

# Report of the Directors

The board of directors ("the Board") of the Company presents their report together with the audited financial statements of CATIC Shenzhen Holdings Limited ("the Company") and its subsidiaries (together "the Group") for the year ended 31st December 2006.

## PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. Details of the current principal activities of its subsidiaries are set out in note 21 to the financial statements.

The Group is principally engaged in the design, manufacture and sale of certain industry and consumer electronic products, including LCD, PCB and mechanical and quartz timepieces. While consolidating the development of its existing businesses, the Company will also focus on the strategic goal of "realization of limited diversification" to seek and explore new businesses in a timely manner. The Company's successful acquisition of Guangdong International Building Industrial Company Limited (廣東國際大廈實業有限公司) in January 2007 marked the Company's first foray into the commercial property domain.

Details of the contribution from each of the businesses to profit attributable to shareholders of the Group for the year ended 31st December 2006 are set out in the business review under the section "Management Discussion and Analysis".

## SUBSIDIARIES

Information on the principal subsidiaries and associated companies of the Company is set out in note 21 and 22 to the financial statements respectively.

## GEOGRAPHICAL LOCATION OF MARKETS

Information on major markets of the Group is set out in note 5 to the financial statements.

## RESULTS

Details of the Group's results for the year ended 31st December 2006 are set out in the consolidated income statement of the financial statements.

## DISTRIBUTABLE RESERVES

As at 31st December 2006, the distributable reserves of the Group were RMB58,481,781 as reported in the statutory accounts prepared in accordance with generally accepted accounting principles in the People's Republic of China.

## PROFIT ALLOCATION

According to the Company Law of the PRC and the Articles of Association of the Company, when distributing net profit each year, the Company shall set aside 10% of its net profit as reported in the PRC statutory accounts for the statutory common reserve fund (except where the fund has reached 50% of the Company's registered share capital). This reserve cannot be used for purposes other than those for which they are created and are not distributable as cash dividends.

The statutory common reserve fund may be converted into share capital provided that it is approved by a resolution at a general meeting and the balance of the statutory common reserve fund does not fall below 25% of the registered share capital.

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**PROFIT ALLOCATION** *(continued)*

Prior to the revised Company Law of PRC which came into effect in late 2005, 5% to 10% of the net profits was required to be appropriated to the statutory common welfare fund, which was used for the collective welfare of the staff and workers of the Group. The revised Company Law ceased such appropriation. The remaining balance of this fund at 1st January 2006 has been transferred to the statutory common reserve fund in accordance with the regulations promulgated by the Ministry of Finance of the PRC.

For the year ended 31st December 2006, the directors of the Company proposed the following appropriation to the statutory common reserve fund:

	2006		2005	
	Percentage	RMB'000	Percentage	RMB'000
Statutory common reserve fund	10%	10,592	10%	586
Statutory common welfare fund	–	–	8%	468
	10%	10,592	18%	1,054

**DIVIDENDS**

Given that the Group declared an interim dividend (RMB6 cents per share, totaling RMB38,520,000) for the six months ended 30th June 2006 through Bank of China (Hong Kong) Trustees Limited on 31st October 2006, the Board did not recommend a final dividend for the year ended 31st December 2006.

**FIVE YEAR FINANCIAL SUMMARY**

A summary of the Group's operating results, assets and liabilities for the past five years ended 31st December 2006 is set out in the section headed "Financial Summary" of this Annual Report.

**MANAGEMENT CONTRACTS**

In the year, the Company did not sign or maintain any contracts in respect of the management or administration of overall business or any major business.

**MAJOR CUSTOMERS AND SUPPLIERS**

The Group's purchases from the five largest suppliers did not exceed 30% of the Group's total purchases for the year ended 31st December 2006. Approximately 7.12% (2005: 6.04%) of the Group's purchases was attributed to the largest supplier.

The Group's five largest customers accounted for approximately 30.89% (2005: 35.61%) of the Group's turnover for the year ended 31st December 2006. Approximately 13.62% (2005: 18.61%) of the Group's turnover was attributed to the largest customer.

As at 31st December 2006, the Company, together with its subsidiary Fiyta, held about 3.7% equity interest in the largest customer of the Group. Save as aforesaid, as at 31st December 2006, none of the Directors, their associates, or any shareholders (who, to the knowledge of the Directors, owns more than 5% of the Company's share capital) had any beneficial interest in the Group's five largest customers and five largest suppliers.

