Solomon Systech (International) Limited
HKSE : 2878
Annual Report 2006

SOLOMON
SYSTECH

SOLOMON SYSTECH
BUILDING ON CHANGE
MAKING A DIFFERENCE

solutions in silicon

Contents

Corporate Profile

Solomon Systech (International) Limited and its subsidiaries as a Group, is a leading semiconductor company providing display IC products on an international basis under its own global brand. Adopting a "fabless" business model, the Group specializes in the design, development and sales of proprietary IC products that enable a wide range of display applications in mobile phones, computer monitors, LCD TVs and other innovative consumer products.

The Group has a high caliber and experienced design team in Mixed Mode High Voltage System-On-Chip (HV-SoC) IC design. It produces highly integrated IC products in 2 main areas, namely Display Panel and Display System, for mobile display, large display and new display applications.

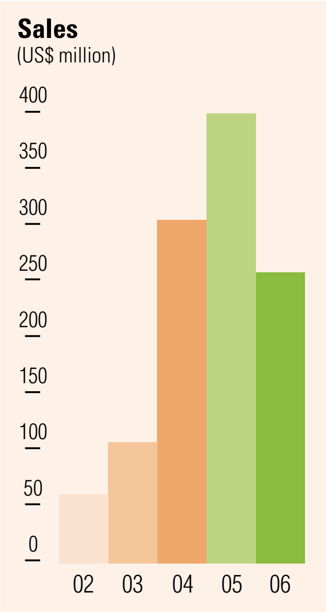
Being a global market leader in mobile display ICs, the Group produces a broad portfolio of driver ICs that supports all mainstreams display technologies such as LCD and OLED. The Group also champions leading ICs in new display markets including bistable display drivers for electronic paper, controllers for microdisplay and interface solutions for high speed video display connectivity. Thanks to its ability to quickly and successfully commercialize new product ideas, the Group has a competitive edge over its rivals in the fast-moving flat panel display area.

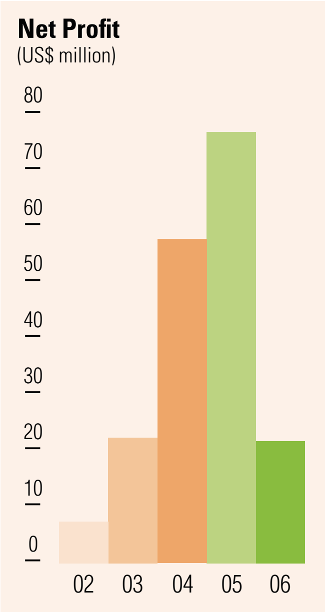
The Group serves many blue-chip clients and has received numerous awards from its customers, suppliers, industrial organizations as well as the investment community. The Company's shares were listed on the Main Board of the Stock Exchange of Hong Kong Limited on 8 April 2004 (HKSE: 2878). As at the end of 2006, it had a workforce of approximately 400 employees.

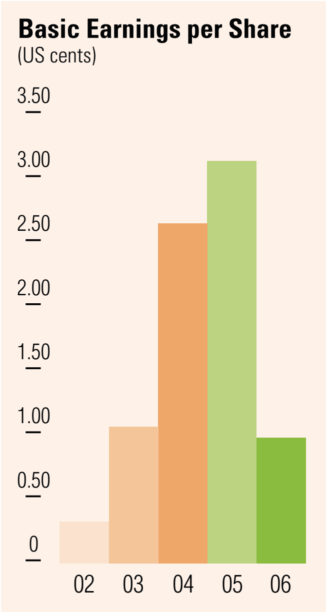
FINANCIAL HIGHLIGHTS

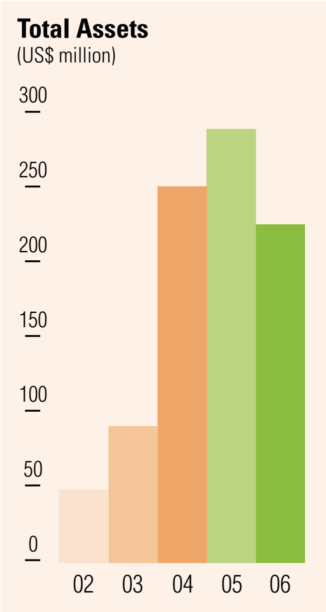
	2006 US$ million	2005 US$ million	Change
Sales	254.1	394.1	-36%
Gross profit	59.3	119.6	-50%
Net profit	22.4	76.3	-71%
Total assets	221.1	270.3	-18%
Shareholders' funds	179.9	207.0	-13%
US cents			
Earnings per share	0.91	3.12	-71%
Dividends per share	0.77	2.44	-68%

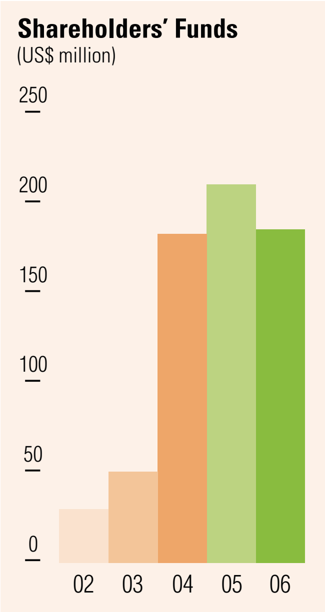
- Sales amounted to US$254 million
- Net profit was US$22.4 million
- Basic earnings per share was 0.91 US cents (7.1 HK cents)
- The Board proposed a final dividend per share of 4 HK cents (0.51 US cents)
- Total dividends per share for the year amounted to 6 HK cents (0.77 US cents)

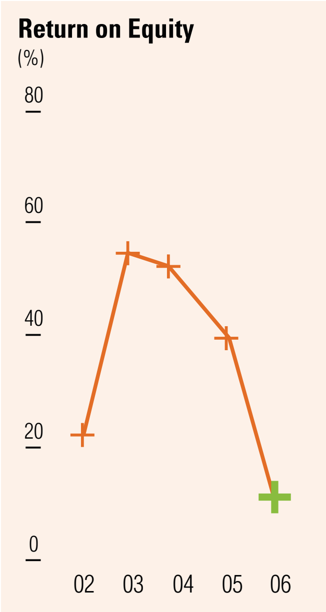






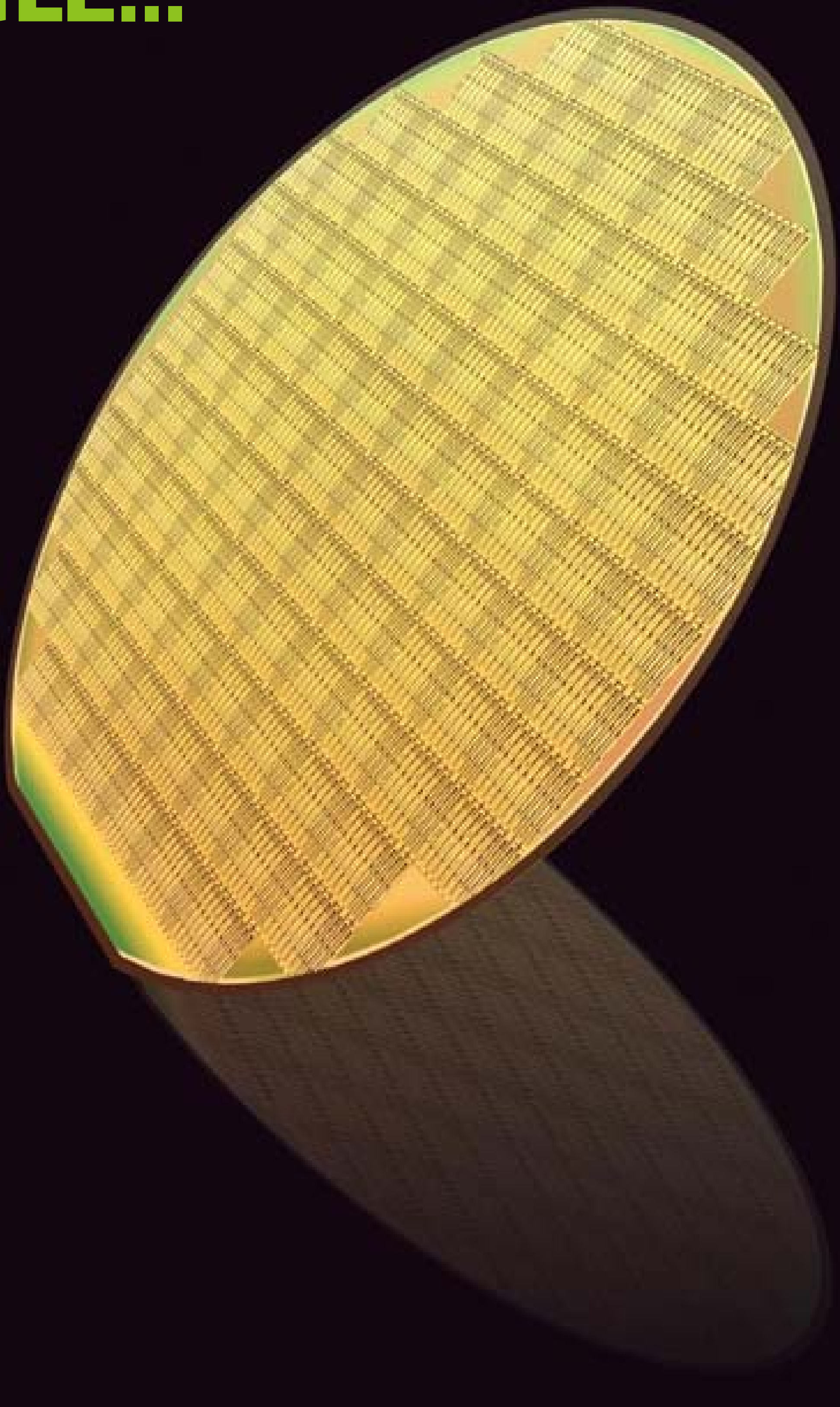


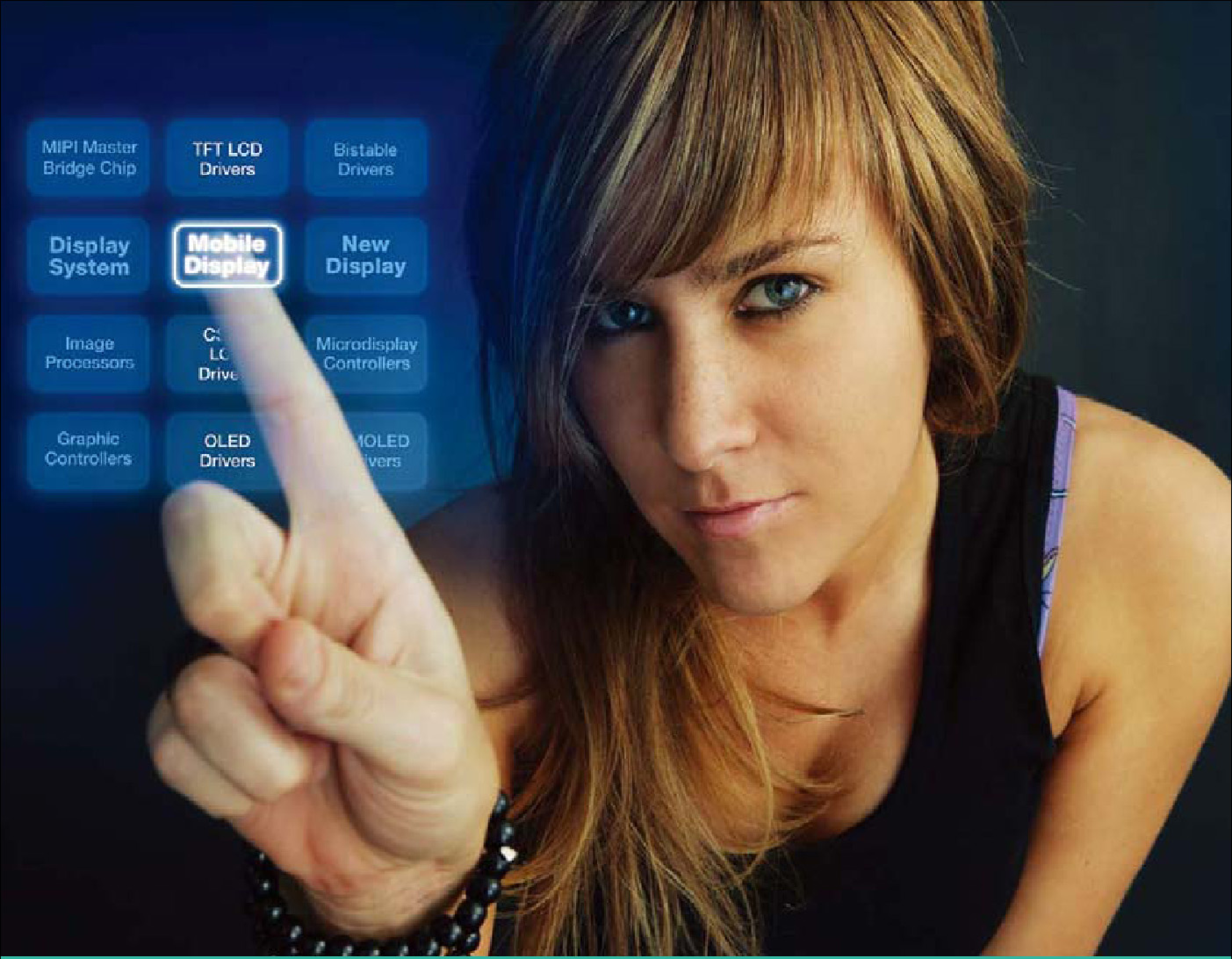




Note: Return on equity is calculated by dividing the net profit for the year by simple average of shareholders' funds at the beginning and end of the year.

SEE US FROM ANOTHER ANGLE...





The difference is our PROFESSIONALISM

Our competence to commercialize unique products

The difference is our PERCEPTIVENESS

Our ability to identify new technology and lead new markets

The difference is our PRINCIPLE

Our integrity to win trust and goodwill from stakeholders

The difference is our SINCERITY

Our commitment to the task
from every individual and
the pride we shared

Our People

Build on CHANGE

Our Technology

Makes a DIFFERENCE

CHAIRMAN'S STATEMENT

The Group is prepared to face and grow with change. It is this forward-looking attitude that makes us different.

Heraclitus, a Greek philosopher of the late 6th century, once said, "Nothing endures but change." I agree with him. Change seems to be the one consistent phenomenon we can expect to see in the global economy, local economies, industries, the environment, and individual businesses. In 2006, there were bigger-than-normal spikes in gasoline prices, IT giants re-positioned themselves for a new era of global competition, and the effects of global warming on world climate capturing the eyes of the world, etc.

I believe in change because we were born of it and have lived by it. But I emphasize that we should not be afraid of change but instead embrace it. And that is how we find solutions to problems and open new opportunities that bring prosperity and growth.

Adapt to and prepare for changes

The semiconductor market is changing with display technologies going through transition. Against this backdrop, we diversified our business, invested in critical areas to make sure we are well positioned to cope with and ride on the changes. Despite being challenged by severe fluctuation in ICs demand during the year, the Group managed a business recovery, higher corporate governance and continuous care for the society. The Group is prepared to face and grow with change. It is this forward-looking attitude that makes us different. I am glad to see the Group making progress in the right directions.

The Group's net profit in 2006 was US$22.4 million and shipped some 230 million units of display IC. Demand was unusually weak in the 3rd quarter, but it picked up in the final quarter with shipment amounts back on track. As a whole, the Group had around 16-18% share in the global mobile display IC market.

In light of the Group's net profit made and rich cash position for the year, the Board resolved to declare a final dividend of 4 HK cents per share. Total dividend payout was over 80% of earnings. The Group will review its expansion plans and cash position from time to time to ensure it has the optimum capital structure that promises to maintain a good balance between the interests of shareholders and the Group's business needs.

Solomon Systech ready to brave new heights

I have had three exciting and rewarding years as Chairman of Solomon Systech. The Group has grown notably since its IPO in 2004 on a foundation getting stronger by the year. It is thus with great satisfaction and pride that I handed over leadership of the Board to Mr. Patrick Sun effective from 1 January 2007. Mr. Sun is the new Non-executive Chairman of the Group and I remain as a Non-executive Director on the Board. I am confident that Mr. Sun, who brings with him solid experiences in the financial service industry and many other leadership attributes, will see to it that the Board provides effective business guidance to the management in growing the Group's business with stakeholders' interests in mind, enhancing its culture and corporate governance and taking its business to new heights.

P L Lam

LAM Pak Lee
Former Chairman

With market conditions mixed, the Group expects to see both challenges and opportunities ahead.

Led by my predecessor Dr. Lam Pak Lee, the Group has established firm footing on the path of success. With market conditions mixed, the Group expects to see both challenges and opportunities ahead. It intends to grow its business through partnerships, strategic investment, M&A and business diversification.

As Chairman of the Board, I will lead fellow members in reviewing the Company's strategies and directions, and work on enhancing external relations and corporate governance in accordance with the responsibilities prescribed for the Chairman by the Board.

Corporate Governance

Effective from 1 January 2007, the Board has 11 members, of whom 5 are executive directors, 2 are non-executive directors and 4 are independent non-executive directors. The Managing Director and other senior management members are responsible for running the business while I and other non-executive directors will monitor the performance and business strategies of the Group, and ensure all activities of the Group comply with the highest corporate governance standards.

Prospects

In the coming year, the Group expects challenges such as pricing pressure and competition to continue. The Group will focus on building on its new leading products to gain market share and achieve earnings growth. I have full confidence in the capabilities of our management team and dedicated staff in helping the Group deliver outstanding results. We have a team that shares the Group's objectives of achieving sound financial performance, maintaining sustainable business growth and being a corporation that cares about society.

SUN, Patrick
Chairman

MANAGING DIRECTOR'S CHAT ROOM

What was the major challenge for the Group in 2006?

2006 was a year of change for Solomon Systech. First of all, the market environment changed as panel makers in OLED and large panel industries realigned their businesses. The display industry was able to maintain a high unit growth rate but had to bear severe pricing pressure. Secondly, we saw the large volume commercialization of much anticipated new display technologies. Our foresight in E-paper came true. The technology was adopted in high volume handset application. As a result, the Group shipped over 10 million units of E-paper IC in the last quarter of 2006 and established firm leadership in this market.

To match the changing environment, we have enhanced our internal operations and launched several key leading new products that meet latest display requirements.

What were the major enhancement made by the Group?

The team is constantly seeking to advance and reinforce its special expertise. During the year, several senior management members were appointed and we continued to recruit high caliber engineers to strengthen our organizational structure and workforce. We also empowered our operation with a tailored Enterprise Resource Planning (ERP) system, which allows us to manage our business more effectively and make faster and more accurate business decisions.

