

## Report of the Directors

The Board hereby presents the report of the Directors and the audited accounts of the Group for the year ended 31 December 2006 to the shareholders.

### Principal operations

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

### Results and dividend

In 2006, the Group has achieved a substantial improvement in the results performance over 2005 by adoption of a series of active and effective sales tactics and the incessant effort of the staff. On the one hand, the production and sales volume of colour picture tubes ("CPTs") attained record high. On the other hand, there was major breakthrough in new business exploration and strategic transformation.

The sales of the Group in 2006 was RMB3,861,710,000, which was almost the same level of 2005. Operating profit increased by RMB1,089,718,000 to RMB250,337,000. Gross profit margin increased from -11% in 2005 to 13% in 2006. The Company turned loss to profit with its profit attributable to equity holders amounted to RMB129,512,000.

The Company's original dividend policy will remain unchanged. In light of the absence of accumulated surplus in 2006, the Board resolved not to distribute any final dividend.

The annual results of the Group for the year ended 31 December 2006 and its financial status as at the same day prepared in accordance with accounting principles generally accepted in Hong Kong are set out on page 68 to page 140 of this annual report.

### Five year financial summary

A summary of the published results and assets, liabilities and minority interests of the Group for the last five years, as extracted from the audited financial statements and adjusted (in applicable), is set out in page 141 of this annual report. This summary does not form a part of the audited financial statements.

### Property, plant and equipment

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

### Share capital

Details of the changes in the Company's share capital, together with the reasons therefore, are set out in note 14 to the financial statements.

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

Save as is disclosed in this annual report, neither has the Company nor any of its subsidiaries purchased, redeemed or sold any of its shares during the year.

### Reserves

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

### Major customers and suppliers

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

#### Purchase

- largest supplier 3%
- five largest suppliers 10%

#### Sales

- largest customer 19%
- five largest customers 65%

Due to the varieties of the Company's production materials, the Company has not yet sought an established supplier with strength sufficient to provide a relatively high proportion of raw materials. Hence, the five largest suppliers represent 10% in total. None of the Directors, their respective associates or any shareholder who, as far as the Directors are aware, holds 5% or more of the Company equity interests had any interest in the above-mentioned major suppliers and customers.

## Report of the Directors (Continued)

### Election of Directors and Supervisors

#### Directors and Supervisors of the Company

The Directors and Supervisors during the year were as follows:

*Executive Directors:*

Xing Daoqin *Chairman*  
Tao Kui *Vice Chairman*  
Guo Mengquan *President*  
Zhang Shaowen  
Niu Xinan

*Non-executive Directors:*

Zhang Xingxi  
Yun Dah Jiunn

*Independent Non-executive Directors:*

Feng Fei  
Xu Xinzhong  
Feng Bing  
Wang Jialu  
Zha Jianqiu

*Supervisors:*

Fu Jiuquan  
Zhang Zhankui  
Zhang Weichuan  
Sun Haiying  
Wu Xiaoguang

Brief biographical details of Directors, Supervisors and Senior Management are set out on page 23 to 29.

Each of the independent non-executive Directors has issued a confirmation in respect of the factors set out in Rule 3.13 of the Listing Rules concerning his independence pursuant to Rule 3.15 of the Listing Rules. The Company considers all of the independent non-executive Directors to be independent.

The existing Directors and Supervisors of the Company were elected at the general meeting held on 9 September 2004, with a term of 3 years. On 29 June 2006 Mr. Niu Xinan was appointed Executive Director by the Board and Mr. Zhang Zhankui was appointed by the Supervisory Committee as supervisor. On 27 December 2006 Mr. Yun Dah Jiunn resigned from the position of chief financial controller and was re-designated from an Executive Director to a Non-executive Director.

## Report of the Directors (Continued)

### Remuneration of Directors and the five highest paid individuals

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

### Management contracts

Save for the contracts in relation to connected transactions as stated in this report, no contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

### Share Appreciation Rights Plan

Pursuant to the Share Appreciation Rights Plan of the Company (details of which were set out in the Company's prospectus dated 8 December 2004), up to 31 December 2006, the following Directors, Supervisor and senior management members were granted share appreciation rights by the Company as follows:

Name	Number of Share Appreciation Rights (Shares)	Note
Xing Daoqin	1,500,000	Director
Tao Kui	1,330,000	Director
Guo Mengquan	1,130,000	Director
Zhang Shaowen	1,000,000	Director
Yun Dah Jiunn	600,000	Director
Niu Xinan	400,000	Director
Zhang Weichuan	320,000	Supervisor
Zhang Chunning	670,000	Senior Management
Wang Ximin	670,000	Senior Management
Zhang Junhua	590,000	Senior Management
Li Miao	590,000	Senior Management

Note: Ng Yuk Keung owned 400,000 share appreciation rights as at 31 December 2006 as a senior management member. However, Ng Yu Keung has resigned as qualified accountant and joint company secretary of the Company on 26 August 2006 but still owned the 400,000 share appreciation rights. In 2007, the Company has granted further share appreciation rights to the following Directors, Supervisors and senior management, namely, Directors: Xing Daoqin for 700,000 shares, Tao Kui for 530,000 shares, Guo Mengquan for 530,000 shares, Zhang Shaowen for 400,000 shares, Niu Xinan for 400,000 shares; Supervisor: Zhang Weichuan for 200,000 shares; and senior management: Zhang Chunning for 300,000 shares, Wang Ximin for 300,000 shares, Li Mao for 300,000 shares, Zhang Junhua for 300,000 shares and Li Xikun for 300,000 shares.

## Report of the Directors (Continued)

### Directors' and Supervisors' equity interest

Save as to the interests mentioned in the section headed "Share Appreciation Rights Plan" above, as at 31 December 2006, none of the Directors, Supervisors or senior management members of the Company had any interest or short position in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")) which shall be recorded in the register of members required to be kept by the Company pursuant to section 352 of the SFO, or which was otherwise required to be notified to the Company or The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code"). During the year, none of the Directors, Supervisors or senior management members of the Company or their spouses or children under the age of 18 held the right to purchase the share capital or debentures of the Company, neither did they exercise such right.

### Directors' and Supervisors' interests in contracts

At end of the year and any time during the year, save for the service contract in relation to the Company's business, none of the Company, its holding company or subsidiaries entered into any contract of significance in which the Director or Supervisor of the Company held, either directly or indirectly, any material interest. For the year ended 31 December 2006, no Director or Supervisor of the Company gave up or agreed to give up any remuneration arrangement.

### Service contracts

The Company has entered service contracts with Directors and Supervisors. None of the Directors or proposed directors of the Company had any existing or proposed service contract with any member of the Group (excluding contracts expiring or terminable by the employer within a year without payment of any compensation (other than statutory compensation)).

## Report of the Directors (Continued)

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

Save as to the interests mentioned in the section headed "Share Appreciation Rights Plan" above, as at 31 December 2006, none of the Directors, Supervisors, Chief Executive or senior management members of the Company or their respective associates had any interest or short position in the shares, underlying shares and/or debentures (as the case may be) of the Company and / or any of its associated corporations (within the meaning of Part XV of the SFO) which was required to be notified to the Company and the Stock Exchange pursuant to the provisions of Divisions 7 and 8 of Part XV of the SFO (including interest and short positions which any such Directors, Supervisors, Chief Executive or senior management member was taken or deemed to have under such provisions of the SFO), or which was otherwise required to be entered in the register of interests to be kept by the Company pursuant to section 352 of the SFO, or which was otherwise required to be notified to the Company and the Stock Exchange pursuant to the Model Code as set out in Appendix 10 to the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules").

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

So far as the Directors are aware, each of the following persons, not being a Director, Supervisor, Chief Executive or member of the Company's senior management, had an interest or short position in the Company's shares or underlying shares (as the case may be) as at 31 December 2006 and as entered in the register of interests to be kept pursuant to section 336 of the SFO:

IRICO Group Corporation had interests in 1,455,880,000 Domestic Shares of the Company (representing 100% of the Domestic Share capital), whereas HKSCC Nominees Limited had interests in 483,889,990 H Shares of the Company (representing 99.71% of the H Share capital).

*Notes:*

As at 31 December 2006, based on the information available to Directors and so far as the Directors are aware, HKSCC Nominees Limited held 483,889,990 H Shares, among which:

J.P. Morgan Fleming Asset Management Holdings Inc. and J.P.Morgan Fleming Asset Management (Asia) Inc. through their controlled corporations had interests in 33,742,000 H Shares of the Company (representing approximately 6.95% of the H Share capital).

Pictet Asset Management on behalf of Pictet Funds Asian Equities had direct interests in 33,226,000 H Shares of the Company (representing approximately 6.85% of the H Share capital).