**INVESTMENT PROPERTY**

Details of major properties held for investment of the Group are set out in note 18 to the financial statements.

## Report of the Directors

### PLEDGED ASSETS

Information on the pledged assets of the Group for the year is set out in note 17 to the financial statements.

### BANK LOANS

Information on the bank loans of the Group for the year is set out in note 31 to the financial statements.

### ENTRUSTED DEPOSITS AND OVERDUE TERM DEPOSITS

During the year ended 31st December 2006, the Company did not have any entrusted deposits or overdue term deposits in any form.

### TAXATION

Details of the Group's taxation for the year are set out in note 12 to the financial statements.

### TAXATION POLICY

The Company's taxation was determined under the relevant income tax laws of PRC and the tax relief policy of the Shenzhen Special Economic Zone, as applicable including 15% enterprise income tax, while companies established in other areas are subject to income tax at a rate of 33%.

### SUBSTANTIAL SHAREHOLDER

As at 31st December 2006, as far as was known to the Directors or the chief executive of the Company, the following are the details of the persons (other than the Directors, supervisors or chief executive of the Company) who had an interest or short position in the shares and underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the Securities and Futures Ordinance ("SFO") or had otherwise notified to the Company:

#### Long position in the shares:

Name of shareholder	Capacity	Number and class of securities	Approximate percentage of the same class of securities	Approximate percentage of total registered share capital
<b>Substantial Shareholders</b>				
China Aviation Industry Corporation I (中國航空工業第一集團公司) (Note 1)	Interest of controlled corporation	400,000,000 domestic legal person shares	100%	62.89%
China Aviation Industry Corporation II (中國航空工業第二集團公司) (Note 2)	Interest of controlled corporation	400,000,000 domestic legal person shares	100%	62.89%
China National Aero-Technology Import and Export Corporation (中國航空技術進出口總公司) (Note 3)	Interest of controlled corporation	400,000,000 domestic legal person shares	100%	62.89%

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**SUBSTANTIAL SHAREHOLDER** *(continued)*

Name of shareholder	Capacity	Number and class of securities	Approximate percentage of the same class of securities	Approximate percentage of total registered share capital
<b>Substantial Shareholders</b> <i>(continued)</i>				
CATIC Shenzhen Company <i>(Note 4)</i>	Beneficial owner	400,000,000 domestic legal person shares	100%	62.89%
<b>Other Shareholders</b>				
Li Ka-Shing	Interest of controlled corporations and founder of discretionary trusts	15,156,000 H shares <i>(Note5)</i>	6.42%	2.38%
Cheung Kong (Holdings) Limited	Interest of controlled corporation	15,156,000 H shares <i>(Note5)</i>	6.42%	2.38%
Li Ka-Shing Unity Trustee Corporation Limited	Trustee and beneficiary of a trust	15,156,000 H shares <i>(Note5)</i>	6.42%	2.38%
Li Ka-Shing Unity Trustcorp Limited	Trustee and beneficiary of a trust	15,156,000 H shares <i>(Note5)</i>	6.42%	2.38%
Li Ka-Shing Unity Trustee Company Limited	Trustee and beneficiary of a trust	15,156,000 H shares <i>(Note5)</i>	6.42%	2.38%
華銀集團投資發展有限公司	Beneficial owner	19,146,000 H shares	8.11%	3.01%
Jiang Jian Jun <i>(Note 6)</i>	Interest of controlled corporation	19,146,000 H shares	8.11%	3.01%

## Report of the Directors

**SUBSTANTIAL SHAREHOLDER** *(continued)*

Note:

- (1) China Aviation Industry Corporation I (中國航空工業第一集團公司) owns 50% interest in China National Aero-Technology Import and Export Corporation (中國航空技術進出口總公司) which in turn owns 100% interest in CATIC Shenzhen Company ("CATIC Shenzhen"). Hence it is deemed to be interested in the shares owned by CATIC Shenzhen;
- (2) China Aviation Industry Corporation II (中國航空工業第二集團公司) owns 50% interest in China National Aero-Technology Import and Export Corporation (中國航空技術進出口總公司) which in turn owns 100% interest in CATIC Shenzhen. Hence it is deemed to be interested in the shares owned by CATIC Shenzhen;
- (3) China National Aero-Technology Import and Export Corporation (中國航空技術進出口總公司) owns 100% interest in CATIC Shenzhen. Hence it is deemed to be interested in the shares owned by CATIC Shenzhen;
- (4) Details of the Directors of the Company who also hold positions in the substantial shareholders as disclosed herein, have been stated in the section headed "Directors, Supervisors and Senior Management" in this report.
- (5) The above five references to the same equity interest of 15,156,000 H shares in the Company comprise:
  - (A) The 7,578,000 H shares held by Empire Grand Limited ("Empire Grand"), a wholly-owned subsidiary of Cheung Kong Investment Company Limited, which in turn is a wholly-owned subsidiary of Cheung Kong (Holdings) Limited ("CKH"); and
  - (B) The 7,578,000 H shares held by Hutchison International Limited ("HIL") which is a wholly-owned subsidiary of Hutchison Whampoa Limited ("HWL").

Li Ka-Shing Unity Holdings Limited, of which each of Mr. Li Ka-shing, Mr. Li Tzar Kuoi, Victor and Mr. Li Tzar Kai, Richard is interested in one-third of the entire issued share capital, owns the entire issued share capital of Li Ka-Shing Unity Trustee Company Limited ("TUT1"). TUT1 as trustee of the Li Ka-Shing Unity Trust, together with certain companies which TUT1 as trustee of the Li Ka-Shing Unity Trust is entitled to exercise or control the exercise of more than one-third of the voting power at their general meetings, hold more than one-third of the issued share capital of CKH. Certain subsidiaries of CKH are entitled to exercise or control the exercise of more than one-third of the voting power at the general meetings of HWL.

In addition, Li Ka-Shing Unity Holdings Limited also owns the entire issued share capital of Li Ka-Shing Unity Trustee Corporation Limited ("TDT1") as trustee of the Li Ka-Shing Unity Discretionary Trust ("DT1") and Li Ka-Shing Unity Trustcorp Limited ("TDT2") as trustee of another discretionary trust ("DT2"). Each of TDT1 and TDT2 holds units in The Li Ka-Shing Unity Trust.

By virtue of the SFO, each of Mr. Li Ka-shing, being the settlor and may being regarded as a founder of each of DT1 and DT2 for the purpose of the SFO, TUT1, TDT1, TDT2 and CKH is deemed to be interested in the aggregate 15,156,000 H shares of the Company held by Empire Grand and HIL.

- (6) Jiang Jian Jun was interested by virtue of his/her 100% beneficial interest in 華銀集團投資發展有限公司.

## SHARE CAPITAL

Details of the share capital of the Company are set out in note 33 to the financial statements.

## PURCHASE, SALE OR REPURCHASE OF SHARES

During the period from 11th August 2006 to 29th August 2006, the Company repurchased 6,000,000 overseas listed foreign invested shares ("H Shares") at a price ranging from HK\$1.5 to HK\$1.66 and a total consideration of HK\$9,701,761 on The Stock Exchange of Hong Kong Limited under the repurchase mandate granted at 2005 Annual General Meeting held on 13th June 2006. After the repurchase of H Shares, the Company has 636,000,000 shares in total, including 400,000,000 domestic legal person shares and 236,000,000 H Shares.

Save as disclosed above, neither the Company nor any of its subsidiaries purchased, sold or repurchased any of the Company's listed shares during the year ended 31st December 2006.

## PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Articles of Association and the laws of the People's Republic of China, which provides the existing shareholders with pre-emptive rights to purchase new shares in any new issue of the Company according to their respective proportions of shareholding.