As for the introduction of leading new products, I am especially pleased to see the launch of the MIPI[1] master bridge chip, the first member of our innovative display high-speed interface solutions that can help to accelerate the adoption of application-rich mobile devices. Solomon Systech was the first in the semiconductor industry to implement the MIPI interface standards for minimal wire connections in a working IC. We presented the product in the 2006 MIPI Third Quarterly Meeting and MIPI alliance members from around the world who attended were astonished by our achievement. Our MIPI leadership will open us to future business opportunities with top tier customers.

These achievements speak to our professionalism, which has enabled us to constantly develop and commercialize unique products that lead the market.

What made you stand out amid keen competition?

Our experience in technology and business management, which underscores our ability to identify new technologies with tremendous application potential, is what set us apart from our competitors. A good example is the OLED driver IC, which we started to develop in early 2001 before the technology had a market. We have been leading the world in this area since then.

Bistable driver IC for E-paper display applications is another outstanding example. We are the first and the only company supporting the driver IC for the world's first E-paper mobile phone in mass production. Foresight, unrivaled technological expertise and innovation are what make us stand out in the market.

1. MIPI – Mobile Industry Processor Interface

You said 2006 was a year of change for Solomon Systech. Had there been any change in the Group's fundamentals?

In our 2004 annual report, we identified five 'I's (Industry Talent, Innovation, Institutionalization, International Partnership and Integrity) as the cornerstones of our business foundation. We have kept and will keep on upholding the five principles to sustain growth of the Group as a business and a corporation so as to win the trust and goodwill of our stakeholders.

Another integral part of our fundamentals is our corporate culture that emphasizes dedication of each and every staff member in completing every task with perfection and sharing of success. Our corporate culture and the spirit it instills in us is also what underpin our pursuit of uncompromising corporate governance.

What will be the major driving force for the Group's business in the coming years?

The mobile display business will continue to be a major focus area of the Group. While display panel ICs will remain as an important part of our business, the emergence of high performance mobile video/TV applications will see our display system ICs business grow quickly. As the first company to offer a working high-speed display interface ICs that comply with the latest industry standard, our system IC solutions will take the Group's business into a new era.

New display business with our E-paper driver IC as the star will also give us significant growth impetus. It complemented the world's first E-paper mobile phone launched last November. From my point of view, there are many more high volume and innovative applications to come. And, as it finds its way into different innovative products, it will bring significant revenue contribution to the Group .

Supported by our advanced technologies and staff committed to excellence, I look forward to growing our business by diversifying our product offerings, creating new market applications for different products and broadening our customer base.

2006 AWARDS AND RECOGNITIONS

Corporate Level:

Dec The One Factory – One Year – One Environmental Project (One-One-One) Programme 2006 – Federation of Hong Kong Industries (FHKI)

Dec Caring Company Award – The Hong Kong Council of Social Service

Dec The 18th Hong Kong Print Awards – Annual Report Printing Champion – Graphic Arts Association of Hong Kong, Hong Kong Publishing Professionals Society, Hong Kong Trade Development Council, Leisure and Cultural Service Department

Dec IR Magazine Awards 2006, Honorable Mention in Best Investor Relations by a CEO or Chairman at a Hong Kong Company – IR Magazine

Dec Corporate Challenge 2006 Champion – Outward Bound Hong Kong

Nov Ranks Among Top 10 Best Corporate Governance Companies – The Hong Kong Institute of Directors (HKIoD), City University of Hong Kong

Sep 2006 International ARC Awards, Gold Winner – Overall Annual Report: Technology Consulting – MerComm Inc.

Sep 2006 International ARC Awards, Gold Winner – Cover Photo/ Design: Technology Consulting – MerComm Inc.

Jul WWF Hong Kong Panda Partner – WWF Hong Kong

Apr Ranks in the Hong Kong Best Managed Companies Poll – FinanceAsia Magazine
– Best Managed Company: No.9
– Best Corporate Governance: No.8
– Best Investor Relations: No.8

Technological Innovations:

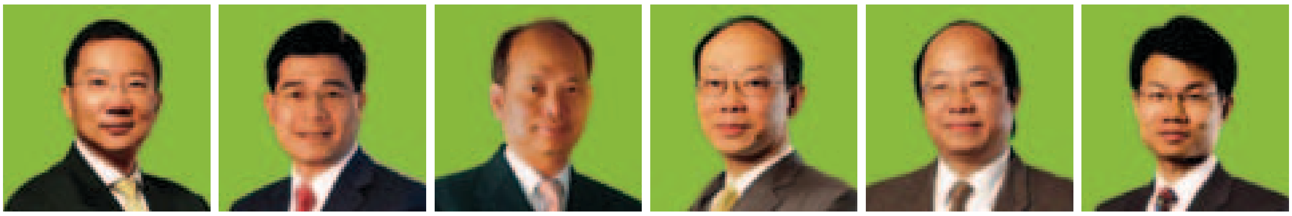
Dec 2006 China Chip Awards – The Software and Integrated Circuit Promotion Center of the Ministry of Information Industry, China

Dec Deloitte Technology Fast 500 Asia Pacific (ranked: 153) – Deloitte Touche Tohmatsu

Nov Deloitte Technology Fast 50 China (ranked: 23) – Deloitte Touche Tohmatsu

Oct Leading Product Winners (Analog & Mixed Signal ICs), 2006 EDN China Innovation Award – EDN China

BOARD OF DIRECTORS AND SENIOR MANAGEMENT



From left to right : SUN, Patrick, LEUNG Kwong Wai, LAM Shun Fu, Percy, HUANG Hsing Hua, LAI Woon Ching, LO Wai Ming

Non-executive Chairman

Mr. SUN, Patrick, aged 48, is the Non-executive Chairman with effect from 1 January 2007. An Independent Non-executive Director ("INED") of the Company since 2004, Mr. Sun remains as an INED after taking up chairmanship of the Board. He is currently the Chief Executive Officer and Executive Director of Value Convergence Holdings Limited (HKSE: 8101) and an Independent Non-executive Director of The Link Management Limited, manager of the Link Real Estate Investment Trust (HKSE: 0823) and Everbright Pramerica Fund Management Company Limited. He is a member of the Hong Kong Institute of Certified Public Accountants and was formerly the Senior Country Officer of JPMorgan Chase in Hong Kong, the Deputy Convenor of the Listing Committee and a member of the Council of The Stock Exchange of Hong Kong Limited and the Honorary Chief Executive of the Chamber of Hong Kong Listed Companies.

Managing Director

Mr. LEUNG Kwong Wai, aged 50, is the Founder and Managing Director of the Group. He also serves as the Group CEO. Prior to 1999, Mr. Leung was the Director of Operations of Motorola Semiconductors Hong Kong Limited. Currently, he is Director of the Society of Information Display, Hong Kong Chapter, Vice-Chairman of the Hong Kong Electronic Industries Association, Vice President of the Hong Kong Semiconductor Industry Council and an executive committee member of the Hong Kong Electronics Industry Council of the Federation of Hong Kong Industries. Mr. Leung received the Young Industrialist Award for Hongkong in 2001, the Outstanding Polytechnic University Alumni Award in 2003 and the Outstanding Achievement Award in the 10 Years' China IC Design Industry Development in 2004.

Executive Directors

Mr. LAM Shun Fu, Percy, aged 51, joined the Group in 2006 and was appointed as a director of the Company on 23 October 2006. He is currently the President of Solomon Systech Limited. Prior to joining the Group, he worked in Motorola (China) Electronics Limited as Vice President and General Manager of Motorola Energy System Group and Motorola Automotive Electronics Group respectively for the Asia Pacific Region.

Mr. HUANG Hsing Hua, aged 48, has been with the Group since 2003. He is currently the Vice President, Sales of Solomon Systech Limited. Prior to joining the Group, he was the Senior Vice President of Solomon Technology Corp. Previously, Mr. Huang worked for Motorola Electronics Taiwan Limited in functions such as product operation, product marketing, business planning and sales.

Mr. LAI Woon Ching, aged 53, has been with the Group since its inception in 1999 and is currently the Vice President, Quality and Manufacturing of Solomon Systech Limited. Prior to joining the Group, he was Senior Quality Manager of Motorola Semiconductors Hong Kong Limited.

Mr. LO Wai Ming, aged 44, has been with the Group since its inception in 1999 and is currently the Vice President, Business Operations of Solomon Systech Limited. Prior to joining the Group, he was the Business Operations Manager of Motorola Semiconductors Hong Kong Limited.

Non-executive Directors

Dr. LAM Pak Lee, aged 57, was the Non-executive Chairman of the Company from 2004 to 2006. He resigned from the Non-executive Chairman position with effect from 1 January 2007. He remains as a Non-executive Director of the Company. Dr. Lam is the Founder, Chairman and CEO of Quanta Computer Inc. (TSE:2382).

Mr. CHANG Ching Yi, Steven, aged 45, has been a Non-executive Director of the Company since 2003. Mr. Chang is also the Founder and Chairman / CEO of The China International Development Consulting, Inc.

From left to right : LAM Pak Lee, CHANG Ching Yi, Steven, CHOY Kwok Hung, Patrick, KAO Kuen, Charles, WONG Yuet Leung, Frankie, FUNG Lui Kit Har, Keziah

Independent Non-executive Directors

Mr. SUN, Patrick
(refer to Non-executive Chairman)

Mr. CHOY Kwok Hung, Patrick, aged 64, has been an Independent Non-executive Director of the Company since 2004. Mr. Choy retired from Motorola as its Corporate Vice President. He is the Founder and Chairman of Global Strategy Group and a Trustee and Board member of Majulah Connection Limited. He is also an Independent Non-executive Director of Evergro Properties Limited (D09.SI), a Corporate Advisor to Keppel Corporation Limited and a Senior Advisor to Motorola Inc.. Mr. Choy is a member of the Chinese People's Political Consultative Conference (CPPCC) National Committee and is also a Standing Committee member of Tianjin CPPCC.

Professor KAO Kuen, Charles, aged 73, has been an Independent Non-executive Director of the Company since 2004. Prof. Kao is also an Independent Non-executive Director of Next Media Limited (HKSE: 0282) and was an Independent Non-executive Director of SUNeVision Holdings Ltd. (HKSE: 8008) until 1 January 2007. Known as "the father of fiber optics", Prof. Kao enjoys international recognition for pioneering the use of fiber optics in telecommunications. He has received numerous awards including the Draper Prize and the Japan Prize, Japan's equivalent of the Nobel Prize. He was also awarded a Marconi International Fellowship by the United Nations and received the Alexander Graham Bell Medal from the U.S. Institute of Electrical and Electronics Engineers. Prof. Kao was previously Chairman of the Energy Advisory Committee of Hong Kong and the Vice-Chancellor (President) of The Chinese University of Hong Kong.

Mr. WONG Yuet Leung, Frankie, aged 58, who had been a Non-executive Director of the Company since 2004, was re-designated as an Independent Non-executive Director with effect from 1 January 2007. He is also the Chief Executive Officer of Shui On Construction and Materials Limited (HKSE: 983) and a Non-executive Director of CIG Yangtze Ports PLC (HKSE: 8233).

Senior Management

Mrs. FUNG Lui Kit Har, Keziah, aged 46, Vice President, Finance. Joined Solomon Systech Limited in 2000 as Finance Director. Mrs. Fung is a "Qualified Accountant" of the Company for the purpose of Rule 3.24 of the Stock Exchange Listing Rules and she is currently acting as the Company Secretary of the Company.

Mr. KUNG Tat Wing, aged 46, Vice President, Business Operations. Joined Solomon Systech Limited in 2005 as Business Operations Director.

Mr. LEONG, John Peter, aged 46, Vice President, Corporate Development. Joined Solomon Systech Limited in 2006 as Corporate Development Director.

Dr. YEH Chao Pin, aged 52, Vice President, Business Operations. Joined Solomon Systech Limited in 2005 as China Operations Director.

Mr. CHEUNG Hung Fai, Peter, aged 47, Planning & Customer Services Director. Joined Solomon Systech Limited in 2000 as Senior Planning Manager.

Dr. LAI Wai Yan, Stephen, aged 60, Design Engineering Director. Joined Solomon Systech Limited at its inception in 1999.

Ms. LO Oi Yee, Mabel, aged 42, Human Resources Director. Joined Solomon Systech Limited in 2000 as Human Resources Manager.

Mr. WANG Wah Chi, Raymond, aged 41, Business Operations Director. Joined Solomon Systech Limited in 2006.

MANAGEMENT DISCUSSION AND ANALYSIS

Overview

2006 was a challenging year for the Group having to manage industry and company specific issues. Nevertheless, with shrewd foresight, the Group was able to devise and implement proactive measures which allowed it to exit the year on a stronger foundation. Apart from stronger customer ties and better product offerings, it has expanded business coverage to beyond mobile phones. The Group has also enhanced its infrastructure including its information technology system and organization structure so as to support its increasingly spread out and diverse business needs. The Group as a flexible fabless designer sees business cycles offering it opportunities to improve.

For the full year, the Group shipped some 230 million units of display IC (2005: 263 million units), mainly in the CSTN LCD category. It missed the business targets set for OLED and L-TFT as a result of unanticipated exit of customers in the display industry. A severe slow down in demand was recorded in 3Q 2006, making it difficult to achieve sequential unit growth. Nevertheless, momentum returned in 4Q 2006 with the Group achieving the second highest quarterly unit shipment in its history. As a positive note in 2006, the Group began volume shipment of bistable display driver IC for E-paper applications in 4Q 2006 and shipped more than 10 million units of the IC as at the end of the year. The Group also made progress in business development of Display System.

In 2006, the mobile phone industry grew approximately 25%. As for the Group's share in the mobile phone display driver IC market for the year, the estimate was 16-18%, compared to 20% in 2005. The decline was the result of the slower than expected growth of the Group's m-TFT business. To rectify the situation, the Group executed business plans to strengthen ties with more top-tier phone brand names as well as their preferred module makers. The Group also brought in technology differentiators to strengthen customer ties. As an example, the Group introduced the world's first MIPI compliant master bridge chip for mobile applications that boasts high video quality.

OLED and L-TFT had setbacks because several OLED panel customers and the anchor L-TFT panel customers chose to scale down or exit the market. The Group continued to deploy resources in these businesses because of the abundant sales opportunities presented by organic display and large display. Efforts are being undertaken to design into new applications and new customers to re-ignite growth momentum.

The Group's bistable display IC supports Motorola's Motofone, the world's first mobile phone with E-paper display. After Motofone was launched, the market has shown keen interest in exploring different potential applications of E-paper with features that enable new display functions beyond the capability of other display technologies. The Group has been approached by potential customers in different sectors from consumer electronics, communications to computer and a wide array of industries to evaluate and explore the application of E-paper in their products as a new value-added feature. The Group has invested resources into extend volume application of the new display technology beyond mobile phones to such as smart cards, timepieces, memory cards, price tags and gift items.

The world's first MIPI compliant master bridge chip for mobile applications boasts high video quality.

The Group's bistable display IC supported Motorola's Motofone, the world's first mobile phone with E-paper display.

The Group adopted Oracle's Enterprise Resource Planning (ERP) System capable of supplying it with detailed operational and business analysis data for facilitating fast and accurate decisions by management.

To realize the maximum value of its key asset – its human resources, the Group improved its infrastructure during the year. In 2006, the Group adopted Oracle's Enterprise Resource Planning (ERP) System to help meet its operational needs. Apart from ensuring smooth operation, the ERP system also provides detailed operational analysis that can facilitate fast and accurate decisions by the management. The Group also realigned human resources to maximize internal efficiency and capability.

The Group continued to focus on IP generation and introducing new products, which it sees as critical initiatives to support its current and future successes. The Group's design team rose to the challenge and achieved a record high of 181 design-wins in 2006, up 25% year-on-year.

For the year 2006, the average trading volume of the Group's share rose to 22.2 million a day, compared to 13.6 million in 2005. The Group continued to be a constituent in the MSCI Standard Index Series and Small Cap Index Series for its share liquidity, free float, industry and country representation. The Group's free float stayed above 80%. The Group conducted share buybacks and cancelled 8.5 million shares to enhance the net asset value.

Last but not least, the Group received a great number of awards presented to it by various entities, ranging from customers, the semiconductor industry to the investment community.

Financial Review

5-year Financial Summary

US$ million	2006	2005	Restated[v] 2004	2003	2002
Sales	254.1	394.1	308.2	109.3	60.0
Gross profit	59.3	119.6	96.6	46.0	20.9
Net profit	22.4	76.3	57.9	22.7	6.8
Assets and liabilities					
Total assets	221.1	270.3	250.1	81.6	48.5
Total liabilities	(41.2)	(63.3)	(73.4)	(31.7)	(15.1)
Shareholders' funds	179.9	207.0	176.8	49.9	33.4
US cents					
Earnings per share					
Basic[i]	0.91	3.12	2.63	1.09	0.33
Diluted[ii]	0.90	3.08	2.50	N/A	N/A
Dividends per share	0.77	2.44	1.88[iii]	0.85[iii]	3.40[iv]
Net asset per share[i]	7.29	8.47	8.02	2.41	1.61

The Company was incorporated on 21 November 2003. The financial information for the year 2002 to 2003 has been prepared using the merger basis of accounting regarding the Group comprising the Company and its subsidiaries as a continuing entity.

i The basic earnings and net assets per share are based on the weighted average of 2,074,852,711, 2,074,852,711, 2,204,501,037, 2,445,135,773 and 2,467,035,647 ordinary shares in issue during each of the years ended 31 December 2002, 2003, 2004, 2005 and 2006, respectively. In determining the weighted average number of ordinary shares in issue, a total of 1,808,846,553 ordinary shares were deemed to be issued as at 1 January 2002. For 2004, 2005 and 2006, the number is based on the weighted average of ordinary shares in issue excluding own shares held during the year.

ii The diluted earnings per share information was not presented for each of the years ended 31 December 2002 and 2003 as there were no dilutive potential ordinary shares. For 2004, 2005 and 2006, the diluted earnings per share information is based on 2,320,846,751, 2,473,217,108 and 2,491,931,274 ordinary shares respectively, which are the adjusted weighted average number of ordinary shares outstanding to assume conversion of all share options outstanding but excluding unallocated own shares held during the year.

iii As the first interim dividend of 2004 paid on 1 March 2004 was attributable to the results of 2003, such interim dividend has been included in the computation of dividend per share for 2003 and excluded from the computation for 2004.

iv The dividend was paid by Solomon Systech Limited ("SSL"), a wholly owned subsidiary of the Company, to its then shareholders during the year. The number of SSL's shares in issue at the time of the payment was 183,290,271 shares.

v The results for 2004 and the assets and liabilities as at 31 December 2004 have been restated to reflect the adoption of the new / revised standards and interpretation of Hong Kong Financial Reporting Standards.

