals | — | (12,247) | (1,249) | (23) | (13,519) |
| At 31 December 2005 | 104,222 | 3,318,453 | 50,433 | 3,391 | 3,476,499 |
| **Accumulated depreciation:** | | | | | |
| At 1 January 2005 | 20,726 | 1,208,324 | 24,854 | 2,519 | 1,256,423 |
| Charge for the year | 3,414 | 275,542 | 5,671 | 261 | 284,888 |
| Disposals | — | (9,860) | (1,245) | (23) | (11,128) |
| At 31 December 2005 | 24,140 | 1,474,006 | 29,280 | 2,757 | 1,530,183 |
| **Net book value:** | | | | | |
| At 31 December 2005 | 80,082 | 1,844,447 | 21,153 | 634 | 1,946,316 |

The Company's buildings, plant and machinery with a net book value of RMB1,905,466,000 at 31 December 2006 (31 December 2005: RMB1,924,529,000) were pledged to banks as security for the bank loans amounting to US$92 million (equivalent to approximately RMB 718,401,000) at 31 December 2006 (31 December 2005: RMB742,458,000).

The proceeds receivable in respect of disposal of property, plant and equipment amounting to RMB596,000 at 31 December 2006 was included in sundry debtors disclosed in Note 19 to the financial statements.

## 13. CONSTRUCTION IN PROGRESS

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Net book value: | | |
| At beginning of year | **175,937** | 207,704 |
| Additions | **173,470** | 712,819 |
| Transferred to property, plant and equipment | **(347,468)** | (742,249) |
| Transferred to inventory | **(1,299)** | — |
| Written off | **(10)** | — |
| Impairment loss reversed/(provided) | **1,299** | (2,337) |
| At end of year | **1,929** | 175,937 |
| Cost | **1,929** | 178,274 |
| Accumulated impairment loss | **—** | (2,337) |
| Net book value at end of year | **1,929** | 175,937 |

The Company's construction in progress with a net book value of RMB1,929,000 at 31 December 2006 (31 December 2005: RMB175,937,000) was pledged to banks as security for the bank loans amounting to US$92 million (equivalent to approximately RMB718,401,000) at 31 December 2006 (31 December 2005: RMB742,458,000).

During the year ended 31 December 2006, an impairment loss of RMB1,299,000 in respect of the equipment for the 6-inch production line was reversed as the equipment was dismantled and used as spare parts for other production lines. In addition, an impairment loss of RMB1,038,000 was written off as the related equipment with cost amounting to RMB1,048,000 were disposed during the year.

## 14. LAND LEASE PREPAYMENTS

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Carrying amount: | | |
| At beginning of year | **37,392** | 38,161 |
| Amortisation for the year | **(769)** | (769) |
| At end of year | **36,623** | 37,392 |
| Current portion included in prepayments, deposits and other receivables | **(769)** | (769) |
| Non-current portion | **35,854** | 36,623 |

The Company's land lease prepayments with a net book value of RMB36,623,000 at 31 December 2006 (31 December 2005: RMB37,392,000) were pledged to banks to secure the bank loans amounting to US$92 million (equivalent to approximately RMB718,401,000 ) at 31 December 2006 (31 December 2005: RMB742,458,000).

## 15. INTANGIBLE ASSETS

| | **2006** **RMB'000** | 2005 RMB'000 |
|---|---|---|
| Cost: | | |
| At beginning of year | **18,569** | — |
| Addition | **2,615** | 18,569 |
| Disposal | **(134)** | — |
| At end of year | **21,050** | 18,569 |
| Accumulated amortisation: | | |
| At beginning of year | **—** | — |
| Amortisation for the year | **(3,491)** | — |
| At end of year | **(3,491)** | — |
| Net book value | **17,559** | 18,569 |

The intangible assets are computer software.