## DIRECTORS AND DIRECTORS' SERVICE CONTRACTS

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

### Executive Directors

Mr. Wu Guang Quan	<i>Chairman</i>
Mr. Lai Wei Xuan	
Mr. Sui Yong	
Mr. Yan Hai Zhong	(resigned on 13th June 2006)
Mr. Cheng Bao Zhong	(appointed on 13th June 2006)
Mr. Liu Rui Lin	
Mr. Xu Dong Sheng	
Mr. You Lei	
Mr. Wang Bao Ying	

### Independent Non-executive Directors

Mr. Poon Chiu Kwok  
Mr. Eugene Liu  
Mr. Liu Xian Fa

### Non-executive Directors

Mr. Wang Bin Bin  
Mr. Li Cheng Ning

Each of the executive Directors has entered into a service contract with the Company. Unless otherwise specified, terms of such contracts, which are identical in all material respects, are as follows:

- (i) Each of the service contracts will expire at the conclusion of the 2008 annual general meeting to be held in 2009, subject to the termination provisions contained therein;
- (ii) The annual basic salaries and aggregate allowances payable to the executive Directors is RMB1,839,000 (details set out in note 9 to the financial statements); and
- (iii) Each of the executive Directors is entitled to a discretionary annual bonus determined by the Board based on the Group's salary policy.

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### **DIRECTORS AND DIRECTORS' SERVICE CONTRACTS** *(continued)*

Each service contract of the independent non-executive Directors will expire at the conclusion of the 2008 annual general meeting to be held in 2009, subject to the termination provisions contained therein. The emolument payable to the independent non-executive Director is totally RMB352,000 per annum (including: HKD300,000, equivalent to approximate RMB302,000) (details set out in note 9 to the financial statements).

Each service contract of the non-executive Directors will expire at the conclusion of the 2008 annual general meeting to be held in 2009, subject to the termination provisions contained therein. The emolument payable to the non-executive Directors is totally RMB100,000 per annum (details set out in note 9 to the financial statements).

No Director and Supervisor of the Company has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

### **PROFILE OF DIRECTORS AND SENIOR MANAGEMENT**

Profiles of the Directors and Senior Management are set out in the section headed "Directors, Supervisors and Senior Management" in this Annual Report.

### **DIRECTORS' AND SUPERVISORS' INTERESTS IN SHARES**

As at 31st December 2006, so far as is known to the Directors and the chief executive of the Company, none of the Directors or supervisors or chief executive of the Company is interested in the shares, underlying shares or debentures of the Company and any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which the Directors or supervisors or chief executives were taken or deemed to have under such provisions of the SFO) or which are required to be entered into the register maintained by the Company under section 352 of the SFO or which are required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers.

### **DIRECTORS' AND SUPERVISORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES**

At no time during the year ended 31st December 2006 was the Company and any of its subsidiaries or its holding company a party to any arrangement to enable any of the Company's Directors, Supervisors or members of its management to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

### **DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS**

No contracts or arrangements of significance in relation to the Company's business to which the Company was a party and in which the Directors and Supervisors of the Company had material interests, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

### **EMOLUMENTS OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT**

Details of the emoluments of Directors and Supervisors are set out in note 9 to the financial statements.

## CHANGES OF DIRECTORS, SUPERVISORS AND SENIOR MANAGEMENT MEMBERS

The term of office of the third session of the board of directors and supervisory committee of the Company ended at the close of the 2005 annual general meeting of the Company held on 13th June 2006 (the "AGM"). Pursuant to the Articles of Association of the Company, the shareholders of the Company re-elected/elected new directors and supervisors in the AGM. Mr. Wu Guang Quan, Mr. Lai Wei Xuan, Mr. Sui Yong, Mr. Liu Rui Lin, Mr. Xu Dong Sheng, Mr. You Lei, Mr. Wang Bao Ying and Mr. Cheng Bao Zhong were re-elected/elected as executive directors of the fourth session of the board of the Company; Mr. Wang Bin Bin and Mr. Li Cheng Ning were re-elected as non-executive directors of the fourth session of the board of the Company, and Mr. Poon Chiu Kwok, Mr. Eugene Liu and Mr. Liu Xian Fa were re-elected as independent non-executive directors of the fourth session of the board of the Company. Mr. Chen Gang, Mr. Huang Gao Jian and Mr. Sheng Fan were re-elected/elected as supervisors of the fourth session supervisory committee of the Company.

The respective term of office of all the above Directors and Supervisors is three years from the date of the AGM to the date on which the 2008 annual general meeting of the Company is held.

Mr. Yan Hai Zhong has resigned as an executive director of the Company with effect from the close of the AGM due to his retirement.

Mr. Shao Ke Xiong has resigned as a supervisor of the Company with effect from the close of the AGM due to his transfer to a new assignment.

Mr. Diao Wei Cheng has resigned as a supervisor of the Company with effect from the close of the AGM due to his transfer to a new assignment.