Sales and profit

The Group's sales were US$254 million (2005: US$394 million). The decline was mainly due to (1) average selling price erosion of 26%, (2) severe demand slowdown in 3Q 2006 and (3) the new business of m-TFT not taking off as quickly as the Group had expected. Gross profit at US$59 million was 50% lower year-on-year as a result of the lower unit shipment and average selling price. The Group's effort to lower manufacturing cost had limited the decline of gross profit margin. The gross profit margin for the year was 23.3% (2005: 30.3%).

The Group employed more resources to conduct business and product development, leading to moderate increase in SG&A and R&D expenses. For other operating expenses, the Group took a provision of US$1.4 million for impairment loss of investment because an invested entity planned to cease operation in 2007. With the higher expenses and lower gross profit, the Group's net profit for the year was US$22.4 million (2005: US$76.3 million).

The Group continued to expend on R&D and business development in order to stay competitive and facilitate capture of more business opportunities by its innovative products.

Liquidity and financial resources

Net cash flow from operations during the year was US$25 million. Net cash of the Group amounted to US$122 million at year-end, compared to US$163 million as at 31 December 2005. The change in cash position was mainly a result of (1) dividends payments of US$55 million, (2) fixed asset purchase of US$9 million, and (3) corporate strategic investment of US$7 million. The Company conducted share buybacks that consumed US$1.5 million, resulting in the cancellation of 8.5 million shares. Regarding the cash reserves, the Group will continue to invest in product development, to secure production capacity, and to invest in corporate ventures while keeping a healthy level of cash to meet general corporate purposes. As at 31 December 2006, the Group had no borrowings and its cash balance was mainly deposited in interest-bearing accounts.

All of the Group's account receivables and most of its payables are quoted in US dollars. The Group closely monitors foreign exchange rates, and seeks to obtain favorable exchange rates for conversion of US dollars into other currencies for the payment of local operating expenses. During the review period, the Group did not use any derivative instruments to hedge its foreign currency exposure as it considered the exposure to be insignificant.

In light of the Group's net profit and relatively rich cash position, the Board of the Company proposed a final dividend of 4 HK cents per share to shareholders whose names appear on the Register of Members of the Company on 3 May 2007. In summary, the full year dividends per share of 6 HK cents represent a payout ratio of approximately 86%, or a yield of 2.5% based on the average daily closing price of HK$2.38 for 2006.

Capital expenditure and contingent liabilities

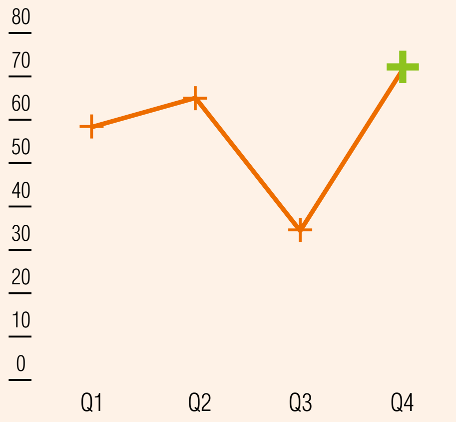
In 2006, the Group spent a total of US$16 million in capital expenditure, of which US$9 million belonged to fixed asset purchase and US$7 million belonged to strategic investment. Fixed asset purchase was primarily consisted of spending on computer hardware and software, intellectual property ("IP") licenses, research and development tools, critical packaging and testing equipment. Currently, all research and development tools are located in the Group's offices while all production equipment is consigned to sub-contractors or located in the manufacturing subsidiary in Dongguan. As at 31 December 2006, the Group had no material capital commitments or contingent liabilities.

Business Review

Products shipment

For 2006, the book to bill ratio stood at 1.0 (2005: 0.93). In total, the Group shipped 229.7 million units of display IC. The unusually weak demand in 3Q 2006 caused the annual unit shipment to decline by 13% year-on-year. After achieving a strong start in 1H 2006 with unit shipment growth of 16% year-on-year, the Group experienced a severe demand slowdown in 3Q 2006 and shipment plunged to the lowest level for the year. Demand picked up again in 4Q 2006 and shipment amount bounced back to the second highest quarterly unit shipment in the Group's history. The blended average selling price (ASP) of the Group's products was US$1.11, down from US$1.50 for 2005. The decrease was mainly due to the pricing pressure exerted at the end-customer level.

2006 Display ICs Shipment
(million units)



LCD (STN, TFT) remained the most popular and dominant display technology found in mobile devices. Therefore, a vast majority of the Group's shipments still fall under the LCD category while transition from STN to TFT is underway. m-TFT had a severe sequential decline caused by customers' product transition as well as slower than expected ramp in new designs. On the OLED front, several panel makers announced their withdrawal from this area of business in 2006, and that affected the overall market demand for OLED driver IC and in turn the size of shipments made by the Group. Bistable display IC achieved strong growth with over 10 million units shipped in 2006, reflecting the successful adoption of E-paper technology in mobile phones and watches. Meanwhile, Large Display of Display Panel and Display System shipped a small amount of ICs in 2006.

Display IC Shipped (million units)	**2006**	**2005**	**Growth**
Monochrome STN	43.3	45.3	-4.4%
Color STN	133.6	142.5	-6.2%
m-TFT	18.9	33.5	-43.6%
OLED	22.0	40.5	-45.7%
Bistable	10.3	–	+%
L-TFT	0.8	0.3	+166.7%
Miscellaneous	0.8	0.9	-11.1%
Total	**229.7**	**263.0**	**-12.7%**

Note: Miscellaneous includes graphics controller, image processor, microdisplay controller and others.


The world's first MIPI master bridge chip introduced by the Group should find applications in portable devices that require high video quality such as mobile TV.

The Group currently serves most of the major display module makers in the world. It will focus on approaching ODM and IDH directly to tighten connection with essential constituents in the value-chain.

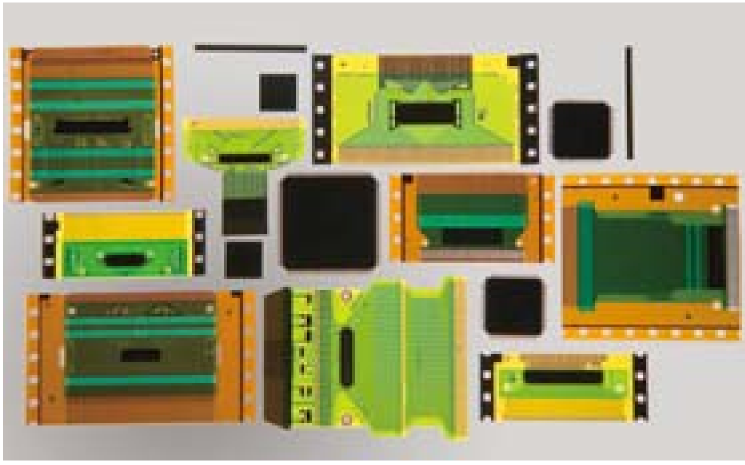
New products and customers

The Group added 26 new products in 2006 for customer design-in and volume production, similar to 2005's total of 27. 16 of the 26 new products were mobile phone related ICs, including 9 belonging to the m-TFT. As part of its efforts to expand sales beyond mobile phones, the Group introduced a new bistable display IC for electronic signs, digital timepieces and smart cards. Regarding products under Display System, four new image processors were released for applications such as car AVs, digital photo frames, electronic dictionaries, MP4 players, Global Positioning Systems (GPS) and industrial products. Moreover, the Group introduced a world first MIPI master bridge chip that contained an interface in compliance with MIPI specifications. It should find applications in portable devices that require high video quality such as mobile TV and game consoles.

To win new business from existing or potential customers, the Group believes that apart from competitive pricing, its capability to offer field application support and reliable solutions are equally important. In 2006, the Group directed more resources in providing customers with more timely services and support.

In the Display Panel segment, the Group currently serves most of the major display module makers in the world. It is the Group's objective to focus on approaching ODM (original design manufacturer) and IDH (independent design house) directly so as to tighten connection with essential constituents in the value-chain. The Group plans to develop more business with Korean and Japanese customers, which will give it the leverage to ultimately forge relationships with more top-tier mobile phone brand names.

In the Display System segment, the Group provides customers with "total display IC solutions" for high volume specific applications. With an enlarged product offering, the Group is able to reinforce its business ties with existing customers and build relationship with new end-product manufacturers.



The Group provides customers with "total display IC solutions" for high volume specific applications.

Research and development capability is one of the Group's core competences.

Research and development

Research and development capability is one of the Group's core competences. The Group's management team regularly keeps track of the Group's research output and its customers' new requirements in connection with product features or specifications.

During the year, the Group spent roughly US$17 million on research and development. As at 31 December 2006, the Group had a research and development workforce of more than 210. The expanded R&D headcount mirrored the Group's determination to expand its business, capture more business opportunities and stay ahead in the competition by developing and offering innovative products for tomorrow's applications.

The Group's existing and future products are supported by three technology centers located in Hong Kong, Shenzhen and Singapore. The research and development team in Hong Kong helps the Group with developing products across its entire portfolio, while the Shenzhen operation takes on OLED and Large Display projects and the Singapore team focuses on multimedia IC and IP development.

In terms of wafer technology under development, the Group's products employ a range of fine technologies from 0.13μm to 0.6μm, depending on cost performance measure against customers' specific requirements. Last but not least, the Group filed 6 patents and published 3 technical articles in 2006.

Human Resources

As at 31 December 2006, the Group had 394 employees, 23% more than the previous year. Approximately 59% of the employees was based in its Hong Kong head office. In 2006, the Group recruited three senior management members for its operation and corporate development departments.

As a technology company, the Group highly values its human resources. To reward good performance and retain talents, the Group offers competitive remuneration to employees and provides employees with relevant trainings, career development programs, job satisfaction and a first-rate working environment in the hope that they will enjoy working for the Group and contribute their efforts to the Group's success.

In the first half of 2006, most employees were granted cash bonuses and shares of the Company to reward their performance in 2005. At the Board level, directors were awarded options for their past and forthcoming contributions to the Group.

Prospects

Following the 2005 initiative to establish two distinct business units, namely Display Panel and Display System, the Group has made progress and is better positioned to grow its business through product diversification.

Display Panel

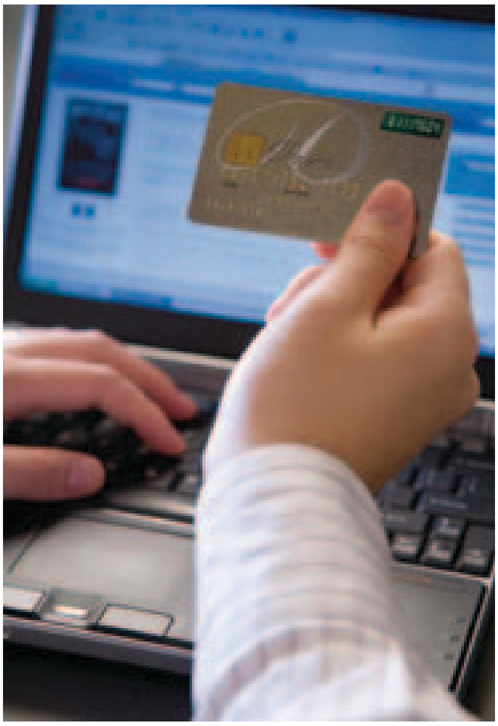
Mobile display

Mobile phone will remain to be the dominant application for mobile display driver ICs. m-TFT had surpassed color STN to become the top display technology in 2006. m-TFT, color STN and monochrome STN will continue to be the major display technologies in 2007. OLED and bistable display technologies will continue to improve and accordingly gain greater market acceptance. The different technologies are in different phases of growth because of their uniqueness in display characteristics. Generally speaking, the mobile phone market will continue to migrate towards incorporating displays that are larger (e.g. from 1.0-in to 3.2-in) and can support more colors (e.g. from monochrome to 1,600k colors), higher resolution (e.g. from QCIF to VGA) and more demanding multimedia features (e.g. 3MP embedded camera, mobile TV).

Although market researchers forecast mobile phone's unit growth to taper towards 10% (2007) from around 25% (2006), the Group expects its unit shipment to grow at a rate above the industry average in 2007 now that it has a complete set of display solutions fitting requirements of all segments. With mature presence in the monochrome and color STN segment, the Group sees potential growth primarily for its m-TFT and bistable display business. Seeing flat to low unit growth rate for STN products, the Group intends to strive for market share gain by introducing more cost competitive products.

To boost its relatively low share in the m-TFT market, the Group will devote more efforts into improving customer relationships, developing product leadership and extending into other volume applications. The Group is making progress in improving relationships with mobile phone brand names and IDH as well as module makers who are gaining influence in m-TFT supply chain management. The Group will continue to improve the competitiveness of its m-TFT products with die shrinkage and through enhancing their functions and integrating different features. Driven by the launch of Microsoft's Vista, the Group has recently extended m-TFT to cover Sideshow applications in notebook computers.

Mobile Display – Driven by the launch of Microsoft's Vista, the Group has extended application of its m-TFT to cover Sideshow applications in notebook computers.



New Display – The Group is developing new high volume applications for its bistable ICs such as in flash memory card, electronic signs, and IC cards, which did not have displays incorporated previously.

New Display – The Group's microdisplay IC can be applied in high definition movies, stereo 3D games entertainment as well as viewfinders of high-end digital cameras.

The Group will continue to develop OLED applications. Initial volume drivers, namely mobile phone (especially sub-display) and MP3 player, will require new OLEDs. Portable video player (e.g. MP4) and notebook sub-display are examples of new drivers and other potential applications of new OLEDs include Bluetooth headset, timepiece, radar detector, GPS, and industrial applications. Although several panel makers who saw uncertainties in the future of OLED exited from the market, the Group intends to extend its leadership into active matrix OLED (AMOLED) which commercial use is expected to begin in 2007.

Large display

In spite of lacking a new anchor customer after Quanta Display Inc.'s merger with AU Optronics, the Group continues to see potential reward from persistently developing its large display driver IC business with an estimated market value of more than US$3 billion a year. The Group is working with a few large TFT LCD panel makers in Japan and the Greater China region on new design-ins. To improve customer service, timing controller products are relocated from Display System to Large Display to facilitate bundling into total solutions. In the short run, progress will possibly be affected by low likelihood of imminent shortage in driver IC due to panel demand seasonality and slower than planned capacity ramp as panel makers encounter challenging times to stay profitable.

New display

The Group expects bistable display IC business to emerge as an important future growth driver. While mobile phone will be the major application in 2007, the bistable IC business is expected to grow faster than the Group's average growth as more applications adopt E-paper display. The Group is developing opportunities in high volume applications besides mobile phones and watches, namely flash memory cards (e.g. SD cards), electronic signs (e.g. remotely controlled price tags) and IC cards (e.g. smart cards) which did not have displays incorporated previously.

The Group continues its collaboration with Kopin to promte the application of microdisplay technology in video-on-the-go eyewear systems. The Group's microdisplay IC can be applied in high definition movies, stereo 3D games entertainment as well as viewfinders of high-end digital cameras. As the pricing of microdisplay module with VGA resolution has lowered to a level affordable for the mass market, the Group is well positioned to reap financial benefits from sales of the product. Overall, the Group believes the demand for new display applications will surge, thus it will keep researching and expanding this business to make sure it stays ahead in the competition.

Display System

This business unit focuses on developing total solutions that complement display panel IC or enrich the image, graphics or functionality of a display. It covers three product families, namely high-speed interface IC, controller and multimedia processor. High-speed interface ICs, for example, the MIPI, MDDI and LVDS, deal with connectivity in a mobile phone, TV or other portable consumer products. Regarding controller, the Group launched image processor for portable products. In the area of multimedia processor, the Group will develop total solutions for high volume applications with strategic alliances.

The Group expects Display System to contribute higher sales in 2007 with its higher level of product readiness. Leveraging its early leadership in MIPI, the business unit will develop more products including IP to grow with increasing demand for mobile TV and VGA features. The Group will promote reference designs using its multimedia processor to accelerate customer's time-to-market of their products. By offering "total display IC solutions" to customers, the Group's Display System business can help to fortify the Group's relationship with key customers. In the long run, the Group believes this business will see strong sales growth and a more balanced business mix.

Display System – With early leadership in MIPI, the Group will develop more products including IP to grow with increasing demand for mobile TV and VGA features.

CORPORATE GOVERNANCE REPORT

The Board of Directors ("Board") and the management of the Group are committed to achieve and maintain high standards of corporate governance, which it considers as critical in safeguarding the integrity of its operations and maintaining investors' trust in the Company. The management also actively and constantly observes latest corporate governance developments in Hong Kong and overseas, particularly in the UK and USA. Throughout the year, the Company complied with all applicable Code provisions as set out in the Code on Corporate Governance Practices in Appendix 14 of the Listing Rules (the "Code"), and there was no deviation from the Code provisions.

Board of Directors

The Board currently consists of five executive directors (including the Managing Director), two non-executive directors and four independent non-executive directors (including the Chairman). Schedule of matters reserved for the Board include:

- Strategy and management
- Group structure and capital
- Financial reporting and control
- Internal controls
- Contracts
- Communication
- Board membership and other appointments
- Remuneration
- Authority and delegation
- Corporate governance
- Policies

Matters not specifically reserved to the Board and necessarily relate to the daily operations of the Group are delegated to the management under the supervision of the respective directors and the leadership of the Managing Director.

At every annual general meeting of the Company, one-third of the directors for the time being, or, if their number is not three or a multiple of three, then the number nearest to but not less than one-third shall retire from office by rotation, provided that every director shall retire from office at least once every three years or within such other period as the rules of the Stock Exchange may from time to time prescribe. A retiring director shall be eligible for re-election and shall continue to act as a director throughout the meeting at which he retires. The membership of the Board represents wide background and rich industry experience.