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

JF Asset Management Limited through its controlled corporations had interests in 33,198,000 H Shares of the Company (representing approximately 6.84% of the H Share capital).

## Report of the Directors (Continued)

### Designated deposit and overdue time deposit

As of 31 December 2006, the Group had no designated deposits in any financial institutions in the PRC. All of the Group's bank deposits are lodged in commercial banks in the PRC, and are in compliance with the relevant laws and regulations.

### Employees

As at 31 December 2006, the Group had 13,036 employees with various talents, of whom approximately 4.3% were management and administrative personnel, 5.6% were technological personnel, 0.7% were accounting and audit personnel, 0.6% were sales and marketing personnel, 85% were production employees and 3.5% were others. The employment and remuneration policy of the Company remained the same as set out in the Company's prospectus dated 8 December 2004. With full enthusiasm in work, the Group's employees are committed to ensure the high quality and reliability of products and services.

### Connected transactions

The connected transactions recorded during the year and up to the date of this report are as follows:

#### I. Continuing connected transactions during the year

For the year ended 31 December 2006, there were various continuing connected transactions between the Group and IRICO Group Corporation, IRICO Display, Xianyang IRICO Electronics Shadow Mask Co., Ltd. ("IRICO Shadow Mask"), IRICO Phosphor, Xianyang Cailian Packaging Material Company Limited ("Xianyang Cailian"), details of which are set out in the Company's prospectus dated 8 December 2004.

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

## Report of the Directors (Continued)

### Connected transactions (continued)

#### I. Continuing connected transactions during the year (continued)

For the year ended 31 December 2006, the approved annual cap and the actual revenue or expenditure in respect of each continuing connected transactions are set out below:

Item	Approved annual cap for 2006 RMB'000	Actual revenue or expenditure for 2006 RMB'000
Supply of fuel, coal, industrial chemicals products and raw materials to IRICO Group Corporation	96,844	22,920
Supply of parts and raw materials to IRICO Display, IRICO Phosphor and IRICO Shadow Mask	684,315	576,090
Purchase of foam plastics, gloves, wood brackets and raw materials from IRICO Group Corporation	231,218	123,086
Purchase of phosphor and shadow mask from IRICO Phosphor and IRICO Shadow Mask	228,025	166,967
Purchase of packaging materials, adhesive tapes and plastic materials from Xianyang Cailian	66,832	48,665
Utilities obtained from IRICO Group Corporation	696,793	454,899
Social and ancillary services obtained from IRICO Group Corporation		
(a) IRICO School	10,334	6,066
(b) Social welfare facilities	2,814	2,416
(c) Security services	800	800
(d) Environmental hyginene and landscaping services	1,200	100
Rental payable to IRICO Group Corporation	40,739	35,665
Land use rights leasing fees payable to IRICO Group Corporation	4,218	4,218
Trademark licensing fees payable to IRICO Group Corporation	7,800	3,828
Equipment Leasing fees payable to Xi'an Guangxin Electronic Co., Ltd.	1,500	—



## Report of the Directors (Continued)

### Connected transactions (*continued*)

#### I. Continuing connected transactions during the year (*continued*)

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

- (1) in the ordinary and usual course of business of the Group;
- (2) either on normal commercial terms or, if there are not sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Company than terms available to or from (as appropriate) independent third parties; and
- (3) in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

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

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

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

### Connected transactions (*continued*)

#### II. Post balance sheet date continuing connected transactions

As the conditional waiver granted by the Stock Exchange in respect of various continuing connected transactions in the year expired on 31 December 2006, the Company held an extraordinary general meeting on 27 December 2006 to seek the approval of independent shareholders of the extension for three financial years, subject to the terms of the renewed agreements, of the continuing connected transactions (with some modifications) with the above connected parties up to 31 December 2009 and of the annual caps of the the relevant extended continuing connected transactions. The renewed agreements in relation to the extended continuing connected transactions were duly signed on 27 December 2006 and were generally and unconditionally approved, confirmed and ratified by the independent shareholders. The terms and annual caps of the renewed agreements of the extended continuing connected transactions were contained in the circular to the shareholders of the Company published on 10 November 2006.