## 16. DEFERRED TAX ASSETS

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Deferred tax assets/(liabilities) in respect of | | |
| - Depreciation charges | **(562)** | (782) |
| - Fair value gain on interest rate swap | **(196)** | (213) |
| - Unutilised tax losses | **4,291** | 5,684 |
| - Provisions | **4,262** | 2,132 |
| | **7,795** | 6,821 |

Under the relevant tax laws of the PRC, the Company is able to carry forward the unutilised tax losses for five years. Subject to the agreement by the Tax Bureau, the Company has recognised the temporary difference on unutilised tax losses amounting to approximately RMB57,217,000 (31 December 2005: RMB75,786,000) as a deferred tax asset at 31 December 2006 as the Directors are confident that the Company is able to generate sufficient taxable profits to utilise the tax losses before the expiry of the five years period.

## 17. INVENTORIES

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Raw materials | **78,340** | 43,726 |
| Spare parts and consumables | **73,467** | 54,508 |
| Work in progress | **123,946** | 79,071 |
| Finished goods | **27,686** | 22,918 |
| | **303,439** | 200,223 |
| Less: Allowance for inventories | **(41,610)** | (28,424) |
| | **261,829** | 171,799 |
| Represented by: | | |
| Inventories carried at cost | **177,193** | 129,654 |
| Inventories carried at net realisable value | **84,636** | 42,145 |
| | **261,829** | 171,799 |
| Analysis of allowance for inventories: | | |
| At beginning of year | **28,424** | 21,368 |
| Provided for the year | **25,793** | 15,028 |
| Utilised for the year | **(12,607)** | (7,972) |
| At end of year | **41,610** | 28,424 |

## 18. ACCOUNTS AND NOTES RECEIVABLES

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Accounts receivable | **137,802** | 117,645 |
| Notes receivables | **—** | 6,619 |
| | **137,802** | 124,264 |

Credit terms granted by the Company to its customers generally range from 30 days to 60 days.

An ageing analysis of the accounts receivable as at 31 December 2006 is as follows:

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Outstanding balances with ageing: | | |
| Within 30 days | **79,462** | 68,840 |
| Between 31 days and 90 days | **57,567** | 47,997 |
| Between 91 days and 180 days | **557** | 113 |
| Between 181 days and 365 days | **216** | 717 |
| | **137,802** | 117,667 |
| Less: Allowance for bad and doubtful debts | **—** | (22) |
| | **137,802** | 117,645 |

## 19. PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Prepayments | **1,641** | 7,639 |
| Prepaid expense | **453** | — |
| Deposits | **340** | 295 |
| VAT refundable | **2,261** | 2,261 |
| Held for trading financial assets | | |
| - Interest rate swap | **2,616** | 2,840 |
| Interest income receivable | **7,371** | — |
| Sundry debtors | | |
| - Proceeds from disposal of property, plant and equipment | **596** | — |
| - Others | **6,458** | 10,708 |
| | **21,736** | 23,743 |

## 20. BALANCES WITH RELATED COMPANIES

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. (formerly known as Philips Electronics South-East Asia Holding B.V.), which held more than 26.6% of the equity interest of the Company.

On 3 August 2006, Royal Philips announced that it had signed an agreement with Kohlberg Kravis Roberts & Co., Sliver Lake Partners and AlpInvest 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, 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 related parties during the year.

The amounts due from/to related companies, which are subsidiaries or associates of Royal Philips and NXP B.V., are unsecured, interest-free and on normal commercial terms. All the balances with related companies arose from trade transactions in the ordinary course of business of the Company.

## 21. CASH AND CASH EQUIVALENTS

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Cash and bank balances | **149,546** | 105,886 |
| Time deposits | **247,441** | — |
| | **396,987** | 105,886 |

The non-pledged time deposits of RMB247,441,000 at 31 December 2006 have varying periods between three months to six months depending on the immediate cash requirements of the Company.