The Company has complied with Rules 3.10 (1) and (2) of the Listing Rules relating to the appointment of at least three independent non-executive directors among whom one has to have appropriate professional qualifications, or accounting of related finance management expertise. All Independent Non-executive Directors bring their wealth of experience to the Board and make active contribution to the Group. They closely monitor the Group's development and freely express their opinions at the Board meetings. All Independent Non-executive Directors, except as disclosed in this annual report, do not have any business with or financial interests in the Group and confirmed their independence to the Group pursuant to Rule 3.13 of the Listing Rules. The Company considers all Independent Non-executive Directors to be independent in accordance with the independence guidelines set out in the Listing Rules. During the year, the Group's management also met with certain non-executive directors to seek their views on certain business or operational matters. The attendance record of the Board meetings for 2006 is as follows:

Number of meetings	**9**	
Members of the Board	**Meetings attended**	**Attendance rate**
Chairman		
LAM Pak Lee (Redesignated as Non-executive Director effective from 1 January 2007)	8	89%
Executive directors		
LEUNG Kwong Wai	9	100%
HUANG Hsing Hua	8	89%
LAI Woon Ching	8	89%
LAM Shun Fu, Percy (appointed on 23 October 2006)	3	100%
LO Wai Ming	7	78%
Non-executive directors		
CHANG Ching Yi, Steven	5	56%
WONG Yuet Leung, Frankie (Redesignated as Independent Non-executive Director effective from 1 January 2007)	9	100%
Independent non-executive directors		
CHOY Kwok Hung, Patrick	8	89%
KAO Kuen, Charles	7	78%
SUN, Patrick (as Non-executive Chairman of the Board effective from 1 January 2007)	9	100%
Attendance rate		**88%**

Non-executive Chairman

In 2006, the Non-executive Chairman of the Board, Dr. LAM Pak Lee, was responsible for ensuring that all directors act in the best interest of shareholders. He was fully accountable to the shareholders and contributed to the Board and the Group on all top-level or strategic decisions. Specifically, he was assigned with four key roles to perform, namely leading the Board, advising the Group on key strategies, ensuring the Group's effective communication with stakeholders and implementing a high level of standard in corporate governance.

Managing Director

The Managing Director, Mr. LEUNG Kwong Wai, is responsible for running the Group and executing the strategies adopted by the Board. He functions as the Chief Executive Officer who leads the Group's management team in accordance with the directions set by the Board. He is responsible for ensuring that a proper internal control system is in place and that the Group's business conforms to applicable laws and regulations. The Managing Director chairs the monthly operations review and bi-weekly staff meeting, as well as the quarterly employees' communication meeting. The role of the Chairman is segregated from that of the Chief Executive Officer as stipulated in the Listing Rules.

Non-executive Directors

At least once a year, non-executive directors and also independent non-executive directors will have a private discussion with the non-executive Chairman on the Group's matters without the presence of executive directors, including the Managing Director. In addition, non-executive directors, according to the Group's policy, may access the Group's employees at anytime they think appropriate. Each of the non-executive directors (including independent non-executive directors) of the Company has entered into a service contract with the Company that will expire on 30 June 2008. The first reappointment date of each non-executive director is listed below:

	First reappointment date
Non-executive directors	
CHANG Ching Yi, Steven	21 November 2004
WONG Yuet Leung, Frankie*	3 February 2005
LAM Pak Lee	25 February 2005
Independent non-executive directors	
CHOY Kwok Hung, Patrick	25 February 2005
SUN, Patrick	25 February 2005
KAO Kuen, Charles	15 March 2005

* WONG Yuet Leung, Frankie redesignated as independent non-executive director of the Company effective from 1 January 2007

Audit Committee

The Audit Committee comprises three independent non-executive directors. The Chairman of the Audit Committee was Mr. SUN, Patrick, an independent non-executive director. Mr. Sun is an experienced investment banker with appropriate professional qualifications, or accounting, or related financial management expertise as required under Rule 3.10(2) of the Listing Rules for the purpose of such appointment. The chairmanship of Audit Committee was taken up by Mr. WONG Yuet Leung, Frankie in 2007 while Mr. Sun remained as a member of the committee.

The Committee meets not less than twice a year to review and discuss the interim and annual consolidated financial statements respectively. Additional meetings may also be held by it from time to time to discuss special projects or other issues it considers necessary. The independent auditor of the Group may request a meeting if they consider it necessary.

The authorities of the Audit Committee include (1) investigating any activity within its terms of reference; (2) seeking any information it requires from any employee; and (3) obtaining outside legal or other independent professional advice if required.

The main duties of the Audit Committee are as follows:

- To consider the appointment of the independent auditor, the audit fee, and any question of resignation or dismissal
- To discuss with the independent auditor the nature and scope of the audit

- To review and monitor the independent auditor's independence and objectivity and the effectiveness of the audit process in accordance with applicable standards
- To develop and implement policy on the engagement of an independent auditor to supply non-audit services
- To review the Group's interim and annual consolidated financial statements before submission to the Board
- To discuss problems and reservations arising from the interim review and final audits and any matters that the independent auditor may wish to discuss
- To review the independent auditor's management letter and the management's response
- To review the Group's statement on internal control system prior to endorsement by the Board
- To review the internal audit plan, and ensure that the internal audit function is adequately resourced and has appropriate standing with the Group
- To consider the major findings of any internal investigation or internal audit reports and the management's response
- To consider other topics, as defined by the Board

The attendance record of Audit Committee meetings for 2006 is as follows:

Number of Meetings	**2**	
Members of the Audit Committee	**No. of Meetings attended**	**Attendance rate**
SUN, Patrick	2	100%
CHOY Kwok Hung, Patrick	2	100%
WONG Yuet Leung, Frankie	2	100%
Attendance rate		**100%**

Throughout the year, the Audit Committee discharged its prescribed responsibilities, and reviewed and discussed the financial results and internal control system of the Group.

Remuneration Committee

The Remuneration Committee comprises one non-executive director (also the Chairman of the Committee) and two independent non-executive directors. A majority of the votes in the Remuneration Committee are exercisable by independent non-executive directors. The Committee does not deal with the remuneration of non-executive directors which shall be a matter for the executive directors of the Board. No director or senior executive will be involved in any discussion in connection with his or her own remuneration. The Remuneration Committee also consults the Non-executive Chairman about their proposals relating to the remuneration of other executive directors and has access to professional advice if considered necessary. The Committee consulted the head of human resources in respect of human resources policy and market as well as other company information.

The meetings of the Remuneration Committee shall normally be held not less than once a year to review and approve principally the remuneration of the Managing Director and executive directors of the Company. The Remuneration Committee, currently chaired by Mr. CHANG Ching Yi, Steven has delegated to the Managing Director the authority to approve the remuneration of all the employees of the Group below the rank of executive directors. For policy related remuneration schemes, they will be decided by the Board.

The main duties of the Remuneration Committee are as follows:

- To determine the framework and broad policy for the remuneration of the Chairman, Managing Director and executive directors
- To approve remuneration package for any new hire or the respective bonus in excess of an amount as specified by the Committee from time to time
- To delegate relevant responsibility and to receive adequately detailed reports of all exercises of such delegated responsibility
- To review the appropriateness and relevance of the remuneration policy
- To approve the performance related pay schemes operated by the Group
- To review all share incentive plans for approval by the Board
- To ensure the contractual terms on termination with senior executives and any payments thereof are fair to the individual and the Group
- To give due regard to legal requirements, tax provisions and recommendations of the Listing Rules and guidelines in respect of remuneration package for senior executives
- To review annually and take note of the remuneration trends of the Group and obtain reliable and up-to-date information about remuneration packages of other closely comparable companies
- To report its proceedings to the Board after each meeting

The attendance record of Remuneration Committee meetings for 2006 is as follows:

Number of Meetings	**4**	
Members of the Remuneration Committee	**No.of Meetings attended**	**Attendance rate**
CHANG Ching Yi, Steven	4	100%
CHOY Kwok Hung, Patrick	4	100%
SUN, Patrick	4	100%
Attendance rate		**100%**

In 2006, the Remuneration Committee determined the remuneration policy for the executive directors, assessed their performances as well as approved their employment contracts with the Group. Details of remuneration of directors can be obtained in the Consolidated Financial Statements section.

Nomination Committee

In 2006, the Nomination Committee comprised the Non-executive Chairman (also the Chair of the Committee), the Managing Director and one non-executive director. The Nomination Committee generally meets before the annual general meeting, or at other times as required by the Chairman of the Committee.

The Nomination Committee, chaired by Dr. LAM Pak Lee, will identify qualified candidates to fill the Board membership whenever such vacancy arises. It will nominate such candidates for the Board to consider, and regularly review the composition of the Board as well as make suggestions on any change that may be required. The chairmanship of Nomination Committee was taken up by Mr. SUN, Patrick in 2007 and Dr. Lam withdrew himself as a member of the Committee.

The main duties of the Nomination Committee are as follows:

- To review the structure, size and composition of the Board regularly and to make recommendations to the Board with regard to any changes required
- To evaluate the balance of skills, knowledge and experience of the Board
- To identify and nominate any candidate for the Board's approval
- To review the leadership needs and succession plans of the Group in relation to both directors and senior executives
- To make recommendations for the appointment and removal of the Chairman, Managing Director or any director
- To make recommendations to the Board on the re-appointment of any non-executive director at the conclusion of his specified term of office
- To report its proceedings to the Board after each meeting

The attendance record of Nomination Committee meetings for 2006 is as follows:

Number of Meetings	**2**	
Members of the Nomination Committee	**No. of Meetings attended**	**Attendance rate**
LAM Pak Lee	2	100%
CHANG Ching Yi, Steven	2	100%
LEUNG Kwong Wai	2	100%
Attendance rate		**100%**

Investment Committee

The Investment Committee comprises three executive directors and one independent non-executive director. It shall meet at the request of any member of the Committee and its meetings will be facilitated by the Vice President, Corporate Development, and the Vice President, Finance will participate in the discussion.

The Investment Committee, currently chaired by Mr. LEUNG Kwong Wai, will evaluate and approve any equity investment of US$2 million or less with the support from the head of Corporate Development. The head of Finance will be involved in the review. Any equity investment exceeding that amount will be proposed by the Committee for the Board's approval. The Committee is authorized, at the expense of the Group, to seek external professional advice it considers necessary and to arrange external advisers to attend its meetings. The Committee will also periodically report the status and performance of investments to the Board.

The main duties of the Investment Committee are as follows:

- To assist the Board in discharging its duties and responsibilities in relation to investment activities (excluding treasury or cash management)
- To assist the Board with all of its policy setting responsibilities related to investment
- To establish and document the basic investment principles and beliefs held by the Committee as well as the Code of Ethics for avoiding possible conflict of interest
- To have all necessary access and authority to seek information from management to fulfill its objectives, duties and responsibilities
- To review the appointment of external professional advisers
- To review and monitor investment performance
- To review and advise on additions to and dispositions of existing investments
- To review annually the terms of reference of the Committee and to recommend to the Board any required changes
- To submit an annual work report to the Board summarizing the Committee's activities, findings, recommendations and results for the past year

The attendance record of Investment Committee meetings for 2006 is as follows:

Number of Meetings	**4**	
Members of the Investment Committee	**No. of Meetings attended**	**Attendance rate**
LEUNG Kwong Wai	4	100%
LO Wai Ming	2	50%
LAI Woon Ching	4	100%
CHOY Kwok Hung, Patrick	4	100%
Attendance rate		**88%**

With more than 15 investment cases studied by the corporate development division, the Committee decided to further study the merits of certain investment cases.

Accountability and Audit

Financial Reporting

The Directors of the Company acknowledge their responsibility to present a balanced, clear and understandable assessment in the Consolidated Financial Statements of the annual and interim reports. The Directors have prepared the Consolidated Financial Statements on a going concern basis, with supporting assumptions or qualifications as necessary. When the Directors are aware of material uncertainties relating to events or conditions that may cast significant doubt upon the Company's ability to continue as a going concern, such uncertainties will be clearly and prominently set out and discussed at length in this Corporate Governance Report.

Internal Controls

The internal controls within the Group are designed to help the Group achieve key initiatives, and represent the Group's efforts in protecting its physical assets, information and technology. The presence of internal controls empowers the Group to implement best business practices in dynamic and challenging business environments. In brief, the Group's internal controls cover a number of in-house procedures and policies. Examples are compliance with the Group's Code of Conduct, adherence to procedure manuals, confidentiality and information disclosure, documentation, authentication of transactions and so on.

During 2006, the Audit Committee conducted a review of the Group's system of internal control and was satisfied that the Group had complied with the code provisions of the Code.

The board conducted a review of the Group's internal control system for the year ended 31 December 2006, including financial, operational and compliance control, and risk management functions. The Board assessed the effectiveness of internal control by considering reviews performed by the Audit Committee, executive management and the internal auditor; and the independent auditor's management letters, if any.

The Internal Audit team follows a risk-based approach. Different audit areas are assigned risk ratings and an audit plan is formulated accordingly so that priority and appropriate audit frequency is given to areas with higher risks. The annual work plan is reviewed and endorsed by the Audit Committee. The team independently conducts regular financial and operational reviews on the Group and reports directly to the chairman of the Audit Committee regularly. Summary of major findings and control weaknesses, if any, are reviewed by the Audit Committee at least twice every year. The Internal Audit team monitors the follow-up actions agreed upon in response to its recommendations.

Independent Auditor

The Group's independent auditor is PricewaterhouseCoopers ("PwC"). PwC is responsible for auditing and forming an independent opinion on the Group's annual consolidated financial statements. Apart from the statutory audit of the annual consolidated financial statements, PwC was also engaged to perform a review on the interim consolidated financial statements of the Group for the six months ended 30 June 2006 as well as advise the Group on tax compliance and related matters.

The fees payable by the Group to the independent auditor in respect of audit and non-audit services provided by them for the year ended 31 December 2006 are US$125,000 and US$34,000 respectively.

Others

Model Code and Code of Conduct

The Group made specific enquiry with all directors of the Company regarding their compliance with the required standard set out in the Model Code (Appendix 10 of the Listing Rules) in relation to their securities transactions. Confirmation has been sought from all directors that they have complied all required Standards. Regarding the shares held by directors, the details are listed in the Report of the Directors section of this Annual Report. Pursuant to Appendix 14 paragraph A.5.4, the Group established its own written guidelines on no less exacting terms than the Model Code for relevant employees who are likely to be in possession of unpublished price sensitive information in respect of their dealings in the securities of the Company. All relevant employees conformed to the Group's own guidelines throughout the year 2006.

Since it was founded in July 1999, the Group has always held a strong belief that its future success relies on its trustworthiness, goodwill and integrity in dealing with customers, suppliers, employees, shareholders, the industry and governments. The Group has therefore established a set of Code of Conduct for all of its employees to follow. Adherence to the Code of Conduct is the responsibility of each employee of the Group and is a condition of continued employment. The Code of Conduct deals with key subject areas such as proper use of the Group's funds and assets, customer/supplier/government relationships, conflicts of interest and operating procedures.

Corporate Transparency and Investor Relations

The Company reports to shareholders semi-annually on the Group's business and financial conditions. Ever since the Group became one of the first IC design companies listed on the Main Board of the Hong Kong Stock Exchange, its management has actively participated in investor forums and conferences in the region as well as met investors during non-deal roadshows, with the purpose of ensuring understanding of the Group's business model and industry dynamics among investors.

It is the Company's intention to hold analyst meetings and press conferences immediately after the announcements of the Group's interim and annual results. In 2006, the Company made the Group's second annual results announcement and the third interim results announcement since listing. The management interacted directly with investors, analysts and the media, and provided them with insightful information and answers to their queries. On 27 April 2006, the Company held its 2006 Annual General Meeting at Conrad Hotel, Pacific Place, 88 Queensway, Hong Kong at 4:00pm. During the said annual general meeting, the following items were discussed:

- Report of the Directors and Independent Auditor's Report for the year ended 31 December 2005
- Final dividend for the year ended 31 December 2005
- Re-election of directors
- Authorization to fix the directors' remuneration
- Appointment of Independent Auditor
- Authorization to repurchase the Company's shares

- Authorization to grant a general mandate to allot, issue or deal with the Company's new shares
- Extension of the general mandate
- Amendments to the Company's Memorandum and Articles of Association

All resolutions related to the above items were passed unanimously.

For the year under review, the Company conducted 170 meetings and 54 conference calls with investors and analysts. On average, the Company had 4.3 meetings or conference calls with the investment community per week. It also participated in 3 non-deal roadshows during which it talked to investors in Hong Kong, Singapore, Tokyo and London, and 5 investor related functions such as corporate days, conferences or luncheons.

As part of its efforts to promote its image and reputation, the Group leveraged the networks and experience of a public relations firm. During 2006, a total of 27 media interviews were conducted on TV and radio, in newspapers and with some well known magazines.

The views of investors are invaluable to the Company. To help it improve communication with investors, the Company has been collecting ideas from shareholders and feedback from the investment community since listing. The Company also appreciates the opportunity to meet shareholders face-to-face.

The Company's Articles of Association were amended during 2006 to align with certain provisions of the Code and minor housekeeping amendment[s] of the Listing Rules. To the best knowledge of the Company, as at 31 December 2006, 4 institutional investors held more than 31% of the Company's shares, the Board as a whole held roughly 9%, and the remaining approximately 60%, is believed to be in public hands.

The website of the Group (www.solomon-systech.com) is also updated constantly to inform investors and the general public of the latest information of the Group, for example, the important dates for shareholders in the coming year and a soft copy of this Corporate Governance Report. Further information for shareholders can be found at the back of this report.

Shareholders' Rights

The Company's shareholders' rights are at all times highly regarded by the Group. The Group will make sure the Company's shareholders know how to exercise their rights. The Group provides effective channels for the Company's shareholders to communicate their ideas to the Group and exert their rights.

With regard to general enquiry, a shareholder may contact the Company's Share Registrar directly. Information on proceedings at general meetings, votes of members, proxies, dividends and reserves, transfer of shares and other information are detailed in the Company's Memorandum and Articles of Association, which is accessible for inspection at the Company's Share Registrar. The contact details of the Share Registrar appear at the end of this report. In the event that a shareholder wishes to put forward a proposal to the Board, he may put forth his enquiry in writing to the Corporate Communications Manager who will act on the subject matter accordingly.

SOCIAL RESPONSIBILITY

The Group is committed to being a "green" partner of its customers and the society. In addition to achieving full compliance with RoHS[1] in 2005, we continued in 2006 to deliver green products. All of the Group's products have passed tighter RoHS substance tests according to Sony's SS-00259 requirements with 18 banned substances. The Group was also certified as Samsung Electronics Eco-partner.

As a socially responsible company, the Group has continually contributed to the welfare of the society. The initiatives undertaken in 2006 are stated below:

1. "Ocean's 10 Project" of WWF

This project is a 3-year awareness campaign featuring "10 marine flagship species" in Hong Kong. The total sponsorship amount spread between 2005 and 2007 will be HK$730,000. The purpose of the project is to raise public awareness of marine heritage of Hong Kong by focusing on the 10 marine flagship species, thereby fostering the perception of Hong Kong being a diverse biological habitat.

In its second year, the educational campaign featured a new, interactive website (www.wwf.org.hk/oceans10), an "Ocean's 10" Bus Design Competition and the launch of a Multimedia Creative Competition.

Apart from monetary support, the Group's employees and their families also participated in the various educational activities to understand and care for the environment. Activities that took place in 2006 included the glass-bottomed boat ride and weed clearing volunteer program.