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

#### III. Post balance sheet date connected transactions

As mentioned in the announcement of the Company dated 7 March 2007, the Company entered into an agreement with Xianyang IRICO Electronics Shadow Mask Co., Ltd. ("IRICO Shadow Mask"), a subsidiary of the Company, of which the Company held 75% equity interest, pursuant to which the Company transferred to IRICO Shadow Mask all the equipment for shadow mask production and other related equipment held by the Company before entering into such agreement (the "Agreement"). The Agreement was effective on the date when it was signed. Please refer to the announcement of the Company dated 7 March 2007 for the relevant terms of the Agreement.

In respect of this connected transaction, the Company confirmed that it had complied with the relevant requirements set out in Chapter 14A of the Listing Rules.

### Bank loans

As at 31 December 2006, details of bank loans of the Group are set out in note 21 to the financial statements.

### Pre-emptive right

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

## Report of the Directors (Continued)

### Subsidiaries

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

### External guarantee

The Group does not have any external guarantee during the year ended 31 December 2006.

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

The Board appointed an independent professional valuer to evaluate the value of the production facilities and construction in progress. A provision for impairment of property, plant and equipment of the Group amounting to approximately RMB67,205,000 was made for 2006, of which a provision for diminution of value amounting to approximately RMB61,151,000 was made for K line planned for production of super large screen high definition flat CPTs, and provisions for diminution of value for other production lines amounted to approximately RMB6,054,000.

### Important Events

IRICO Display Devices Co., Ltd (“IRICO Display”) is a subsidiary of the Company with its A shares listed on the Shanghai Stock Exchange, in which the Company held 236,440,000 unlisted shares, representing 56.14% of the issued share capital of IRICO Display before the implementation of the Share Reform Proposal of IRICO Display. Pursuant to the rules and regulations issued by the related authorities of the PRC, including the “The Guidelines on Share Reform Proposals of Listed Companies” and “Provisions on Management of Share Reform Proposals of Listed Companies”, the Board proposed the Share Reform Proposal of IRICO Display, in which the Company agreed to offer to holder of every 10 listed A shares 3.5 to 4.2 unlisted shares to implement the Share Reform Proposal. IRICO Display completed the Share Reform Proposal in the period between 19 May 2006 and 31 July 2006, details of which were set out in the announcements dated 19 May, 2 June, 21 June and 20 July, and the circular dated 12 July 2006. Pursuant to the amended share reform plan, unlisted shareholders offered 4.2 unlisted shares in IRICO Display for every 10 listed A shares to the A shareholders of IRICO Display as of the consideration for the agreement to convert all unlisted shares into A shares of IRICO Display. After the implementation of the Revised Share Reform Proposal of IRICO Display, the Company held 180,675,565 shares in IRICO Display, representing approximately 42.9% of the issued share capital of IRICO Display, taking into account the 4,361,150 shares being the consideration shares paid by the Company on behalf of the 15 unlisted corporate shareholders. If the 15 unlisted corporate shareholders repay the 4,361,150 shares to the Company under the Revised Share Reform Proposal of IRICO Display, the Company will hold 185,036,715 shares in IRICO Display, representing approximately 43.94% of the issued share capital of IRICO Display. As the Company continues to control the majority of the Board and remain as the largest shareholder, the Company still has effective control on IRICO Display, and thus IRICO Display continues to remain as a subsidiary of the Company.

### Material litigation

- **The dispute between Xianyang Xingyun Mechanical Company Limited (“Xingyun”) and the Company**

On or about 19 June 2006, Xingyun brought an action against the Company in the People’s High Court of Shaanxi. The Company received a notice ((2006) Shaan Min Chu Zi No. 16) from the court on 20 June 2006 requesting the Company to respond to the action and produce evidence in relation thereto.

On 28 July 2003, five Confirmation Agreements on Parts and Materials (“Confirmation Agreements”) were entered into between Xingyun and the IRICO Colour Picture Tube Plant No. 1 CPT plant (彩虹彩色顯像管總廠彩管一廠) (“No. 1 CPT Plant”). According to the five Confirmation Agreements, Xingyun shall provide No. 1 CPT Plant with 5 types of parts samples including 37cm CPT model L shadow mask frame and anti-implosion band for mass pre-sale quality confirmation. In around February 2005, since the parties failed to agree on the price of bulk provision of goods upon the completion of the Confirmation Agreements, No. 1 CPT Plant notified Xingyun to suspend the provisions of parts as agreed in the Confirmation Agreements. Xingyun believes that this caused a total loss of RMB30,300,000 which was incurred from the investments in the construction of facilities and the purchase of materials.