## 22. ACCOUNTS PAYABLE

| | 2006<br>RMB'000 | 2005<br>RMB'000 |
|---|---|---|
| Outstanding balances with ageing: | | |
| Within 30 days | **144,646** | 108,714 |
| Between 31 days and 90 days | **33,790** | 46,737 |
| Between 91 days and 180 days | **7,245** | 10,679 |
| Between 181 days and 365 days | **3,461** | 15,140 |
| Over 365 days | **5,202** | 14,930 |
| | **194,344** | 196,200 |

## 23. INTEREST-BEARING BORROWINGS

| | **2006** | 2005 |
|---|---|---|
| | **RMB'000** | RMB'000 |
| Bank loans: | | |
| - Unsecured | **23,426** | 443,861 |
| - Secured | **718,401** | 742,458 |
| | **741,827** | 1,186,319 |
| Bank loans repayable: | | |
| - Within one year | **286,451** | 1,186,319 |
| - In the second year | **234,702** | — |
| - Between the third and fifth years | **220,674** | — |
| | **741,827** | 1,186,319 |
| Bank loans: | | |
| - Current portion | **286,451** | 1,186,319 |
| - Non-current portion | **455,376** | — |
| | **741,827** | 1,186,319 |

The bank loans bear interest at rates from 6.17% to 6.58% per annum (2005: 1.97% to 5.25% per annum).

On 9 February 2006, the Company obtained a final unconditional waiver letter from the syndicate of banks (the "Lenders") for the US$100 million credit facility term loan agreement (the "Term Loan Agreement") in respect of the breach of certain financial covenants on testing days as at 30 June 2005 and 30 September 2005, as stipulated in the Term Loan Agreement. Accordingly, the secured bank loan of US$92,000,000(equivalent to approximately RMB742,458,000) under the Term Loan Agreement, was classified as short term loan at 31 December 2005 because of the breach of the financial covenants. The Company signed a supplementary agreement with the Lenders on 8 May 2006 to finalise the terms of the final unconditional waiver letter. Accordingly, the short-term portion has been reclassified as long-term loan as at 31 December 2006.

On 31 December 2006, the Company complied with the revised financial covenants as set out in the supplementary agreement dated 8 May 2006.

The principal debt covenants of the Term Loan Agreement are set out below:

(a) The Company shall comply with certain financial covenants on every testing date of every quarter end;

(b) The Company shall not engage in any business beyond its business scope as indicated in its business license;

(c) The Company shall not merge or consolidate with other entities, nor take any step with a view toward dissolution, liquidation or winding-up;

## 23. INTEREST-BEARING BORROWINGS *(Continued)*

(d) The Company shall not guarantee, provide security (other than to the Lenders), sell, transfer, lend, lease (as a lessor), or otherwise dispose of any whole or substantial part of its property, assets, or cash flows, whether by a single transaction or a series of transactions, and whether it is a related party transaction or not (other than any guarantee, security, sale, transfer, lending or lease entered into by the Company in the normal course of business);

(e) The Company shall not incur any additional indebtedness (except clean facility, subordinated loan and trade facilities) without the Lender's prior consent;

(f) The Company shall maintain the status of all insurance policies that have been assigned to the Lenders;

(g) No dividend or other distribution shall be made by the Company prior to its listing on any stock exchange. After the Company is listed, up to (and including) 25% of its net profit after tax for any financial year may be declared, made or distributed as a dividend by the Company;

(h) No decrease or reduction shall be made to the Company's registered capital without prior written consent of the Lenders; and

(i) The Company shall mortgage in favour of the Lenders all its land lease prepayments, buildings, machinery and equipment. For any of such land lease prepayments, buildings, machinery or equipment that the Company acquires after the first drawdown under the Term Loan Agreement, the Company shall undertake to perfect or register the mortgage once a year after the first drawdown date, over such property or assets that the Company has acquired during the immediate past year.

The Company's buildings, plant and machinery, construction in progress, and land lease prepayments with a net book value of RMB1,905,466,000, RMB1,929,000 and RMB36,623,000, respectively, at 31 December 2006 were pledged to banks as security for the bank loans amounting to US$92 million (equivalent to approximately RMB718,401,000).