2. A "Caring Company"

Apart from making donations to charities, the Group consistently partners with the social service sector on voluntary work. During the year, the Group actively invited employees and their families to join its charitable and recreational activities. To show its support to the handicapped,

©Byron Li / WWF

Primary school students Lau Ching Fung and Kwai Ming Wu of Memorial School of The Precious Blood (PM), and secondary school student Ho Ka U of TWGHs S.C.Gaw Memorial College, were winners of the "Ocean's 10" Bus Design Competition. Chan Ying Lee triumphed in the Open section.

On 12 August 2006, some staff and members of their families participated in WWF's Mai Po Volunteer Program, helping WWF to remove weeds from the coast along the Mai Po Nature Reserve. Though a hard day of work, it gave participants a meaningful experience in helping to save the environment.

1. A European Union's Directive of Restriction on Hazardous Substances (2002/95/EC), which became European Law in February 2003 and effective on 1 July 2006, restricts the use of six hazardous materials (lead, mercury, cadmium, chromium VI, PBB and PBDE) in the manufacture of various types of electronic and electrical equipment.

Around 70 employees and their family members participated in the " Walks for Millions – New Territories Walk – Deep Bay Link" on 5 November 2006 to raise funds for the Community Chest.

the Group uses local courier and car cleaning services provided by companies that employ the handicapped or disabled people. The Group's commitment to charity and betterment of the society again earned it the "Caring Company" name presented by the Hong Kong Council of Social Service. It was also named a Panda Partner by WWF Hong Kong for its continuous efforts in environmental protection.

3. Sponsorships, charitable activities and advisory

The Group granted 5 scholarships, of HK$20,000 each, to universities in Hong Kong. Including development foundations, the Group had offered more than HK$170,000 in funding to universities in Hong Kong. Its donations to charitable organizations such as the Pok Oi Hospital, Yan Oi Tong, Outward Bound Trust of Hong Kong and the Community Chest of Hong Kong amounted to over HK$125,000. In November 2006, 70 staff members of the Group participated in the "Walks for Millions – New Territories Walk – Deep Bay Link" of the Community Chest and the "Dress Special Day" of the charity in September 2006 had the support of 182 employees.

As a hi-tech company, the Group continues to act as an advisor to the industry, the local government and universities, and supports the growth of the technology sector that plays an essential role in fostering the well being of the society.

EMPLOYEES

Showing a strong team spirit, passion and tenacity, the Solomon Systech team won the Corporate Challenge 2006.

Undeniably, the Group's most important assets are its employees. Top on the operational agenda for the management is offering the right training to employees to help them realize their full potential and sharpen their ability to cope with changes and new challenges. In 2006 a total of 13,437 hours of training, equivalent to an average of 39.4 hours a year per person, was provided to employees. The various topics covered included language skills, product knowledge, marketing and leadership skills, with external consultants or internal experienced employees as instructors. Apart from in-house training, the Group encourages employees to take external job-related courses and will sponsor a portion of the course fee. Last year, the Group spent around HK$1.3 million on training and related sponsorship.

All new employees are required to take mandatory programs on topics including internal control and information protection, ISO and quality management system, as part of the job orientation. Specifically designed for new hires, these programs familiarize them with the Group's operations and its emphasis on quality. All trainings and development programs primarily serve one or more of three main purposes: enhancing an employee's skills, strengthening an employee's understanding of the Group's culture and internal procedures, and providing professional development to the employee.

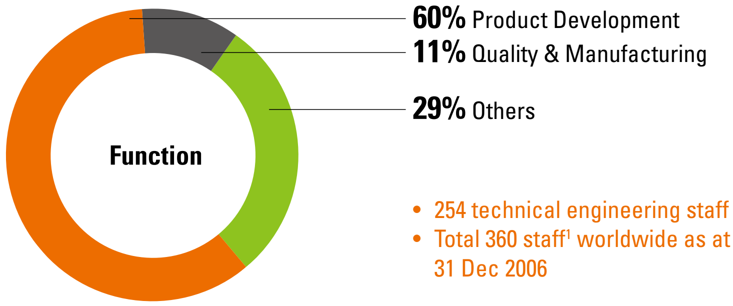
Remuneration of the Group's employees includes basic salaries and bonuses. The Group believes in incentivizing, retaining and rewarding employees and attracting new talents with the right incentives, cash or share based, to make sure their interests are aligned with that of the Group. In addition to the two programs (Share Option Scheme and Share Award Plan) in placed, the Group implements a cash rewarding program, namely NPI Incentive Program, to reward development teams for success of new product introduction through monitoring time to market and revenue contribution of specific new products.

In addition to encouraging dedication to work, the Group believes building a corporate culture that promotes strong team spirit is also very important. Last year, for the first time, the Group rallied a team of over 30 staff members to participate in the Corporate Challenge 2006 and was very proud to see the team win the championship in the Mobicon Cups among total 59 participating teams. Organized annually by the Outward Bound Trust of Hong Kong since 1986, the

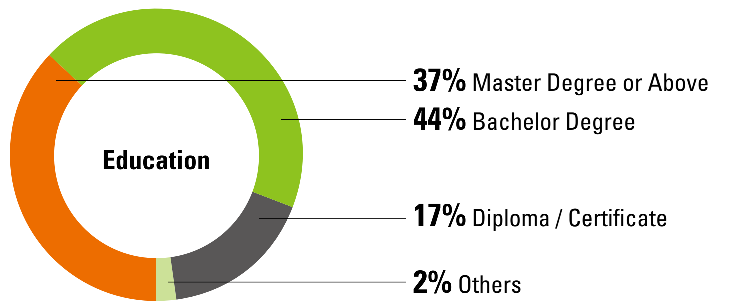
Corporate Challenge gathers teams representing Hong Kong's leading corporations, to compete in games specially designed for fun and team building. Living out its "One Team, One Spirit" slogan, the company's team showed their confidence and ability in rising above challenges, coming up with creative solutions and delivering excellence as a united force.

The Group's Staff Recreation Club also organizes weekly activities for employees including games of sport such as basketball, badminton, football, bowling, squash and table tennis, and other social events such as a cuttlefish fishing tour and boat trips. The Group believes such activities will enhance relationship among employees and can help to foster a sense of belonging to the "big family".

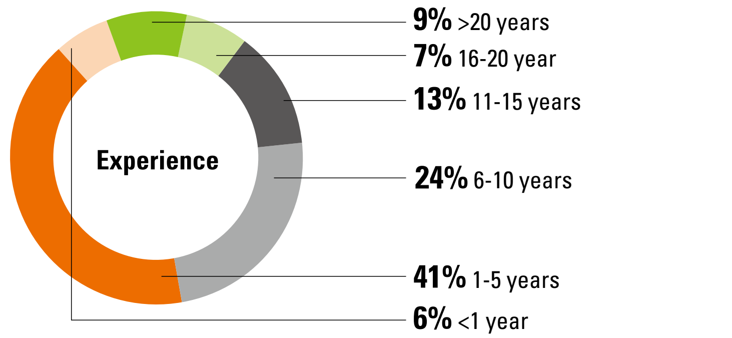
The Group values its pool of industry talents and rewards its members for excellence. Through offering employees job satisfaction, it instills in them a sense of ownership of the company and its mission.



- 254 technical engineering staff
- Total 360 staff[1] worldwide as at 31 Dec 2006



- 37% Master Degree or above
- 81% Bachelor Degree or above



- Management team > 20 years of working experience
- Average 8.6 years of working experience

More than 80% of the Group's employees hold university degrees or above, and more than one-third have master degrees or higher academic standings. The Group's emphasis research and development is also reflected in the make-up of its workforce, with around 60% being engineers who specialize in product development. The entire team has, on average, 8.6 years of working experience.

1. Data in all the charts exclude manufacturing subsidiary.

REPORT OF THE DIRECTORS

The directors submit their report together with the audited financial statements of the Company and its subsidiaries (collectively, the "Group") for the year ended 31 December 2006.

Principal activities and geographical analysis of operations

The principal activity of the Company is investment holding. The activities of the subsidiaries are set out in note 16 to the consolidated financial statements.

An analysis of the Group's performance for the year by business and geographical segments is set out in note 5 to the consolidated financial statements.

Results and appropriations

The results of the Group for the year are set out in the consolidated income statement on page 58.

During the year, the directors have declared an interim dividend of HK$0.02 per ordinary share, totalling HK$50,183,000 (US$6,467,000) attributed to the results of 2006, which was paid on 18 September 2006.

The directors recommend the payment of a final dividend of HK$0.04 per ordinary share, totalling HK$100,106,000 (US$12,869,000).

The proposed final dividend, if approved at the forthcoming annual general meeting of the Company to be held on 3 May 2007, is expected to be paid on 10 May 2007 to the shareholders of the Company whose names appear on the register of members of the Company on 3 May 2007, and for the purpose of determining the entitlements of the shareholders, the register of members of the Company will be closed from 27 April 2007 to 3 May 2007, both days inclusive.

Reserves

Movements in the reserves of the Group and of the Company during the year are set out in note 24 to the consolidated financial statements.

Donations

Charitable and other donations made by the Group during the year amounted to US$ 52,000.

Property, plant and equipment

Details of the movements in property, plant and equipment of the Group are set out in note 14 to the consolidated financial statements.

Share capital

Details of the movements in share capital of the Company are set out in note 22 to the consolidated financial statements.

Distributable reserves

Distributable reserves of the Company as at 31 December 2006, comprising share premium reserve of US$113,582,000 that is subject to the regulation of Section 34 of the Cayman Islands Companies Law and the Articles of Association of the Company, the equity compensation reserve of US$9,302,000 and retained earnings of US$27,337,000 totalling US$150,221,000 are available for distribution to the Company's shareholders.

Pre-emptive rights

There is no provision for pre-emptive rights under the Company's Articles of Association and there is no restriction against such rights under the laws of the Cayman Islands which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

Five-year financial summary

A summary of the results and of the assets and liabilities of the Group for the last five financial years ended 31 December is set out on page 24.

Purchase, sale or redemption of Company's listed shares

Except for the repurchase of the Company's own ordinary shares as set out in note 22 to the consolidated financial statements, there were no purchases, sales or redemptions of the Company's listed securities by the Company or any of its subsidiaries during the year. Shares were repurchased during the year to enhance the net asset value.

Share options

Share options have been granted to directors and senior management of the Group under the Share Option Scheme approved by the shareholders of the Company at an Extraordinary General Meeting on 25 February 2004.

The purpose of the Share Option Scheme is to provide the participants who may be executive directors, non-executive directors, independent non-executive directors, employees of any member of the Group, any advisers, consultants, distributors, contractors, contract manufacturers, suppliers, agents, customers, business partners, joint venture business partners or service providers of any member of the Group who as the Board of Directors, in its sole discretion, may consider, will contribute to the Group, with opportunity to acquire proprietary interests in the Company so as to encourage such participants to work towards enhancing the value of the Company and its shares for the benefit of the Group with a flexible means of retaining, incentivising, rewarding, remunerating, compensating and/or providing benefits to such participants. The terms of the Share Option Scheme are in accordance with the provisions of the Chapter 17 of The Rules Governing the Listing of Securities (the "Listing Rules") on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

The Share Option Scheme is valid and effective for a period of 10 years commencing on 19 March 2004, being the date of adoption of such scheme by the Board of Directors of the Company.

The options were granted at a nominal consideration of HK$1.00. Each option gives the holder the right to subscribe for one share of the Company at a pre-determined price per share.

The exercise price of the options granted under the Share Option Scheme shall be no less than the higher of (i) the average closing price of the ordinary shares issued by the Company, with a nominal value of HK$0.10 each (the "Shares"), as stated in the daily quotations sheet issued by the Stock Exchange for the five business days immediately proceeding the date of grant; and (ii) the closing price of the Shares as stated in the daily quotations sheets issued by the Stock Exchange on the date of grant. Each option gives the holder the right to subscribe for one share of the Company. Options to subscribe for 5,500,000 new shares of the Company were granted by the Company to directors and senior management of the Group under the Share Option Scheme on 28 June 2006. These options are exercisable at the exercise price of HK$1.98 per share, starting from 1 July 2007 and will lapse on 1 July 2009.

The Company can issue options so that the total number of shares that may be issued upon exercise of all options to be granted under the share option schemes does not in aggregate exceed 10% of the shares in issue on the date of approval of the Share Option Scheme. The Company may renew this limit at any time, subject to shareholders' approval and the issue of a circular and in accordance with the Listing Rules provided that the number of shares to be issued upon exercise of all outstanding options granted and yet to be exercised under all the share option schemes does not exceed 30% of the shares in issue from time to time.

Share options (continued)

Details of the share options outstanding as at 31 December 2006 which were granted under the Share Option Scheme are as follows:

Name of participants	Number of options: Held on 1 January 2006	Granted during the year	Exercised during the year	Held on 31 December 2006	Exercise price HK$	Grant date	Exercise period Begins	Ends
Executive and Non-executive Directors								
Lam Pak Lee	800,000	—	—	800,000	2.695	14 June 2005	1 July 2006	30 June 2008
	—	500,000	—	500,000	1.980	28 June 2006	1 July 2007	30 June 2009
	800,000	500,000	—	1,300,000				
Chang Ching Yi, Steven	800,000	—	—	800,000	2.695	14 June 2005	1 July 2006	30 June 2008
	—	500,000	—	500,000	1.980	28 June 2006	1 July 2007	30 June 2009
	800,000	500,000	—	1,300,000				
Wong Yuet Leung, Frankie (i)	500,000	—	—	500,000	2.695	14 June 2005	1 July 2006	30 June 2008
	—	500,000	—	500,000	1.980	28 June 2006	1 July 2007	30 June 2009
	500,000	500,000	—	1,000,000				
Leung Kwong Wai	800,000	—	—	800,000	2.695	14 June 2005	1 July 2006	30 June 2008
	—	500,000	—	500,000	1.980	28 June 2006	1 July 2007	30 June 2009
	800,000	500,000	—	1,300,000				
Huang Hsing Hua	300,000	—	—	300,000	2.695	14 June 2005	1 July 2006	30 June 2008
	—	500,000	—	500,000	1.980	28 June 2006	1 July 2007	30 June 2009
	300,000	500,000	—	800,000				
Lai Woon Ching	300,000	—	—	300,000	2.695	14 June 2005	1 July 2006	30 June 2008
	—	500,000	—	500,000	1.980	28 June 2006	1 July 2007	30 June 2009
	300,000	500,000	—	800,000				
Lo Wai Ming	300,000	—	—	300,000	2.695	14 June 2005	1 July 2006	30 June 2008
	—	500,000	—	500,000	1.980	28 June 2006	1 July 2007	30 June 2009
	300,000	500,000	—	800,000				
Subtotal	3,800,000	3,500,000	—	7,300,000				

(i) Mr. Wong Yuet Leung, Frankie was re-designated as an Independent Non-executive Director of the Company effective from 1 January 2007.

Share options (continued)

Name of participants	Held on 1 January 2006	Number of options Granted during the year	Exercised during the year	Held on 31 December 2006	Exercise price HK$	Grant date	Exercise period Begins	Ends
Independent Non-executive Directors								
Choy Kwok Hung,	500,000	—	—	500,000	2.695	14 June 2005	1 July 2006	30 June 2008
Patrick	—	500,000	—	500,000	1.980	28 June 2006	1 July 2007	30 June 2009
	500,000	500,000	—	1,000,000				
Kao Kuen, Charles	500,000	—	—	500,000	2.695	14 June 2005	1 July 2006	30 June 2008
	—	500,000	—	500,000	1.980	28 June 2006	1 July 2007	30 June 2009
	500,000	500,000	—	1,000,000				
Sun, Patrick	800,000	—	—	800,000	2.695	14 June 2005	1 July 2006	30 June 2008
	—	500,000	—	500,000	1.980	28 June 2006	1 July 2007	30 June 2009
	800,000	500,000	—	1,300,000				
Subtotal	1,800,000	1,500,000	—	3,300,000				
Senior Management								
Senior	500,000	—	—	500,000	2.695	14 June 2005	1 July 2006	30 June 2008
management	—	500,000	—	500,000	1.980	28 June 2006	1 July 2007	30 June 2009
Subtotal	500,000	500,000	—	1,000,000				
Total	6,100,000	5,500,000	—	11,600,000				

No option under the Share Option Scheme lapsed, or was cancelled or exercised during the year.

Share options (continued)

On 28 June 2006 when the relevant options were granted under the Share Option Scheme, the closing market value per share was HK$1.75. The value of the options granted to the respective parties is as follows:

	HK$'000	US$'000
Dr. Lam Pak Lee	152	20
Mr. Leung Kwong Wai	152	20
Mr. Chang Ching Yi, Steven	151	19
Mr. Sun, Patrick	151	19
Prof. Kao Kuen, Charles	151	19
Mr. Choy Kwok Hung, Patrick	152	19
Mr. Wong Yuet Leung, Frankie	152	19
Mr. Huang Hsing Hua	152	20
Mr. Lai Woon Ching	152	20
Mr. Lo Wai Ming	152	20
Senior management	152	20
	1,669	215

The value of the options granted during the year is HK$1,669,000 (approximately US$215,000), based on the Black-Scholes valuation model. The significant inputs into the model were the share price of HK$1.75 at the grant date, exercise price shown above, expected life of option of 2 years, expected dividend paid out rate of 10.86% and annual risk-free interest rate of 4.63%. The volatility of 53.8% measured at the standard deviation of the expected share price returns is based on statistical analysis of daily share prices from 29 June 2005 to 28 June 2006. The Black-Scholes model is developed to estimate the fair value of European share options. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used. The value of an option varies with different variables of certain subjective assumptions. Any change in variables so adopted may materially affect the estimation of the fair value of an option.

Directors

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

Mr. Sun, Patrick, Independent Non-executive Director (and Non-executive Chairman effective from 1 January 2007)

Dr. Lam Pak Lee, Non-executive Chairman (as Non-executive Director effective from 1 January 2007)

Mr. Leung Kwong Wai, Managing Director
Mr. Huang Hsing Hua, Executive Director
Mr. Lai Woon Ching, Executive Director
Mr. Lo Wai Ming, Executive Director
Mr. Lam Shun Fu, Percy, Executive Director (appointed on 23 October 2006)
Mr. Chang Ching Yi, Steven, Non-executive Director
Mr. Choy Kwok Hung, Patrick, Independent Non-executive Director
Prof. Kao Kuen, Charles, Independent Non-executive Director
Mr. Wong Yuet Leung, Frankie, Non-executive Director (as Independent Non-executive Director effective from 1 January 2007)

In accordance with Article 95 of the Company's Articles of Association, Mr. Lam Shun Fu, Percy appointed during the year, shall hold office until the forthcoming Annual General Meeting and being eligible, offers himself for re-election.