## EMPLOYEES AND SALARIES

As at 31st December 2006, the Group had a total of approximately 8,619 employees (2005: 6,886 employees), with employee related costs of approximately 293,290,000 (2005: RMB256,872,000). The additional staff members were mainly employed to meet the business development demands of the Group. The Group formulated its competitive salary policy based on the reference of market condition and individual employee's performance.

## SOCIAL INSURANCE SCHEMES

Details of the Retirement Fund Scheme and Health Insurance Scheme maintained by the Group are set out in note 11 to the financial statements.

## SIGNIFICANT CONNECTED TRANSACTIONS

During the year ended 31st December 2006 particulars of significant contracts entered into between the Group and its controlling shareholders or any of its subsidiaries are as follows:

### 1. Letting and Lease

Details of the leases entered into between the Group and CATIC Shenzhen's connected companies as at 31st December 2006 are set out in note 36(a) to the financial statements.

### 2. Loan From CATIC Shenzhen

Details of the loan entered into between the Group's subsidiaries and CATIC Shenzhen as at 31st December 2006 are set out in note 31(a) and 36(c) to the financial statements.



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### **SIGNIFICANT CONNECTED TRANSACTIONS** *(continued)*

#### **3. Loan Guaranteed by CATIC Shenzhen**

Details of the guarantee entered into between the Group's subsidiaries and CATIC Shenzhen as at 31st December 2006 are set out in note 31(a) and 36(a) to the financial statements.

#### **4.** Details of other significant connected transactions of the Group during the year are set out under the section of "OTHER SIGNIFICANT EVENTS".

### **INDEPENDENT DIRECTORS' CONFIRMATION IN RESPECT OF THE CONNECTED TRANSACTIONS**

The independent non-executive Directors of the Company have reviewed the above connected transactions and confirm that the transactions have been entered into:

- (1) in the ordinary and usual course of business of the Company;
- (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.

### **CONTINGENT LIABILITIES**

The Company provided a one-year guarantee for a loan of RMB140,000,000 in favour of Fiyta, a subsidiary of the Company, and a one-year guarantee for a credit facility of RMB5,000,000 in favour of Maiwei, a subsidiary of the Company.

### **MATERIAL LITIGATION**

During the year, the Group did not have any material litigation.

### **OTHER SIGNIFICANT EVENTS**

#### **1. Tian Ma proposed to issue additional 80 million shares**

The board of directors of Tian Ma, a non-wholly owned subsidiary of the Company and the shares of which are listed on the Shenzhen Stock Exchange, proposed to issue not more than 80,000,000 circulating shares to a limited number of institutional investors. The relevant proposal was approved at the second temporary meeting 2006 of the 4th board of directors of Tian Ma held on 11th July 2006 and was approved by the board of directors of the Company on 11th July 2006.

The relevant proposal constitutes a major transaction under the Listing Rules. As such, the Company made an announcement on 11th July 2006 and a circular on 26th July 2006 in this respect. The said approval was granted by the shareholders in the extraordinary general meeting and the class meetings of the Company and the general meeting of Tian Ma. As at the date of this report, the relevant proposal has obtained the conditional approval from China Securities Regulatory Commission.

**OTHER SIGNIFICANT EVENTS** *(continued)***2. Formation of Joint Venture – Shanghai Tian Ma Microelectronics Company Limited**

On 1st December 2005, the Company, Tian Ma, Shanghai Industrial Investment (Group) Company Limited (上海工業投資(集團)有限公司), Shanghai State-owned Assets Management Company Limited (上海國有資產經營有限公司) and Shanghai Zhang Jiang (Group) Company Limited (上海張江(集團)有限公司) entered into a joint venture agreement and a supplemented agreement, to establish a joint venture named as Shanghai Tian Ma Microelectronics Company Limited (上海天馬微電子有限公司), for the purpose of engaging in the construction and operation of production line in the 4.5 generation tube size thin film transistor liquid-crystal display ("TFT-LCD"). The relevant arrangement has been approved by the shareholders in the extraordinary general meeting held on 28th March 2006 under the Listing Rules. The project as a whole is on schedule. The land title certification was granted at the end of January, 2007 and the construction work has been fully carried out. The open tender and direct procurement on production and auxiliary equipment are mostly completed.