As at 31 December 2006, the Company had unutilised banking facilities of approximately US$72,887,000 (equivalent to approximately RMB569,153,000), out of which amounts of US$37,000,000 (equivalent to RMB288,922,000), US$35,887,000 (equivalent to RMB280,231,000) will expire on 6 December 2007 and 24 November 2008, respectively.

## 24. REGISTERED AND PAID-UP CAPITAL

| | Notes | 31 December 2006 Number of shares '000 | 31 December 2005 Number of shares '000 | 31 December 2006 RMB'000 | 31 December 2005 RMB'000 |
|---|---|---|---|---|---|
| Registered | | **1,109,080** | 1,109,080 | **1,109,080** | 1,109,080 |
| Issued and fully paid: | | | | | |
| Non-listed foreign shares | (a) | **33,272** | 696,946 | **33,272** | 696,946 |
| Domestic Shares | (b) | **369,621** | 412,134 | **369,621** | 412,134 |
| H Shares | (c) | **467,660** | — | **467,660** | — |
| Converted H Shares | (d) | **663,674** | — | **663,674** | — |
| Total | | **1,534,227** | 1,109,080 | **1,534,227** | 1,109,080 |

According to the relevant regulations of the PRC, Domestic Shares, Foreign Shares (whether all in the form of Converted H Shares or Non-listed Foreign Shares) and H Shares are ordinary shares in the Company's share capital. The holders of ordinary shares are entitled to receive dividends declared by the Company, and are entitled to voting rights without restriction.

### *(a) Non-listed Foreign Shares*

Although there is at present no applicable PRC laws or regulations governing the rights of such Non-Listed Foreign Shares, and the Company's Articles of Association contain no express provisions as to whether such Non-Listed Foreign Shares constitute a different class of shares from the H Shares, Jingtian & Gongcheng, the Company's legal advisor as to PRC law, have confirmed that the subsistence of Non-Listed Foreign Shares do not contravene any PRC laws or regulations, and until new laws or regulations are introduced the holders of Non-Listed Foreign Shares shall be treated as being in the same class as the holders of Domestic Shares. The holders of the Non-Listed Foreign Shares enjoy the same rights as the holders of Domestic Shares, plus the following rights:

- to request the Company to pay dividends in foreign currencies;
- to request the Company distribute its assets upon the winding-up of the Company in foreign currencies and remit out of the PRC, subject to the applicable foreign exchange control regulations; and
- may resolve disputes with holders of Domestic Shares or H Shares by way of arbitration.

## 24. REGISTERED AND PAID-UP CAPITAL *(Continued)*

### *(b) Domestic Shares*

Domestic Shares may only be subscribed for by, and traded between, legal or natural persons of the PRC and must be subscribed for and traded in RMB. The Domestic Shares held by Shanghai Chemical Industry Park Investment Enterprise Co., Ltd. ("SCIPI"), Shanghai Belling Co., Ltd. ("Shanghai Belling") and China Orient Asset Management Corporation ("COAMC") are not admitted for listing on any stock exchange and no arrangement has been made for the Domestic Shares to be traded or dealt with on any other authorised trading facility in the Mainland China.

### *(c) H Shares*

H Shares may only be subscribed for in Hong Kong dollars by, and traded between, legal or natural persons of Hong Kong, Macau, Taiwan or any country other than the Mainland China.

### *(d) Converted H Shares*

Converted H Shares are H Shares held by Philips Electronics China B.V. and SCIP (HK) Limited. H Shares and Converted H Shares belong to the same class of shares in the Company's share capital. Converted H Shares have identical rights as that of H Shares, except that Converted H Shares may not be transferred (a) until the expiry of the lock-up period, being shortly after the one-year period pursuant to the PRC Company Law commencing from the date on which the Company is listed on the Hong Kong Stock Exchange, and (b) the trading of such Converted H shares on the Hong Kong Stock Exchange upon the expiry of the lock up period will require prior approval from the Ministry of Commerce.