In accordance with Article 112 of the Company's Articles of Association, Mr. Leung Kwong Wai, Mr. Sun Patrick, Mr. Choy Kwok Hung, Patrick and Prof. Kao Kuen, Charles, directors of the Company, will retire by rotation at the forthcoming annual general meeting and, being eligible, will offer themselves for re-election.

Mr. Choy Kwok Hung, Patrick, Prof. Kao Kuen, Charles and Mr. Sun, Patrick are Independent Non-executive Directors and their service contracts were renewed in 2006 for a term expiring on 30 June 2008.

Furthermore, Mr. Wong Yuet Leung, Frankie, was re-designated as Independent Non-executive Director on 1 January 2007. His service contract was renewed in 2006 for a term expiring on 30 June 2008.

Directors' service contracts

None of the directors who are proposed for re-election at the forthcoming annual general meeting has a service contract with the Company or any of its subsidiaries which is not determinable within one year without payment of compensation, other than statutory compensation.

Directors' interests in contracts

No contract of significance in relation to the Group's business to which the Company, any of its subsidiaries, fellow subsidiaries or its parent company was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Biographical details of directors and senior management

Brief biographical details of directors and senior management are set out on pages 20 to 21.

Directors' and Chief Executive's interests and short positions in the shares and underlying shares of the Company or any associated corporation

As at 31 December 2006, the interests and short positions of each director and chief executive in the shares and underlying shares of the Company or its associated corporations (within the meaning of the Securities and Futures Ordinance ("SFO")), as recorded in the register required to be kept by the Company under Section 352 of Part XV of the SFO or as notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies were as follows:

		Ordinary shares of HK$0.10 each in the Company as 31 December 2006				
		Directly owned		Beneficially owned		
Name of Director		**Shares**	**options (vi)**	**Shares**	**Total**	**Percentage**
Chang Ching Yi, Steven	Long position	1,800,000	1,300,000	—	3,100,000	0.12%
	Short position	—	—	—	—	—
Choy Kwok Hung, Patrick	Long position	1,100,000	1,000,000	—	2,100,000	0.08%
	Short position	—	—	—	—	—
Huang Hsing Hua	Long position	7,168,000	800,000	2,192,000(i)	10,160,000	0.41%
	Short position	—	—	2,192,000(i)	2,192,000	0.09%
Kao Kuen, Charles	Long position	500,000	1,000,000	—	1,500,000	0.06%
	Short position	—	—	—	—	—
Lai Woon Ching	Long position	26,489,600	800,000	2,592,000(ii)	29,881,600	1.19%
	Short position	—	—	2,592,000(ii)	2,592,000	0.10%
Lam Pak Lee	Long position	25,800,000	1,300,000	—	27,100,000	1.08%
	Short position	—	—	—	—	—
Leung Kwong Wai	Long position	110,240,001	1,300,000	10,250,000(iii)	121,790,001	4.87%
	Short position	—	—	10,250,000(iii)	10,250,000	0.41%
Lo Wai Ming	Long position	28,328,000	800,000	4,192,000(iv)	33,320,000	1.33%
	Short position	—	—	4,192,000(iv)	4,192,000	0.17%
Sun, Patrick	Long position	—	1,300,000	—	1,300,000	0.05%
	Short position	—	—	—	—	—
Wong Yuet Leung, Frankie	Long position	—	1,000,000	—	1,000,000	0.04%
	Short position	—	—	—	—	—
Lam Shun Fu, Percy	Long position	—	—	1,300,000(v)	1,300,000	0.05%
	Short position	—	—	1,300,000(v)	1,300,000	0.05%

(i) Out of the 2,192,000 Shares held by Mr. Huang:

(a) 1,600,000 Shares are subject to lock-up and shall be released in two equal tranches of 800,000 Shares each on 8 April 2007 and 2008 respectively. These shares are held by HSBC International Trustee Limited as custodian ("the Custodian") for Mr. Huang under the Pre-IPO Loyalty Plan[1]; and

(b) 592,000 Shares are subject to a two year vesting period and held by HSBC International Trustee Limited as trustee (the "Trustee") for the benefit of Mr. Huang under the Share Award Plan of the Company. 136,000 shares, 252,000 shares, and 204,000 shares shall be vested respectively on 28 April 2007, 8 June 2007 and 28 April 2008.

[1] Under the Pre-IPO Loyalty Plan, each of the beneficiaries is subject to lock-up for a period from the vesting date up to four years after the Listing Date. During the said lock-up period, the Shares are held by the Custodian. 25% of such Shares are released from the lock-up upon each of the anniversary of the Listing Date.

Directors' and Chief Executive's interests and short positions in the shares and underlying shares of the Company or any associated corporation (continued)

(ii) Out of the 2,592,000 Shares held by Mr. Lai:

(a) 2,000,000 Shares are subject to lock-up and shall be released in two equal tranches of 1,000,000 Shares each on 8 April 2007 and 2008 respectively. These shares are held by the Custodian for Mr. Lai under the Pre-IPO Loyalty Plan; and

(b) 592,000 Shares are subject to a two year vesting period and held by the Trustee for the benefit of Mr. Lai under the Share Award Plan of the Company. 136,000 shares, 252,000 shares, and 204,000 shares shall be vested respectively on 28 April 2007, 8 June 2007 and 28 April 2008.

(iii) Out of the 10,250,000 Shares held by Mr. Leung:

(a) 6,000,000 Shares are subject to lock-up and shall be released in two equal tranches of 3,000,000 Shares each on 8 April 2007 and 2008 respectively. These shares are held by the Custodian for Mr. Leung under the Pre-IPO Loyalty Plan; and

(b) 4,250,000 Shares are subject to a two year vesting period and held by the Trustee for the benefit of Mr. Leung under the Share Award Plan of the Company. 1,076,000 shares, 1,560,000 shares and 1,614,000 shares shall be vested respectively on 28 April 2007, 8 June 2007 and 28 April 2008.

(iv) Out of the 4,192,000 Shares held by Mr. Lo:

(a) 3,600,000 Shares are subject to lock-up and shall be released in two equal tranches of 1,800,000 Shares each on 8 April 2007 and 2008 respectively. These shares are held by the Custodian for Mr. Lo under the Pre-IPO Loyalty Plan; and

(b) 592,000 Shares are subject to a two year vesting period and held by the Trustee for the benefit of Mr. Lo under the Share Award Plan of the Company. 136,000 shares, 252,000 shares, and 204,000 shares shall be vested respectively on 28 April 2007, 8 June 2007 and 28 April 2008.

(v) 1,300,000 Shares held by Mr. Lam are subject to a two year vesting period and held by the Trustee for the benefit of Mr. Lam under the Share Award Plan of the Company. 520,000 shares and 780,000 shares shall be vested respectively on 28 December 2007 and 28 December 2008.

(vi) These are options granted under the Share Option Scheme (see section headed "Share Option Scheme" for more details).

Saved as disclosed above, at no time during the year, the directors and chief executive (including their spouse and children under 18 years of age) had any interest in, or had been granted, or exercised, any rights to subscribe for shares of the Company and its associated corporations required to be disclosed pursuant to the SFO.

At no time during the year was the Company, its subsidiaries or its associated companies a party to any arrangement to enable the directors and chief executive of the Company (including their spouse and children under 18 years of age) to hold any interests or short positions in the shares or underlying shares in, or debentures of, the Company or its associated companies other than Mr. Leung Kwong Wai who holds shares of certain subsidiaries solely for the purpose of ensuring that the relevant subsidiary has more than one member.

Substantial shareholders' interests and/or short positions in the shares and underlying shares of the Company

The register of substantial shareholders required to be kept by the Company under section 336 of Part XV of the SFO shows that as at 31 December 2006, the Company had been notified of the following substantial shareholders' interests and short positions, being interests of 5% or more of the Company's issued share capital. These interests are in addition to those disclosed above in respect of the directors and chief executive of the Company.

	Ordinary shares of HK$0.10 each in the Company			
	Capacity	**Long/short positions**	**Number of shares**	**% of the issued share capital of the Company**
Government of Singapore Investment Corporation Pte Ltd	Investment Manager	Long	173,968,800	6.95%
TIAA-CREF Investment Management, LLC	Beneficial Owner	Long	197,989,193	7.91%
Genesis Fund Managers, LLP	Investment Manager	Long	241,745,500	9.66%
Morgan Stanley Investment Management Limited	Investment Manager	Long	178,082,000	7.12%

Management contracts

No contract concerning the management and administration of the whole or any substantial part of any business of the Company were entered into or existed during the year.

Major suppliers and customers

The percentages of purchases and sales for the year attributable to the Group's major suppliers and customers are as follows:

Purchases	
- the largest supplier	41%
- five largest suppliers combined	77%
Sales	
- the largest customer	64%
- five largest customers combined	84%

None of the directors of the Company or their associates holds, nor does any shareholder (which to the knowledge of the directors own more than 5% of the Company's share capital) had an interest in the major suppliers or customers noted above.

Sufficiency of public float

Based on the information that is publicly available to the Company and within the knowledge of the Directors, it is confirmed that there is sufficient public float of more than 25% of the Company's issued shares as at 26 March 2007.

Compliance with the Code on Corporate Governance Practices

The Company has complied with all applicable code provisions as set out in the Code on Corporate Governance Practices in Appendix 14 of the Listing Rules during the year ended 31 December 2006.

Compliance with the Model Code for Securities Transactions by Directors of Listed Issuer

The Company has its own written guidelines on securities transactions by Directors and relevant employees on no less exacting terms than the required standard set out in Appendix 10 of the Listing Rules. Specific enquiry has been made to all Directors and all of them were in compliance with such guidelines during the year ended 31 December 2006.

Independent Auditor

The consolidated financial statements for the year ended 31 December 2006 have been audited by PricewaterhouseCoopers, Certified Public Accountants, who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board

LEUNG Kwong Wai
Managing Director
Hong Kong, 26 March 2007

INDEPENDENT AUDITOR'S REPORT

羅兵咸永道會計師事務所

PricewaterhouseCoopers
22nd Floor, Prince's Building
Central, Hong Kong

TO THE SHAREHOLDERS OF
SOLOMON SYSTECH (INTERNATIONAL) LIMITED
(incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of Solomon Systech (International) Limited (the "Company") and its subsidiaries (together, the "Group") set out on pages 58 to 99, which comprise the consolidated and Company balance sheets as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors of the Company are responsible for the preparation and the true and fair presentation of these consolidated financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 26 March 2007

CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2006

	Notes	2006 US$'000	2005 US$'000
Sales	5	**254,092**	394,089
Cost of sales		**(194,823)**	(274,538)
Gross profit		**59,269**	119,551
Other gain - net		**787**	—
Research and development costs		**(17,373)**	(17,523)
Selling and distribution expenses		**(4,128)**	(2,255)
Administrative expenses		**(14,322)**	(11,789)
Other operating expenses		**(1,265)**	(235)
Operating profit		**22,968**	87,749
Interest income	6	**6,290**	4,485
Finance costs	9	**(1)**	(2)
Share of results of associated companies	17	**(662)**	(216)
Profit before taxation		**28,595**	92,016
Taxation	10	**(6,177)**	(15,762)
Profit attributable to shareholders	11	**22,418**	76,254
Dividends	12	**19,336**	61,452
Earnings per share (expressed in US cents per share)	13		
Basic		**0.91**	3.12
Diluted		**0.90**	3.08

The notes on pages 63 to 99 are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

As at 31 December 2006

	Notes	2006 US$'000	2005 US$'000
ASSETS			
Non-current assets			
Property, plant and equipment	14	13,785	11,077
Investments in associated companies	17	3,185	903
Available-for-sale financial assets	18	2,535	—
Fixed bank deposits	21	2,000	5,000
		21,505	16,980
Current assets			
Inventories	19	18,253	36,212
Trade and other receivables	20	61,688	59,219
Other financial assets	21	1,000	1,250
Pledged bank deposits		130	130
Short-term fixed deposits	21	8,083	37,000
Cash and cash equivalents	21	110,422	119,479
		199,576	253,290
Total assets		221,081	270,270
EQUITY			
Capital and reserves			
Share capital	22	32,251	32,360
Own shares held		(491)	(605)
Reserves			
Proposed final dividend	12	12,869	48,540
Others		135,254	126,718
		179,883	207,013
LIABILITIES			
Non-current liabilities			
Obligations under finance leases	26	19	29
Deferred tax liabilities	27	827	574
		846	603
Current liabilities			
Trade and other payables	25	38,527	56,357
Tax payables		1,815	6,287
Obligations under finance leases	26	10	10
		40,352	62,654
Total liabilities		41,198	63,257
Total equity and liabilities		221,081	270,270
Net current assets		159,224	190,636
Total assets less current liabilities		180,729	207,616

The notes on pages 63 to 99 are an integral part of these consolidated financial statements.

LEUNG Kwong Wai
Director

LAI Woon Ching
Director

BALANCE SHEET

As at 31 December 2006

	Notes	2006 US$'000	2005 US$'000
ASSETS			
Non-current assets			
Property, plant and equipment	14	473	296
Investments in subsidiaries	16	50,128	50,078
		50,601	50,374
Current assets			
Trade and other receivables		665	1,033
Amounts due from subsidiaries	16	41,873	59,062
Other financial assets	21	1,000	1,000
Short-term fixed deposits	21	6,083	32,000
Cash and cash equivalents	21	82,944	65,379
		132,565	158,474
Total assets		183,166	208,848
EQUITY			
Capital and reserves			
Share capital	22	32,251	32,360
Other reserves			
Reserves			
Proposed final dividend	12	12,869	48,540
Others		137,352	127,786
		182,472	208,686
LIABILITIES			
Current liabilities			
Amount due to a subsidiary	16	50	48
Provisions for other liabilities and charges		561	114
Deferred tax liabilities	27	83	—
		694	162
Total liabilities		694	162
Total equity and liabilities		183,166	208,848
Net current assets		131,871	158,312
Total assets less current liabilities		182,472	208,686

The notes on pages 63 to 99 are an integral part of these consolidated financial statements.

LEUNG Kwong Wai
Director

LAI Woon Ching
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2006

	Share capital US$'000	Share premium US$'000	Own shares held US$'000	Merger reserve US$'000	Exchange reserve US$'000	Equity compensation reserve US$'000	Retained earnings US$'000	Total US$'000
At 1 January 2005, as previously reported	32,279	86,394	—	2,082	(41)	—	55,865	176,579
Effect of changes in accounting policies	—	—	(1,338)	—	—	1,616	(77)	201
At 1 January 2005, as restated	32,279	86,394	(1,338)	2,082	(41)	1,616	55,788	176,780
Exchange difference	—	—	—	—	17	—	—	17
Exercise of share option	81	1,337	—	—	—	—	—	1,418
Dividends paid, net of portion for own shares held	—	—	—	—	—	—	(50,599)	(50,599)
Profit for the year	—	—	—	—	—	—	76,254	76,254
Equity compensation	—	—	—	—	—	3,143	—	3,143
Equity compensation transferred to share premium	—	1,624	733	—	—	(1,624)	(733)	—
At 31 December 2005	32,360	89,355	(605)	2,082	(24)	3,135	80,710	207,013
At 1 January 2006	32,360	89,355	(605)	2,082	(24)	3,135	80,710	207,013
Exchange difference	—	—	—	—	36	—	—	36
Dividends paid, net of portion for own shares held	—	—	—	—	—	—	(54,255)	(54,255)
Shares repurchased	(109)	(1,387)	—	—	—	—	—	(1,496)
Profit for the year	—	—	—	—	—	—	22,418	22,418
Equity compensation	—	—	114	—	—	6,167	(114)	6,167
At 31 December 2006	32,251	87,968	(491)	2,082	12	9,302	48,759	179,883

The notes on pages 63 to 99 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2006

	Notes	2006 US$'000	2005 US$'000
Operating activities			
Cash generated from operations	29	**35,185**	93,724
Hong Kong profits tax paid		**(10,356)**	(18,847)
Overseas tax (paid)/refunded		**(7)**	17
Interest element of finance lease rental payments		**(1)**	(2)
Net cash generated from operating activities		**24,821**	74,892
Investing activities			
Decrease in fixed bank deposits		**3,000**	6,000
Purchase of property, plant and equipment		**(8,875)**	(6,205)
Proceeds from sale of property, plant and equipment		**—**	6
Acquisition of associated companies		**(2,944)**	—
Acquisition of available-for-sale financial assets		**(3,902)**	—
Decrease/(increase) in short-term fixed deposits		**28,917**	(37,000)
Decrease/(increase) in other financial assets		**250**	(1,250)
Interest received		**5,422**	4,485
Net cash generated from/(used in) investing activities		**21,868**	(33,964)
Financing activities			
Repurchase of ordinary shares		**(1,496)**	—
Proceeds from the exercise of Pre-IPO Share Options		**—**	1,418
Payment of capital element of finance leases		**(10)**	(8)
Inception of finance lease		**—**	19
Decrease in pledged bank deposits		**—**	2,000
Dividends paid		**(55,007)**	(51,567)
Dividends used in own shares held not vested		**752**	968
Net cash used in financing activities		**(55,761)**	(47,170)
Net decrease in cash and cash equivalents		**(9,072)**	(6,242)
Effect of foreign exchange rate changes		**15**	6
Cash and cash equivalents at 1 January		**119,479**	125,715
Cash and cash equivalents at 31 December		**110,422**	119,479
Analysis of balances of cash and cash equivalents:			
Bank balances and cash		**110,422**	119,479

The notes on pages 63 to 99 are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. General information

Solomon Systech (International) Limited (the "Company") and its subsidiaries (together the "Group") are fabless semiconductor companies specializing in the reseach, design, development and sales of proprietary integrated circuits.

The Company was incorporated in the Cayman Islands on 21 November 2003 as an exempted company with limited liability under the Companies Law, Cap.22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands (the "Cayman Companies Law"). The address of its registered office is P.O. Box 309GT, Ugland House, South Church Street, George Town, Grand Cayman, Cayman Islands and the address of its principal office in Hong Kong is 6/F., No.3 Science Park East Avenue, Hong Kong Science Park, Shatin, New Territories, Hong Kong.

The Company has been listed on the main board of the Stock Exchange since 8 April 2004.

These consolidated financial statements are presented in US dollars, unless otherwise stated. These consolidated financial statements have been approved for issue by the Board of Directors on 26 March 2007.

2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Company have been prepared in accordance with Hong Kong Financial Reporting Standards (HKFRS). The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and financial assets at fair value through profit or loss.