**3. Share Segregation Reform**

According to the share segregation reform requirements of the China Securities Regulatory Commission (中國證券監督管理委員會), the Company, being the holder of the non-circulating shares of the three A share issuers, namely Fiyta, Tian Ma and Shenzhen Nanguang (Group) PLC ("Nanguang") (深圳市南光(集團)股份有限公司), agreed the share segregation reforms proposed by the three companies. The share segregation reforms of Tian Ma and Nanguang were completed in April 2006 and the total consideration in relation thereto was RMB63,978,585 (RMB58,999,434 for Tian Ma and RMB4,979,151 for Nanguang). As CATIC Shenzhen Company, the controlling shareholder of the Company, was one of the Nanguang Non-circulating shares shareholders, the transfer of shares of Nanguang by the Company to the Nanguang A shares shareholders constituted a connected transaction of the Company under Chapter 14A of the Listing Rules. The Company complied with the reporting and announcement requirements under the Listing Rules. The Company holds 52.62% shares of Tian Ma and 10.70% shares of Nanguang after the share segregation reforms. The share segregation reform of Fiyta was not approved by the shareholders of Fiyta. As at the date of this report, the new proposal of Fiyta has not been formulated yet. Fiyta will re-consider restarting the procedures of share reform at a proper time according to relevant laws and regulations.

**4. Subscription of Nanguang new shares**

On 31st October 2006, the Board announced that Nanguang proposed to issue not more than 140,000,000 Nanguang new shares to not more than 10 designated investors. The Company intends to subscribe for not more than 26,595,744 but not less than 24,177,949 Nanguang new shares at a price range from RMB7.52 to RMB8.272 per Nanguang new share. The total subscription price payable by the Company shall not exceed RMB200,000,000. The subscription constituted a connected transaction of the Company due to the fact that a promoter and controlling shareholder of the Company, CATIC Shenzhen Company, was a substantial shareholder of Nanguang. The Company has complied with the reporting, announcement and independent shareholders' approval requirements according to the Listing Rules. For more details, please refer to the circular of the Company dated 21st November 2006. As at the date of this report, the relevant proposal was approved conditionally by China Securities Regulatory Commission. The Company will confirm whether to make the subscription depending on the prevailing market conditions and market price of the shares of Nanguang upon the launch of the Nanguang issue and the final subscription price.

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**OTHER SIGNIFICANT EVENTS** *(continued)***5. Short-term Commercial Paper Program**

The Company proposed to issue short-term commercial papers with an amount not exceeding RMB450,000,000. The matters relating to the short-term commercial papers were considered and approved in the Board meeting held on 24th August 2006. As such, the Company made an announcement on 31st August 2006 in this respect. Approval was granted by the shareholders in the extraordinary general meeting held on 18th October 2006.

According to the Regulations on the Administration of Short-term Commercial Papers (短期融資券管理辦法), the said commercial papers will be issued to institutional investors approved by the People's Bank of China, who participate in the inter-bank debt market (銀行間債券市場) in the People's Republic of China. The term of maturity of the commercial papers shall not be more than 365 days from the date of issue and the interest rates shall be determined in accordance with the market circumstances. The proceeds of these commercial papers will mainly be used as working capital for operation of the Company, with a view to reducing the costs of financing of the Company and improving the financing structure.

**6. Capital Increase Agreement**

On 22nd September 2006, K-Bridge Electronics Co., Ltd ("K-Bridge") agreed to increase its capital contribution in an amount of USD360,000 (i.e. RMB2,910,000) to the joint venture company, Shenzhen CAERO Inc. ("CAERO") from RMB4,000,000 to RMB6,910,000 pursuant to the Capital Increase Agreement entered into between the Company, K-Bridge and Shenzhen CATIC Commerce & Trading Corporation ("CATIC Commerce Corporation"). After the increase, the registered capital of CAERO will be increased from RMB10,000,000 to RMB12,910,000. Therefore, K-Bridge' shareholding in CAERO will be increased from 40% to 53.52%, and the Company's shareholding in CAERO will be decreased from 51% to 39.51%. K-Bridge was a substantial shareholder of CAERO, which was a subsidiary of the Company. Therefore, K-Bridge was a connected person of the Company. CATIC Commerce Corporation was wholly owned by CATIC Shenzhen Company, the promoter and substantial shareholder of the Company. Therefore, CATIC Commerce Corporation was also a connected person of the Company. The entering into the Capital Increase Agreement constituted a connected transaction of the Company. The Company has complied with the reporting and announcement requirements according to the Listing Rules.