Pursuant to the "Provisional Administrative Measures for the Reduction of State-owned Shares in Raising the Social Security Fund", COAMC sold a number of its Domestic Shares amounting to 10% of the H Shares offered in the Global Offering (the "Sale H Shares"). The proceeds arising from the sales of 42,513,000 Sale H Shares as a result of the conversion of 42,513,000 Domestic Shares into Sale H Shares have been remitted to the National Social Security Fund (the "NSSF") during the year.

The nominal value of 467,660,000 H shares, less 42,513,000 Sale H Shares, issued pursuant to the Global Offering has not been registered as the registered capital of the Company as the registration process had not been completed at 31 December 2006.

There were 467,660,000 H Shares of the Company, which represent 369,693,000 New H Shares and 36,969,000 Sale H Shares, listed on the Main Board of the Hong Kong Stock Exchange on 7 April 2006 and 55,454,000 additional New H Shares and 5,544,000 Sale H Shares, issued upon exercise of an over-allotment option, listed on the Main Board of the Hong Kong Stock Exchange on 11 April 2006. These H Shares, with a nominal value of RMB1.00 each, were issued to the public by way of Global Offering at an offer price of HK$1.60 per share. After deducting net proceeds of approximately RMB62,699,000 from the sale of the 42,513,000 Sale H Shares, which will be remitted to the NSSF as explained above, and the share issue expenses of approximately RMB82,606,000, the net proceeds from the Global Offering of approximately RMB630,471,000 were credited to the paid-up capital and capital reserve as RMB425,147,000 and RMB205,324,000, respectively. Share issue expenses payable amounting to RMB696,000 at 31 December 2006 were included in accrued liabilities and other payables of RMB95,433,000.

## 25. RESERVES

### *(a) Capital reserve*

On 7 April 2006, pursuant to the Global Offering, RMB287,930,000 of share premium was created. Share issue expenses of RMB82,606,000 in relation to the Global Offering had been offset against the share premium.

### *(b) Statutory surplus reserve*

Following the re-registration of the Company as a foreign invested joint stock limited company, and in accordance with the Company Law of the PRC and the Articles of Association of the Company, the Company is required to allocate 10% of its profit after tax to the statutory surplus reserve until such reserve reaches 50% of the registered share capital of the Company. Subject to certain restrictions set out in the Company Law of the PRC, part of this reserve may be converted to increase the share capital, provided that the remaining balance after the capitalisation is not less than 25% of the registered share capital.

### *(c) Statutory public welfare fund*

According to Company law of the PRC, the Company is no longer required to make any transfer of profit after tax to the statutory public welfare fund. The balance of statutory public welfare fund as at 31 December 2005 is transferred to statutory surplus reserve.

### *(d) Retained earnings*

The amount which the Company can legally distribute by way of a dividend is determined based on the lower of the Company's profits determined under PRC GAAP and IFRSs.

## 26. FINANCIAL INSTRUMENTS

### *Financial risk management objectives and policies*

The main financial risks faced by the Company are interest rate risk, foreign currency risk and credit risk. The Company does not hold or issue derivative financial instruments either for hedging or for trading purposes, other than interest rate swaps disclosed in interest rate risk below.

### *Interest rate risk*

The Company's exposure to market risk for changes in interest rates relates primarily to its interest-bearing borrowings.

The Company uses interest rate swaps to hedge its interest rate risk. The interest rate swap contracts that the Company has entered into entitle it to receive interest at floating rates on notional principal amounts and oblige it to pay interest at fixed rates on the same amounts. Under the interest rate swaps, the Company agrees with other parties to exchange, at semi-annual intervals, the differences between the fixed rate and floating rate interest amounts calculated by reference to the agreed notional principal amounts.

The floating rates of the Company's interest rate swap contracts are linked to the US$-LIBOR-BBAM. The weighted average interest rate of the Company's floating rate borrowings at the balance sheet date was 6.45% per annum. After the interest rate swap, the Company's weighted average interest rate at the balance sheet date was 6.14% per annum.