The hearing of the case has ended. On 27th December 2006, the Company received a civil verdict ((2006) Shaan Min Er Chu Zi No. 16) from the People’s High Court of Shaanxi. The court ruled that the claim by Xingyun against the Company to bear its investment loss of RMB26,340,000 and its claim against the Company to bear its production loss of RMB3,960,000 were not justified and were dismissed. The court also ruled that, according to the principle of fairness, the Company should acquire finished products, semi-finished products and raw materials held by Xingyun in the value of RMB3,880,000 according to the quantities, types and prices determined by both parties. Those finished products, semi-finished products and raw materials can still be utilized in the process of production by the Company, and therefore no loss would be incurred.

The period allowed for appeal stipulated in the civil verdict ((2006) Shaan Min Er Chu Zi No. 16) expired on 14 January 2007, and Xingyun has not filed an appeal to the People’s Supreme Court of the PRC within such stipulated period.

On 11 April 2007, the Company received a writ of summons ((2007) Shaan Min Er Chu Zi No.10) from the People’s High Court of Shaanxi, and was informed that Xingyun brought an action for a second time against the Company in respect of the same matter.

In the opinion of the Directors of the Group, the outcome of the above litigation will not give rise to any significant impact on the Financial Report of the Group for the year ended 31 December 2006.

## Report of the Directors (Continued)

### Material litigation (*continued*)

- **Baystar Capital II, LP et al. v. Core-Pacific Yamaichi International (HK) Ltd. et al., Case No 05 1091 ABC (CWx) (filed in the United States District Court for the Central District of California) (the “Baystar Litigation”).**

On or about 11 February 2005, BayStar Capital Management, LLC and BaystarCapital II, LP (hereinafter collectively referred to as “Baystar”), holders of the Company’s H shares, commenced a litigation against Core-Pacific Yamaichi International (H.K.) Limited, et.al (hereinafter referred to as “CPYI”), one of the underwriters that offered the Company’s H shares to investors in the United States pursuant to Rule 144A of the Securities Act of the USA. Baystar alleges that it entered into a strategic business development agreement with CPYI, pursuant to which CPYI acted as an investment consultant to Baystar in the greater China area. Baystar claims that CPYI breached the agreement and its fiduciary duties to Baystar. In addition, Baystar alleges that CPYI made material misrepresentations and omissions to Baystar, in violation of United States federal and state securities laws and the common law. Baystar has not commenced any action against the Company.

On or about 20 May 2005, CPYI commenced a third-party action against the Company and the lead underwriter of the Company, as part of the Baystar Litigation. CPYI seeks contractual and common law indemnification and / or contribution from the Company in the event that CPYI is found liable to Baystar.

A copy of the third-party complaint was served by Law Debenture Society on the Company on or about 11 June 2005. The Company has retained a law firm to represent the Company in the litigation. On 18 August 2005, such law firm filed a motion to dismiss the third-party complaint in its entirety. On 13 October 2005, the Court granted in part and denied in part the motion to dismiss. Thereafter, on 7 November 2005, the Company filed an answer to CPYI’s claims, denying all liability.

Because no party has identified a single material misrepresentation or omission made by the Company in the offering circular, the Company filed a motion for summary judgement on 15 May 2006. On 9 August 2006 the Court partly dismissed the motion, and the discovery procedure and the expected litigation procedure continued to proceed. Pursuant to the schedule approved by the Court, the closing date of the discovery procedure was postponed to 1 December 2006. The trial by jury will start on 1 May 2007. The discovery procedure has now ended.

As there is no significant facts or evidence unfavourable to the Company, according to legal advice, the Company will file a motion for summary judgment again in the near future, expecting the litigation to end as soon as possible.

The result of the above case will not have material impact on the 2006 financial statements of the Group.

## Report of the Directors (Continued)

### Code on Corporate Governance Practices

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

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

### Model Code

The Company has adopted the Model Code set out in Appendix 10 to the Listing Rules. Having made specific enquiry of all Directors, the Company has confirmed that all Directors have complied with the requirements set out in the Model Code.

### Public float

Based on the information that is publicly available to the Company and within the knowledge of the Directors, as at the date of this report, the Directors believe that the relevant minimum percentage applicable to listed securities was maintained throughout the reporting period.

### Auditors

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

The Company has not changed the auditors in the past three financial years.

By order of the Board  
**Xing Daoqin**  
*Chairman*

Xianyang, the PRC  
12 April 2007