The preparation of financial statements in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

(a) *Amendments to published standards effective and new/revised standard/interpretation which are relevant to the Group's operations and are mandatroy in 2006:*

- HKAS 19 (Amendment) – Actuarial Gains and Losses, Group Plans and Disclosures
- HKAS 21 (Amendment) – New Investment in a Foreign Operation
- HKAS 39 (Amendment) – Cash Flow Hedge Accounting of Forecast Intragroup Transactions
- HKAS 39 (Amendment) – The Fair Value Option
- HKAS 39 (Amendment) and HKFRS 4 (Amendment) – Financial Instruments: Recognition and Measurement
- HKFRS – Int 4 – Determining Whether an Arrangement Contains a Lease

The adoption of new/revised HKAS 19 (Amendment), 21 (Amendment), 39 (Amendment), HKFRS 4 (Amendment) and HKFRS – Int 4 did not result in substantial changes to the accounting policies of the Group.

2. Summary of significant accounting policies (continued)

2.1 *Basis of preparation* (continued)

(b) New standards, amendments to standards and interpretations relevant to the Group's operation that have been issued but are not yet effective for 2006 and have not been early adopted by the Group:

- HKAS 1 (Amendment) – Presentation of Financial Statement – Capital Disclosures
- HKFRS 7 – Financial Instruments: Disclosures
- HKFRS 8 – Operating Segments
- HK (IFRIC) – Int 7 – Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economics
- HK (IFRIC) – Int 8 – Scope of HKFRS 2
- HK (IFRIC) – Int 9 – Reassessment of Embedded Derivatives
- HK (IFRIC) – Int 10 – Interim Financial Reporting and Impairment
- HK (IFRIC) – Int 11 – HKFRS 2 — Group and Treasury Share Transactions
- HK (IFRIC) – Int 12 – Service Concession Arrangements

The new/revised HKAS 1 (Amendment), HKFRS 7, and 8, HK (IFRIC) — Int 7, 8, 9, 10, 11 and 12 will not result in substantial changes to the accounting policies of the Group.

2. Summary of significant accounting policies (continued)

2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all its subsidiaries made up to 31 December.

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

A special purpose entity is an entity over which the Group has the power to govern the financial and operating policies. A special purpose entity is fully consolidated from the date on which control is transferred to the Group and is deconsolidated from the date that control ceases.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill (Note 2.6). If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the income statement.

Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet, the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted by the Company on the basis of dividend received and receivable.

2. Summary of significant accounting policies (continued)

2.2 Consolidation (continued)

(b) Associated companies

Associated companies are entities over which the Group have significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associated companies are accounted for by the equity method of accounting and are initially recognized at cost.

The Group's share of its associated companies post-acquisition profits or losses are recognized in the income statement, and its share of post-acquisition movements in reserves is recognized in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in associated companies equal or exceed its interest in the associated companies, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associated companies.

Unrealized gains on transactions between the Group and its associated companies are eliminated to the extent of the Group's interest in the associated companies. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of the associated companies have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet, the investment in associated companies are stated at cost less provision for impairment losses (Note 2.7). The results of associated companies are accounted for by the Company on the basis of dividend received and receivable.

2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those segments operating in other economic environments.

2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the"functional currency"). The consolidated financial statements are presented in US dollars, which is the Company's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement, except when deferred in equity as qualifying cash flow hedges or qualifying net investment hedges.

Changes in the fair value of monetary securities denominated in foreign currencies classified as available-for-sale are analyzed between translation differences resulting from changes in the amortized cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in the amortized cost are recognized in the income statement, and other changes in the carrying amount are recognized in equity.

Translation differences on non-monetary items, such as equity instruments held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the available-for-sale reserve in equity.

2. Summary of significant accounting policies (continued)

2.4 Foreign currency translation (continued)

(c) Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognized as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is partially disposed of or sold, such exchange differences are recognized in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

2.5 Property, plant and equipment

All property, plant and equipment are stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the income statement during the financial period in which they are incurred.

Depreciation of property, plant and equipment is calculated using the straight-line method to allocate cost or revalued amounts to their residual values over their estimated useful lives, as follows:

Leasehold improvements	20% or over the unexpired lease period, whichever is shorter
Furniture, fixtures and office equipment	33.33%
Machinery and laboratory equipment	12.50% to 33.33%
Motor vehicles	33.33%

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.7).

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized within other gain - net, in the income statement.

2. Summary of significant accounting policies (continued)

2.6 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associated company at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associated companies is included in investments in associated companies. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose. The Group allocates goodwill to each business segment in each country in which it operates (Note 2.7).

(b) Patents and intellectual property

Patents and intellectual property are shown at historical cost. Patents and intellectual property have a definite useful life and are carried at cost less accumulated amortization. Amortization is calculated using the straight-line method to allocate the cost of trademarks and licences over their estimated useful lives of five years.

2.7 Impairment of investments in subsidiaries, associated companies and non-financial assets

Assets that have an indefinite useful life or are not yet available for use are not subject to amortization and are tested annually for impairment.

Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.8 Financial assets

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition.

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date, in which case they are classified as non-current assets. Loans and receivables are included in trade and other receivables in the balance sheet (Note 2.10).

2. Summary of significant accounting policies (continued)

2.8 Financial assets (continued)

(c) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Regular purchases and sales of investments are recognized on trade-date, the date on which the Group commits to purchase or sell the asset. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortized cost using the effective interest method.

Gains or losses arising from changes in the fair value of the financial assets at fair value through profit or loss' category are presented in the income statement within other (loss)/gain - net, in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognized in the income statement as part of other income when the Group's right to receive payments is established.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the income statement as gains and losses from investment securities.

Interest on available-for-sale financial assets calculated using the effective interest method is recognized in the income statement as part of other income. Dividends on available-for-sale financial assets are recognized in the income statement as part of other income when the Group's right to receive payments is established.

The fair value of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, or discounted cash flow analysis refined to reflect the issuer's specific circumstances. Investments in equity instruments that do not have a quoted market price in an active market and those fair value cannot be reliably measured, are measured at cost less impairment.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the income statement - is removed from equity and recognized in the income statement. Impairment losses recognized in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade receivables is described in Note 2.10.

2.9 Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the weighted average method. The cost of finished goods and work in progress comprises raw materials and subcontracting charges. It excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

2. Summary of significant accounting policies (continued)

2.10 Trade and other receivables

Trade and other receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognized in the income statement.

2.11 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks and fixed deposits with maturity within 3 months or less.

2.12 Share capital

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares options are shown in equity as a deduction, net of tax from the proceed.

Where any Group company purchases the Company's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued. Where such shares are subsequently reissued, any consideration received (net of any directly attributable incremental transaction costs and the related income tax effects) is included in equity attributable to the Company's equity holders.

2.13 Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associated companies, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

2. Summary of significant accounting policies (continued)

2.14 Employee benefits

(a) Pension obligations

The group operates defined contribution plans, under which the Group pays fixed contributions into separate entities. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

(b) Share-based compensation

The Group operates equity-settled, share-based compensation plans. The fair value of the employee services received in exchange for the grant of the shares or share options is recognized as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the shares or share options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). At each balance sheet date, the entity revises its estimates of the number of shares or share options that are expected to become exercisable. It recognizes the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

Under the Share Award Plan, directors and employees of the Group are entitled to receive shares in the Company. The shares held under trust by HSBC International Trustee Limited for the benefit of the directors and employees, have been created by capitalising the Company's retained earnings to pay up consideration in full prior to the listing of the Company in the Stock Exchange. Detail of outstanding shares can be referred to Note 23 to the consolidated financial statements on page 92.

The Company also adopted the Share Option Scheme under which options may be granted to subscribe for the Company's shares. Please refer to Note 23 to the consolidated financial statements on pages 90 and 91 for details.

(c) Employee leave entitlements

Employee entitlements to annual leave are recognized when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are not recognized until the time of leave.

(d) Profit-sharing and bonus plans

The Group recognizes a liability and an expense for bonuses and profit-sharing, based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognizes a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

2. Summary of significant accounting policies (continued)

2.15 Provisions

Provisions for restructuring costs and legal claims are recognized when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognized for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as an interest expense.

2.16 Trade payables

Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

2.17 Revenue recognition

Revenue comprises the fair value for the sale of products, net of discount and after eliminating sales within the Group. Revenue is recognized as follows:

(a) Sales of products

Sales of products are recognized on the transfer of risks and rewards of ownerships, which generally coincides with the time of shipment/delivery.

(b) Interest income

Interest income is recognized on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income.

2.18 Leases (as the lessee)

(a) Operating lease

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

(b) Finance lease

The Group leases certain property, plant and equipment. Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments.

Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other short-term and other long-term payables. The interest element of the finance lease payment is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the useful live of the asset and the lease term.

2. Summary of significant accounting policies (continued)

2.19 Government grants

Grants from the government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to costs are deferred and recognized in the income statement over the period necessary to match them with the costs that they are intended to compensate.

2.20 Research and development

Research expenditure is expensed as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognized as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility, and costs can be measured reliably. Other development expenditures are expensed as incurred. Development costs previously recognized as an expense are not recognized as an asset in a subsequent period. Development costs with a finite useful life that have been capitalized are amortized from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit, not exceeding five years.

2.21 Dividend distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders or directors as appropriate.

3. Financial risk management

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value risk, interest risk and price risk), credit risk, liquidity risk and; cash flow and interest rate risk.

(a) Market risk

Foreign exchange risk

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar. Revenue and majority of the cost of sales are US dollar based. Foreign exchange risk arises from future commercial transactions, recognized assets and liabilities and net investments in foreign operations.

(b) Credit risk

Customers of the Group are mainly well-known distributors with sound financial background. In addition, the Group has policies in place to ensure that sales of products are made to customers with appropriate credit history and within their respective credit limits.

(c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Group aims to maintain flexibility in funding by keeping committed credit lines available.

(d) Cash flow and fair value interest rate risk

The Group has no significant interest-bearing assets or liabilities except for bank balances. In view that majority of these bank balances are under short maturity terms, the cash flow and fair value interest rate risk is considered to be low.

3. Financial risk management (continued)

3.2 Fair value estimation

The fair value of financial instruments traded in active markets (such as publicly traded available-for-sale financial assets) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price; the appropriate quoted market price for financial liabilities is the current ask price.

The nominal value less estimated credit adjustments of trade receivables and payables approximate their fair values.

4. Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial period are discussed below.

(a) Income taxes

The Group is subject to income taxes in several jurisdictions. Significant judgment is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

(b) Equity compensation

In determining the total expenses for the Group's share-based compensation plans, the Group estimates the number of options/shares that are expected to become exercisable/vested at the date of grant. At each balance sheet date before the options/shares become fully exercisable/vested, the Group will revise the total expenses where the number of options/shares that are expected to become exercisable/vested is different from previously estimated.

(c) Property, plant and equipment and depreciation

The Group determines the estimated useful lives and related depreciation charges for the Group's property, plant and equipment. The Group will revise the depreciation charge where useful lives are different from previously estimated, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

5. Segment information - Group

(a) *Primary reporting format – business segment*

During the year, the Group is principally engaged in the research, design, development and sales of proprietary integrated circuits ("IC").

The Group has been operating in one single business segment, i.e. the research, design, development and sales of ICs. Sales amounted to US$254,092,000 and US$394,089,000 for the years ended 31 December 2006 and 2005 respectively.

(b) *Secondary reporting format – geographical segments*

The Group mainly operates in Hong Kong SAR ("Hong Kong"). The Group mainly sells to customers located in Hong Kong, Taiwan and Japan.

(i) Sales

	2006 **US$'000**	2005 US$'000
Hong Kong	**182,004**	125,195
Taiwan	**24,820**	158,324
Japan	**21,759**	85,887
Mainland China ("China")	**10,847**	511
Singapore	**6,814**	1,046
Korea	**5,832**	21,467
United States of America ("U.S.A.")	**609**	94
Others	**1,407**	1,565
	254,092	394,089

Sales are allocated based on the places/countries in which customers are located.

(ii) Total assets

	2006 **US$'000**	2005 US$'000
Hong Kong	**191,613**	230,519
Taiwan	**18,434**	32,723
Others	**11,034**	7,028
	221,081	270,270

Assets are allocated based on where the assets are located. Others comprises China, Japan, Singapore, Korea and the U.S.A.

5. Segment information - Group (continued)

(b) Secondary reporting format – geographical segments (continued)

(iii) Capital expenditures

	Property, plant, and equipment		Investments in associated companies		Investments in available-for-sale financial assets	
	2006	2005	**2006**	2005	**2006**	2005
	US$'000	US$'000	**US$'000**	US$'000	**US$'000**	US$'000
Hong Kong	**4,162**	5,378	**2,944**	—	**—**	—
China	**3,205**	267	**—**	—	**2,346**	—
Taiwan	**736**	341	**—**	—	**1,556**	—
Others	**772**	219	**—**	—	**—**	—
	8,875	6,205	**2,944**	—	**3,902**	—

Capital expenditures are allocated based on where the assets are located.

6. Interest income - Group

	2006	2005
	US$'000	US$'000
Bank interest income	**6,290**	4,485

7. Expenses by nature - Group

Expenses included in cost of sales, research and development costs, selling and distribution expenses, administrative expenses and other operating expenses are analysed as follows:

	2006	2005
	US$'000	US$'000
Loss on disposal of property, plant and equipment	**85**	12
Auditor's remuneration	**138**	123
Depreciation of owned property, plant and equipment	**6,053**	4,660
Depreciation of leased property, plant and equipment	**17**	9
Operating leases for land and buildings	**794**	778
Employee benefit expenses (excluding Directors' emoluments (note 8(a))	**18,399**	16,412
Directors' emoluments (note 8(b))	**2,991**	2,608
Net exchange (gain)/loss	**(145)**	127
Provision for impairment loss of available-for-sale financial assets	**1,367**	—
Provision/(Write-back of provision) for impairment of receivables	**28**	(1,782)
Provision/(Write-back of provision) for obsolete or slow moving inventories	**2,268**	(65)

8. Employee benefit expense - Group

(a) Employee benefit expenses

	2006 US$'000	2005 US$'000
Wages and salaries	**10,841**	8,702
Discretionary bonus	**1,665**	4,023
Equity compensation - shares	**4,469**	2,245
Pension costs - defined contribution plans [(i)]	**513**	440
Other staff benefits	**911**	1,002
	18,399	16,412

(i) Forfeited contribution to the defined contribution plans are utilized to reduce future contributions. During the year, there was US$14,000 contribution being forfeited.

8. Employee benefit expense - Group (continued)

(b) Directors' emoluments

The remuneration of every director including the equity compensation charged to the income statement per HKFRS 2 "Share-Based Payments" is set out below:

For the year ended 31 December 2006

Name of Director	Fees US$'000	Salary US$'000	Discretionary bonuses[i] US$'000	Inducement fees US$'000	Other benefits[ii] US$'000	Employer's contribution to pension scheme US$'000	Compensation for loss of office as director US$'000	Subtotal US$'000	Equity Compensation[iii] US$'000	Total US$'000
Leung Kwong Wai	—	226	193	—	60	10	—	489	1,012	1,501
Lam Shun Fu, Percy	—	83	36	—	2	4	—	125	2	127
Huang Hsing Hua	—	117	41	—	11	6	—	175	159	334
Lai Woon Ching	—	131	41	—	2	6	—	180	159	339
Lo Wai Ming	—	128	41	—	2	6	—	177	159	336
Lam Pak Lee	25	—	—	—	—	—	—	25	40	65
Chang Ching Yi, Steven	22	—	—	—	—	—	—	22	40	62
Wong Yuet Leung, Frankie	24	—	—	—	—	—	—	24	29	53
Choy Kwok Hung, Patrick	27	—	—	—	—	—	—	27	29	56
Kao Kuen, Charles	22	—	—	—	—	—	—	22	29	51
Sun, Patrick	27	—	—	—	—	—	—	27	40	67
Total	147	685	352	—	77	32	—	1,293	1,698	2,991

For the year ended 31 December 2005

Name of Director	Fees US$'000	Salary US$'000	Discretionary bonuses[i] US$'000	Inducement fees US$'000	Other benefits[ii] US$'000	Employer's contribution to pension scheme US$'000	Compensation for loss of office as director US$'000	Subtotal US$'000	Equity Compensation[iii] US$'000	Total US$'000
Leung Kwong Wai	—	226	529	—	51	10	—	816	443	1,259
Lam Shun Fu Percy	—	—	—	—	—	—	—	—	—	—
Huang Hsing Hua	—	115	122	—	12	5	—	254	76	330
Lai Woon Ching	—	129	122	—	2	6	—	259	82	341
Lo Wai Ming	—	125	122	—	2	6	—	255	84	339
Lam Pak Lee	19	—	—	—	—	—	—	19	44	63
Chang Ching Yi, Steven	19	—	—	—	—	—	—	19	44	63
Wong Yuet Leung, Frankie	19	—	—	—	—	—	—	19	28	47
Choy Kwok Hung, Patrick	23	—	—	—	—	—	—	23	28	51
Kao Kuen, Charles	23	—	—	—	—	—	—	23	28	51
Sun, Patrick	23	—	—	—	—	—	—	23	41	64
Total	126	595	895	—	67	27	—	1,710	898	2,608

8. Employee benefit expense - Group (continued)

(b) Directors' emoluments (continued)

(i) Discretionary bonus was determined by the Remuneration Committee of the Group after taking into account of the Group's profit for the year and individual employee's performance.

(ii) Other benefits include leave pay, insurance premium and other allowances.

(iii) This represents the amount charged to income statement per requirement under HKFRS 2. Equity compensation granted in prior periods with vesting term extended into the year will impact the current year.

(c) Equity compensation to directors

More details for the Equity Compensation Scheme can be referred to Note 23 to the consolidated financial statements. Details of the share options and shares granted to each of the directors and their corresponding fair value are listed as below:

	2006				2005			
Name of Director	**No. of Share Options Granted [1] (in thousand)**	**Fair value of the share option at Grant Date [3] US$'000**	**No. of Shares Granted [2] (in thousand)**	**Fair Value of the share at Grant Date [3] US$'000**	No. of Share Options Granted [4] (in thousand)	Fair Value at Grant Date [3] US$'000	No. of Shares Grant [5] (in thousand)	Fair Value at Grant Date [3] US$'000
Leung Kwong Wai	500	20	2,690	1,161	800	66	2,600	886
Lam Shun fu, Percy	—	—	1,300	204	—	—	—	—
Huang Hsing Hua	500	20	340	147	300	25	420	143
Lai Woon Ching	500	20	340	147	300	25	420	143
Lo Wai Ming	500	20	340	147	300	25	420	143
Lam Pak Lee	500	20	—	—	800	66	—	—
Chang Ching Yi, Steven	500	19	—	—	800	66	—	—
Wong Yuet Leung, Frankie	500	19	—	—	500	41	—	—
Choy Kwok Hung, Patrick	500	19	—	—	500	41	—	—
Kao Kuen, Charles	500	19	—	—	500	41	—	—
Sun, Patrick	500	19	—	—	800	66	—	—
Total	5,000	195	5,010	1,806	5,600	462	3,860	1,315

1. 5,000,000 share options were granted to the directors of the Group on 28 June 2006 under the Share Option Scheme. The share options can be exercised commencing from 1 July 2007.