The remaining terms and notional principal amounts of the outstanding interest rate swap contracts of the Company at the balance sheet date, which are denominated in US Dollars ("US$"), were as follows:

| | **2006**<br>**RMB'000** | 2005<br>RMB'000 |
|---|---|---|
| Later than one year and not later than five years | **195,218** | 201,750 |

The fair value gain of the interest rate swap contracts at 31 December 2006 of RMB2,616,000 has been recorded in note 19 to the financial statements as held for trading financial asset.

## 26. FINANCIAL INSTRUMENTS *(Continued)*

### *Foreign currency risk*

The Company has transactional currency exposures. Such exposures arise from the sales, purchases and borrowings of the Company in currencies other than the RMB. The Company does not use derivative financial instruments to hedge its exchange rate risk.

The foreign currency profile of the financial assets and liabilities denominated in currencies other than the functional currency of the Company is as follows:

| | **2006 RMB'000** | 2005 RMB'000 |
|---|---|---|
| Financial assets | | |
| Cash and cash equivalents: | | |
| - US$ | **378,258** | 50,781 |
| - Others | **7,244** | — |
| | **385,502** | 50,781 |
| Accounts and notes receivables: | | |
| - US$ | **105,903** | 84,087 |
| - Others | **—** | — |
| | **105,903** | 84,087 |
| Due from related companies: | | |
| - US$ | **35,894** | 31,866 |
| - Others | **—** | — |
| | **35,894** | 31,866 |
| Financial liabilities | | |
| Interest-bearing borrowings: | | |
| - US$ | **741,827** | 1,186,319 |
| - Others | **—** | — |
| | **741,827** | 1,186,319 |
| Accounts payable: | | |
| - US$ | **93,089** | 120,419 |
| - Others | **4,488** | 8,182 |
| | **97,577** | 128,601 |
| Accrued liabilities and other payables: | | |
| - US$ | **29,447** | 1,493 |
| - Others | **2,151** | 3,124 |
| | **31,598** | 4,617 |
| Due to related companies: | | |
| - US$ | **12,492** | 1,830 |
| - Others | **—** | 1,249 |
| | **12,492** | 3,079 |

## 26. FINANCIAL INSTRUMENTS *(Continued)*

### *Credit risk*

Credit risk arising from the inability of a counterparty to meet the terms of the Company's financial instrument contracts is generally limited to the amounts, if any, by which the counterparty's obligations exceed the obligations of the Company. Financial assets of the Company that are potentially subject to significant concentration of credit risk consist principally of cash and cash equivalents, accounts, notes and other receivables and amounts due from related companies. The Company's maximum exposure to credit risk in relation to each class of the recognised financial assets is the carrying amount of these assets. There is no significant concentration of credit risk for the Company's financial assets.

### *Fair value*

Fair value estimates are made at a specific point in time and based on relevant market information and information about the financial instruments. These estimates are subjective in nature, involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The carrying amounts of the financial assets and liabilities of the Company at balance sheet date approximated to their fair values.

## 27. RELATED PARTY TRANSACTIONS

As set out in note 20 to the financial statements, the companies controlled by or under the significant influence of Royal Philips and NXP B.V. are considered to be related to the Company.

The Company had the following material transactions with the companies controlled by or under the significant influence of Royal Philips and NXP B.V. during the year ended 31 December 2006:

| | Notes | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|---|
| Sales | (i) | **245,450** | 152,258 |
| Purchases | (i) | **1,016** | 6,560 |
| Technology transfer fees | (ii) | **21,530** | 13,757 |
| Information technology ("IT") related service fees | (iii) | **2,613** | 2,641 |

*Notes:*

(i) Sales to and purchases from the related companies were carried out based on normal commercial terms and at market prices.

(ii) Royalties in the form of technology transfer fees and identification licensing fees paid/payable to a related company were determined at 3% or 10% of the net sales of certain specified products sold by agreement of the parties.

(iii) IT related service fees were charged by the related companies based on services rendered in accordance with the terms of agreements signed by the parties.

In the opinion of the Directors, all transactions above were carried out in the ordinary course of business of the Company. Such transactions were conducted on an arm's length basis and on normal commercial terms, and will continue as such in the future.