As at 31st December 2006, the relevant procedures for capital increase were still under way.

**7. Disposal of 64.5% Equity Interest of the Mould Company**

On 25th January 2006, the Company entered into an agreement ("the Agreement") with Shan'xi Baocheng Aviation Science & Technology Corporation (陝西寶成航空科技有限公司) ("Baocheng Company"), pursuant to which the Company agreed to dispose its 64.5% equity interest of Shenzhen Aero-Precision Mould and Plastic Co., Ltd. (深圳航空精密模具塑膠製品公司) to the Baocheng Company ("the Disposal") for a consideration of RMB9,833,500. Baocheng Company was 49% beneficially and indirectly owned by China Aviation Industry Corporation I ("China Aviation I"). China Aviation I also indirectly held 50% of CATIC Shenzhen Company, which was a promoter and controlling shareholder of the Company. Baocheng Company was considered as a connected person of the Company and the Disposal constituted a connected transaction for the Company. The Company has complied with the reporting and announcement requirements according to the Listing Rules.

The Disposal was completed on 7th March 2006.

**OTHER SIGNIFICANT EVENTS** *(continued)***8. Concessionaire Framework Agreement**

On 10th August 2006, Fiyta, a non-wholly owned subsidiary of the Company, entered into the Concessionaire Framework Agreement with Shenzhen Rainbow Department Stores Co, Ltd ("Shenzhen Rainbow"), pursuant to which Fiyta is allowed to occupy designated areas in the Rainbow Department Stores owned by Shenzhen Rainbow and establish its own sales counters for the sale of Fiyta watches and world-famous watches, etc. for a term commencing from 10th August 2006 to 31st December 2008. It is agreed that the annual cap of the turnover commission payable by Fiyta to Shenzhen Rainbow under the Concessionaire Framework Agreement will not exceed RMB3,000,000, RMB7,000,000 and RMB9,000,000 respectively for the twelve-month periods ending 31st December 2006, 31st December 2007 and 31st December 2008, respectively.

Since Shenzhen Rainbow was controlled by CATIC Shenzhen Company, a promoter and a controlling shareholder of the Company, it was considered as a connected person of the Company under Chapter 14A of the Listing Rules and the Concessionaire Framework Agreement constituted a continuing connected transaction of the Company. The Company has complied with the reporting and announcement requirements according to the Listing Rules.

The independent non-executive Directors of the Company have reviewed the above continuing connected transaction and confirm that the transaction has been entered into:

- (1) in the ordinary and usual course of business of the Company;
- (2) either on normal commercial terms or, if there are not sufficient comparable transactions to judge whether it is 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.

**SUBSEQUENT EVENTS****1. Acquisition of 75% of the investment interest and the transferred debt in the Industrial Company**

On 30th January 2007, the Company entered into a transfer agreement (the "Transfer Agreement") with 廣東國際信託投資公司破產清算組 (Insolvency and Liquidation Committee of Guangdong International Trust Investment Company), 深圳市一浪投資有限公司 (Shenzhen Yilang Investment Company Limited) ("Shenzhen Yilang") and CATIC Shenzhen Company, and a cooperation agreement (the "Cooperation Agreement") with Shenzhen Yilang and CATIC Shenzhen Company, pursuant to which the Company would acquire the 75% investment in 廣東國際大廈實業有限公司 (Guangdong International Building Industrial Company Limited) and a debt of RMB630,000,000. The Company has complied with the reporting, announcement and independent shareholders' approval requirements according to the Listing Rules. Further details please refer to the circular of the Company dated 29th March 2007.

The Cooperation Agreement and the Transfer Agreement and the transactions contemplated thereunder were approved at the extraordinary general meeting held on 14th May 2007.

## Report of the Directors

### SUBSEQUENT EVENTS *(continued)*

#### 2. Proposed change of company name and proposed amendment to articles of association

In order to devote its efforts to seek continuous and sustainable development and diversify its operations, on 30th March 2007, the Board proposed to change the Chinese name of the Company from 深圳中航實業股份有限公司 to 深圳中航集團股份有限公司. The English name of the Company will remain unchanged. The articles of association of the Company will be proposed to be amended to cater for the proposed change of the Company's name.

The proposed change of the Company name will not affect any rights of any shareholder of the Company. All existing H share certificates of the Company in issue bearing the existing name of the Company will, following the effective change of the name of the Company, continue to be evidence of the title to the H Shares and valid for trading, settlement and registration purposes. There will be no arrangement for exchange of share certificate. Following the effective change of the name of the Company, share certificates for the new shares of the Company will be issued in the new name of the Company. Further details please refer to the circular of the Company dated 4th April 2007.

The proposal was approved at the extraordinary general meeting held on 21st May 2007.

### COMPLIANCE WITH THE CODE

The Company has complied with all the code provisions of the Code on Corporate Governance Practices (the "Code"), as set out in Appendix 14 of the Listing Rules throughout the financial year ended 31st December 2006, save and except that the positions of the Company's Chairman and Chief Executive Officer (General Manager) were originally assumed by Mr. Wu Guang Quan. In order to better comply with the provisions of the Code, in the Board meeting held on 13th April 2007, the Board passed a resolution to approve the resignation of Mr. Wu Guang Quan as General Manager. The Board is currently in the process of seeking a new General Manager. Since the Company is a holding company without daily operation businesses, the temporary vacant of General Manager has no material effect on the Company.

### CONDUCT ON SHARE DEALINGS

The Model Code for Securities Transactions by Directors of Listed Companies set out in Appendix 10 of the Listing Rules has been adopted as a code of securities transactions for directors and supervisors of the Company. The Company, having made specific enquiries with its Directors and supervisors, confirms that, throughout the financial year ended 31st December 2006, all Directors and supervisors met the criteria laid down in the said code of securities transactions by Directors and supervisors.

### AUDIT COMMITTEE

The Board has formed an audit committee in accordance with the Listing Rules to fulfill the functions of reviewing and monitoring the financial reporting and internal control of the Company. The Audit Committee has reviewed and approved the Company's results announcement and financial statements for the twelve months ended 31st December 2006. The Audit Committee of the Company now comprises Mr. Poon Chiu Kwok, Mr. Eugene Liu and Mr. Liu Xian Fa, all of whom are independent non-executive Directors.

### INDEPENDENCY OF INDEPENDENT NON-EXECUTIVE DIRECTORS

The Board of the Company has obtained written confirmations from all independent non-executive Directors concerning their independence in accordance with Rule 3.13 of the Listing Rules. The Directors believe that the incumbent independent non-executive directors are independent based on the guidelines set out in rule 3.13 of the Listing Rules.

## PUBLIC FLOAT

Based on the publicly available information and to the best knowledge of the Directors, the Company has maintained sufficient public float as at the latest practicable date prior to the date of this annual report.

## AUDITORS

The financial statements for the year ended 31st December 2006 have been audited by PricewaterhouseCoopers. The appointment of PricewaterhouseCoopers as the Company's auditors for the year 2006 will be proposed at the 2006 Annual General Meeting for the confirmation. A resolution to re-appoint PricewaterhouseCoopers as the Company's auditors for the year 2007 will be proposed at the forthcoming 2006 Annual General Meeting.

## CHANGES OF AUDITORS

On 10th January 2007, the Company announced that PricewaterhouseCoopers ("PwC") was terminated as the auditors of the Company with effect from 13th November 2006 and on 10th January 2007 the Company appointed Deloitte Touche Tohmatsu ("Deloitte") as the new auditors of the Company to fill in the vacancy left by the termination of PwC and to hold office until the conclusion of the next annual general meeting of the Company.

On 27th April 2007, the Company announced that Deloitte was terminated as the auditors of the Company with effect from 18th April 2007 and the Company had approached other auditors to fill in the vacancy left by the termination of Deloitte and to hold office until the conclusion of the next annual general meeting of the Company.

On 10th May 2007, the Company further announced that with effect from 10th May 2007, PwC has been appointed as the new auditors of the Company to fill in the vacancy left by the termination of Deloitte and to hold office until the conclusion of the next annual general meeting of the Company.

By Order of the Board

**Wu Guang Quan**

*Chairman*

Shenzhen, PRC, 6th June 2007