The above related parties transactions also constitute continuing connected transactions as defined in Chapter 14A of the Listing Rules.

## 28. COMMITMENTS

The Company had the following capital commitments as at 31 December 2006:

| | 2006 RMB'000 | 2005 RMB'000 |
|---|---|---|
| Capital commitments in respect of property, plant and equipment: | | |
| - contracted, but not provided for | **6,584** | 163,177 |
| - authorised, but not contracted for | **46,182** | 91,038 |
| | **52,766** | 254,215 |

## 29. CONTINGENT LIABILITIES

(a) On 8 March 2005, the Company received summons issued by the United States District Court, Northern District of California regarding the case known as Monolithic Power Systems, Inc. v. O2 Micro International Limited, in which the Company was identified as one of the counter-defendants and was alleged, by virtue of its manufacture and sale of wafers to Monolithic Power Systems, Inc. ("MPS"), without the permission or license from O2 Micro International Limited ("O2 Micro"), to induce infringement and/or contribute to the infringement of the United States Patent No. 6396722 (the "722 patent").

On 20 April 2005, the Company received summons issued by the United States District Court, Eastern District of Texas regarding the case known as O2 Micro International Limited v. Monolithic Power Systems, Inc., in which the Company was identified as one of the defendants and was alleged, by virtue of its manufacture and sale of wafers to MPS, without permission or license from O2 Micro, to induce infringement and/or contribute to the infringement of US Patent No. 6804129 (the "129 patent"). The case was transferred to the United States District Court, Northern District of California in May 2006. The court subsequently ordered consolidation of the two cases.

Subsequently, O2 Micro dropped its allegations against the Company with respect to the 129 patent, but claimed that it should be entitled to damages from MPS by reason of the latter's infringement of the 722 patent for US$149 million and that the Company should be jointly liable for the same damages. The Company has denied infringement and has claimed that the 722 patent is invalid and unenforceable. The Company has filed a motion for summary judgment of non-infringement and has also joined a motion for summary judgment seeking to have the 722 patent declared invalid by reason of the inventor's failure to comply with the best mode requirement of the US patent law.

On 8 February 2007, the court granted summary judgement in favour of the Company that O2 Micro had presented no evidence of damages and that the Company should not be stopped from challenging the infringement and validity of the 722 patent. The court denied the Company's other motions for summary judgment. The court also concluded that the Company should not be liable for conduct that had occurred before 6 December 2004, though it might be liable for conduct occurring thereafter. The court previously decided that the trial would begin on 30 April 2007 and last for three weeks. The issues at trial will be limited to whether the 722 patent is invalid, whether the Company and other defendants infringe the 722 patent, and, should the 722 patent be found valid and enforceable, whether O2 Micro is entitled to an injunction.

The Company considered that the liability arising from the 722 patent is possible but not probable and therefore no provision is being made in the financial statements. The Directors are of the opinion that this litigation will not have a material adverse effect on the financial position or operational results of the Company. The revenue derived from the wafers that used the allegedly infringed patent accounted for less than 1% of the total revenue of the Company for the year ended 31 December 2006. The Company believes that it can, if necessary, replace its foundry capacity and/or orders related to the allegedly infringed products from MPS with similar technology and order levels from its other customers (including MPS).

## 29. CONTINGENT LIABILITIES *(Continued)*

(b) During the year, the Company received an unsubstantiated allegation amounting to USD1.97 million (equivalent to approximately RMB15.4million) for alleged breaches of certain terms of a foundry agreement dated 22 October 2004. The Company has obtained preliminary legal advice on this allegation. Given the allegation was not reasonably specified and supported by evidence, the Company considered the liability as not probable and therefore no provision is being made in the financial statements of the Company. Should the allegation be subsequently escalated to a legal claim, the Directors will seek further legal advice and consider its provision in the financial statements.

## 30. COMPARATIVES

Certain comparative figures have been reclassified to conform with current year's presentation.

## 31. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 19 March 2007.