2. A total of 5,010,000 shares under the Share Award Plan of the Company were granted to the Executive Directors of the Company during the year. 3,710,000 shares were granted on 27 April 2006 of which 1,484,000 shares (40% of the 3,710,000) will be vested on 28 April 2007 and 2,226,000 shares (60% of the 3,710,000) will be vested on 28 April 2008. The other 1,300,000 shares were granted on 27 December 2006 of which 520,000 shares (40% of the 1,300,000) will be vested on 27 December 2007 and 780,000 shares (60% of the 1,300,000) will be vested on 27 December 2008.

3. These represent the full fair value at grant date to be amortized in accordance to the vesting terms of the Share Option Scheme and may differ from the total charge to the income statement of the corresponding year.

4. 5,600,000 share options were granted to the directors of the Group on 14 June 2005 under the Share Option Scheme. The share options can be exercised commencing from 1 July 2006.

5. 3,860,000 shares from the Share Award Plan of the Company were granted to the Executive Directors of the Company on 7 June 2005. 1,544,000 shares (40% of the total) were vested on 7 June 2006 and 2,316,000 shares (60% of the total) will be vested on 7 June 2007.

8. Employee benefit expense - Group (continued)

(d) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group during the year include four (2005: three) directors whose emoluments are reflected in the analysis above. The amount of emolument paid and payable to the remaining one (2005: two) individual during the year is as follows:

	2006	2005
Number of individuals (excluding directors)	1	2

	2006 US$'000	2005 US$'000
Basic salaries, other allowances and benefits in kind	130	225
Discretionary bonus	24	154
Employer's contribution to pension scheme	6	10
	160	389
Equity compensation [1]	196	334
	356	723

(1) This represents the amount charged to income statement per HKFRS 2's requirement.

The emoluments fell within the following bands:

	Number of individuals	
	2006	2005
US$350,001 to US$400,000	1	1
US$300,001 to US$350,000	—	1
US$250,001 to US$300,000	—	—
	1	2

None of the Directors of the Company waived any emoluments during the year.

During the year, no emoluments have been paid to the directors of the Company or the five highest paid individuals as an inducement to join or upon joining the Group or as compensation for loss of office (2005: Nil).

9. Finance costs - Group

	2006 US$'000	2005 US$'000
Interest element of finance leases	1	2

10. Taxation - Group

Hong Kong profits tax has been provided at the rate of 17.5% (2005: 17.5%) on the estimated assessable profits for the year. Taxation on overseas profits has been calculated on the estimated assessable profit for the year at the rates of taxation prevailing in the countries in which the Group operates.

	2006 US$'000	2005 US$'000
Current taxation:		
Hong Kong profits tax	5,654	15,869
Overseas profits tax paid/(refunded)	52	(17)
Under/(over) provision in prior years	218	(635)
Deferred taxation (note 27)	253	545
	6,177	15,762

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the taxation rate of Hong Kong, the Group's principal place of operation, as follows:

	2006 US$'000	2005 US$'000
Profit before tax	28,595	92,016
Tax calculated at a taxation rate of 17.5% (2005: 17.5%)	5,004	16,103
Income not subject to tax	(1,518)	(1,779)
Expenses not deductible for taxation purposes	2,517	1,773
Utilization of previously unrecognized tax losses	(167)	—
Tax losses not recognized	123	300
Under/(over) provision in prior years	218	(635)
Taxation expense	6,177	15,762

The Company has tax losses in Hong Kong of approximately US$ 48,000 (2005: US$ 1,004,000) that are available indefinitely for offsetting against future taxable profit. Deferred tax asset has not been recognized in respect of these losses as the amount is insignificant.

11. Profit attributable to shareholders

The profit attributable to shareholders of the Company is dealt with in the financial statements of the Company to extent of profit of US$24,122,000 (2005: US$67,675,000).

12. Dividends

		2006 US$'000	2005 US$'000
(a)	Final dividend attributed to the year:		
	2006 final dividend, proposed, of HK$0.04 (approximately 0.51 US cents) per ordinary share (i)	12,869	—
	2005 final dividend, paid, of HK$0.15 (approximately 1.93 US cents) per ordinary share (ii)	—	48,540
	Less : Company's share of dividends paid on the shares held by a special purpose entity of the Group	—	(658)
		12,869	47,882
(b)	Interim dividend declared and paid by the Company during the year:		
	2006 interim dividend, paid, of HK$0.02 (approximately 0.26 US cents) per ordinary share (iii)	6,467	—
	2005 interim dividend, paid, of HK$0.04 (approximately 0.51 US cents) per ordinary share	—	12,912
	Less : Company's share of dividends paid on the shares held by a special purpose entity of the Group	(94)	(242)
		6,373	12,670
	Dividend attributed to the year	19,336	61,452

(i) At a meeting held on 26 March 2007, the Directors proposed a final dividend of HK$0.04 (approximately 0.51 US cents) per ordinary share. The proposed dividend is not reflected as a dividend payable in these financial statements, but will be reflected as an appropriation of retained earnings for the year ending 31 December 2007.

(ii) On 13 March 2006, the Directors proposed a final dividend of HK$0.15 (approximately 1.93 US cents) per ordinary share. The final dividend was paid on 12 May 2006.

(iii) On 3 August, 2006, the Directors declared an interim dividend of HK$0.02 (approximately 0.26 US cents) per ordinary share. The interim dividend was paid on 18 September 2006.

13. Earnings per share

The calculation of basic and diluted earnings per share is based on the Group's profit attributable to shareholders of US$22,418,000 (2005: US$76,254,000).

The basic earnings per share is based on the weighted average of 2,467,035,647 (2005: 2,445,135,773) ordinary shares in issue excluding own shares held during the year.

Diluted earnings per share information is based on 2,491,931,274 (2005: 2,473,217,108) ordinary shares which is the adjusted weighted average number of ordinary shares outstanding assuming conversion of all share options outstanding but excluding unallocated own shares held during the year. A calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares as calculated is compared with the number of shares that would have been issued assuming the exercise of the share options.

	2006	2005
Weighted average number of ordinary shares in issue	2,467,035,647	2,445,135,773
Adjustments for - allocated own shares	24,895,627	27,052,538
- share options	—	1,028,797
Weighted average number of ordinary shares for diluted earnings per share	2,491,931,274	2,473,217,108

14. Property, plant and equipment

	Group					Company
	Leasehold improvements US$'000	**Furniture, fixtures and office equipment** US$'000	**Machinery and laboratory equipment** US$'000	**Motor vehicles** US$'000	**Total** US$'000	**Furniture, fixtures and office equipement** US$'000
At 1 January 2005						
Cost	1,384	5,954	9,025	153	16,516	—
Accumulated depreciation	(414)	(4,176)	(2,292)	(86)	(6,968)	—
Net book amount	970	1,778	6,733	67	9,548	—
Year ended 31 December 2005						
Opening net book amount	970	1,778	6,733	67	9,548	—
Exchange differences	—	5	6	—	11	—
Additions	535	4,011	1,659	—	6,205	296
Disposals	—	(18)	—	—	(18)	—
Depreciation	(406)	(1,784)	(2,428)	(51)	(4,669)	—
Closing net book amount	1,099	3,992	5,970	16	11,077	296
At 31 December 2005						
Cost	1,919	9,884	10,690	153	22,646	296
Accumulated depreciation	(820)	(5,892)	(4,720)	(137)	(11,569)	—
Net book amount	1,099	3,992	5,970	16	11,077	296
Year ended 31 December 2006						
Opening net book amount	1,099	3,992	5,970	16	11,077	296
Exchange differences	9	(8)	(13)	—	(12)	—
Additions	250	4,173	4,452	—	8,875	385
Disposals	(24)	(56)	(5)	—	(85)	—
Depreciation	(547)	(2,826)	(2,681)	(16)	(6,070)	(208)
Closing net book amount	787	5,275	7,723	—	13,785	473
At 31 December 2006						
Cost	2,092	14,037	15,111	153	31,393	681
Accumulated depreciation	(1,305)	(8,762)	(7,388)	(153)	(17,608)	(208)
Net book amount	787	5,275	7,723	—	13,785	473

Depreciation expense of US$2,376,000 (2005: US$2,366,000) has been expensed in cost of sales, US$1,304,000 (2005: US$398,000) in research and development costs and US$2,390,000 (2005: US$1,905,000) in administrative expenses.

The net book value of Group's furniture, fixture and office equipment of US$5,275,000 includes an amount of US$13,000 (2005: US$30,000) in respect of assets held under finance leases.

15. Intangible assets - Group

	Patents and intellectual property US$'000
At 31 December 2005 and 2006	
Cost	4,500
Accumulated amortization	(4,500)
Net book amount	—

16. Investments in subsidiaries

(a) Investments in subsidiaries

	Company	
	2006 **US$'000**	2005 US$'000
Investments in unlisted shares, at cost	**50,128**	50,078

(b) Amounts due from/to subsidiaries

	Company	
	2006 **US$'000**	2005 US$'000
Amounts due from subsidiaries	**41,873**	59,062
Amount due to a subsidiary	**50**	48

The amounts due from/to subsidiaries are secured, interest-free and have no fixed terms of repayment.

The carrying amounts due from/to subsidiaries of the Company approximate their respective fair values.

16. Investments in subsidiaries (Continued)

(c) *Particulars of subsidiaries*

The following is a list of the principal subsidiaries at 31 December 2006:

Name	Place of incorporation and kind of legal entity	Principal activities and place of operation	Particulars of issued share capital	Interest held
Directly held:				
Solomon Systech Limited ("SSL")	Hong Kong, limited liability company ("LLC")	Research, design and distribution of integrated circuits, Hong Kong	188,585,271 ordinary shares of HK$1 each	100%
Ample Pacific Limited ("Ample")	The British Virgin Islands, LLC	Investment holding, Hong Kong	50,000 ordinary shares of US$1 each	100%
Cornway International Limited ("Cornway")	The British Virgin Islands, LLC	Investment holding, Hong Kong	50,000 ordinary shares of US$1 each	100%
Pac-Pacific Limited ("Pac-Pacific")	Hong Kong, LLC	Investment holding, Hong Kong	2 ordinary shares of HK$1 each	100%
Mentor Ventures Limited ("Mentor")	The British Virgin Islands, LLC	Investment holding, Hong Kong	50,000 ordinary shares of US$1 each	100%
In Achieve Limited ("In Achieve")	The British Virgin Islands, LLC	Investment holding, Hong Kong	50,000 ordinary shares of US$1 each	100%
Indirectly held:				
Systech Technology China Limited ("STCL")	Hong Kong, LLC	Investment holding, Hong Kong	10,000 ordinary shares of HK$1 each	100%
Solomon Systech Inc. ("SSI")	U.S.A., LLC	Market research, U.S.A.	20,000 ordinary shares of US$1 each	100%
Solomon Systech (Shenzhen) Limited ("SSSZ")	China, LLC	Research, design and distribution of integrated circuits, China	HK$8,000,000 registered and paid up capital	100%
Solomon Systech Japan Company Limited ("SSJCL")	Japan, LLC	Market research, Japan	10,000 ordinary shares of JPY1,000 each	100%
Solomon Systech Pte. Ltd. ("SSPL")	The Republic of Singapore, LLC	Research, design and distribution of integrated circuits, Singapore	480,000 ordinary shares of SGD1 each	100%
Jing Guang Semiconductors (Dongguan) Limited ("JGDG")	China, LLC	Manufacturing of integrated circuits, China	US$5,500,000 registered capital (US$5,318,694 paid up)	100%
Solomon Systech Taiwan Limited ("SST")	Republic of China ("Taiwan"), LLC	Market research, Taiwan	5,000,000 ordinary shares of TWD10 each	100%

17. Investments in associated companies - Group

	2006 US$'000	2005 US$'000
Beginning of the year	**903**	1,119
Acquisition of associated companies	**2,944**	—
Share of losses	**(662)**	(216)
End of the year	**3,185**	903

The Group's interests in its associated companies were as follows:

Name	Place of incorporation and operation	Principal activities	Particulars of issued shares held	As at 31 December 2006 Assets US$'000	As at 31 December 2006 Liabilities US$'000	For the year ended 31 December 2006 Revenue US$'000	For the year ended 31 December 2006 Loss US$'000	Interest held indirectly
WE3 Technology Company Limited	Hong Kong	Research, design, development & distribution of handsets solutions	8,571,950 ordinary shares of HK$1 each	3,145	589	1,066	2,233	36.7%
EPD Technology Limited	Hong Kong	Research, design, development, manufacturing & distribution of E-paper display modules	100,000 ordinary shares of HK$1 each	1,017	1,041	3	56	40%
Kitronix Limited	Hong Kong	Research, design, development, manufacturing & distribution of LCD modules	9,500,000 ordinary shares of HK$1	5,256	544	4	174	25%

18. Available-for-sale financial assets - Group

	2006 US$'000	2005 US$'000
Unlisted shares, at cost	**4,186**	284
Less: Provision for impairment loss	**(1,651)**	(284)
	2,535	—

These were no disposal of available-for-sale financial assets during the year. All the available-for-sale financial assets are unlisted equity securities.

19. Inventories - Group

	2006 US$'000	2005 US$'000
Finished goods	3,075	4,576
Raw materials and work in progress	22,657	36,847
	25,732	41,423
Less: Provision for obsolete or slow moving inventories	(7,479)	(5,211)
	18,253	36,212

The cost of inventories that is recognized as an expense and included in cost of sales amounted to US$192,867,000 (2005: US$278,529,000).

20. Trade and other receivables - Group

	2006 US$'000	2005 US$'000
Trade and bills receivables	57,707	56,146
Less: provision for impairment of receivables	(61)	(33)
Trade and bills receivables - net	57,646	56,113
Prepayments and other receivables	4,042	3,106
	61,688	59,219

The Group's sales to corporate customers are mainly entered into on credit terms of 30 days. The ageing analysis of trade and bills receivables is as follows:

	2006 US$'000	2005 US$'000
0 - 30 days	41,633	53,997
31 - 60 days	12,445	1,843
61 - 90 days	2,980	273
91 - 120 days	488	—
121 -365 days	100	—
	57,646	56,113

21. Cash and cash equivalents, short-term fixed deposits, other financial assets and fixed bank deposits

	Group		Company	
	2006 US$'000	2005 US$'000	2006 US$'000	2005 US$'000
Cash at bank and in hand	7,643	8,160	605	165
Short-term bank deposits[1]	102,779	111,319	82,339	65,214
Cash and cash equivalents	110,422	119,479	82,944	65,379
Short-term fixed deposits[2]	8,083	37,000	6,083	32,000
Other financial assets[3]	1,000	1,250	1,000	1,000
Fixed bank deposits[4]	2,000	5,000	—	—
	121,505	162,729	90,027	98,379

1 The effective interest rate on short-term bank deposits was 5.1% (2005: 4.0%); these deposits have an average maturity of 36 days (2005: 26 days).

2 The effective interest rate on short-term fixed deposits was 5.0% (2005: 3.5%); these deposits have an average maturity of 193 days (2005: 231 days).

3 Other financial assets represent the structured bank deposits.

4 The effective interest rate on fixed bank deposits was 6% (2005: 2.8%); these deposits have an average maturity of 424 days (2005: 375 days).

22. Share Capital

	2006		2005	
	No. of shares	US$'000	No. of shares	US$'000
Authorized:				
Ordinary shares of HK$0.10 each	5,000,000,000	64,433	5,000,000,000	64,433
Issued and fully paid:				
At 1 January	2,511,154,351	32,360	2,504,854,351	32,279
Shares repurchased	(8,500,000)	(109)	—	—
Exercise of share options (Note 23(a))	—	—	6,300,000	81
At 31 December	2,502,654,351	32,251	2,511,154,351	32,360

22. Share Capital (Continued)

During the year, the Company repurchased its own ordinary shares on the Stock Exchange as follows:

Month/year	Number of shares repurchased	Highest price paid per share	Lowest price paid per share	Aggregate price paid	
		HK$	HK$	HK$'000	US$'000
August 2006	2,000,000	1.70	1.59	3,290	424
September 2006	2,500,000	1.49	1.35	3,525	454
December 2006	4,000,000	1.20	1.19	4,785	618
	8,500,000			11,600	1,496

The repurchased shares were cancelled and accordingly the issued share capital of the Company was reduced by the nominal value of these shares.

23. Employee Compensation Scheme

(a) *The Pre-IPO Share Option Scheme*

The Company adopted the Pre-IPO Share Option Scheme (the "Pre-IPO Scheme") at an extraordinary general meeting held on 25 February 2004 and a meeting of the Board on 19 March 2004. The purpose of the Pre-IPO Scheme is to recognize the contribution of certain directors and members of the Group to the growth of the Group and/or to the listing of the Company's shares on the Stock Exchange.

On 19 March 2004, options to subscribe for an aggregate of 6,300,000 new shares of the Company at the IPO Offer Price were offered by the Company to directors and senior management of the Group at a nominal consideration of HK$1.0 payable by each grantee. No further options can be offered under the Pre-IPO Scheme after the Listing Date. These options may be exercised at any time commencing 9 April 2005 to 8 April 2009, at the exercise price of HK$1.75 per share.

All share options were exercised in 2005 and there was no share option outstanding under the Pre-IPO Share Option Scheme as at 31 December 2005 and 2006 respectively.

(b) *The Share Option Scheme*

The Company also adopted the Share Option Scheme at an extraordinary meeting held on 25 February 2004 and a meeting of the Board on 19 March 2004 under which options may be granted to subscribe for the Company's shares. Participants of the Scheme shall include directors (including executive directors, non-executive directors and independent non-executive directors) and employees of any member of the Group and any advisers, consultants, distributors contractors, contract manufacturers, suppliers, agents, customers, business partners, joint venture business partners, service providers of any member of the Group who the Board considers have contributed or will contribute to the Group (the "Participants"). The purpose of the Share Option Scheme is to provide Participants with the opportunity to acquire proprietary interests in the Company and its shares for the benefits of the Company with a flexible mean of either retaining, incentivising, rewarding, remunerating, compensating and/or providing benefits to the Participants. The terms of the Scheme are in accordance with the provisions of the Chapter 17 of the Listing Rules on the Stock Exchange.

On 28 June 2006, options to subscribe for 5,500,000 shares of the Company were granted by the Company to directors and senior management of the Group at a nominal consideration of HK$1.0 payable by each grantee. These options may be exercised at any time commencing 1 July 2007 to 30 June 2009, at the exercise price of HK$1.98 per share.

23. Employee Compensation Scheme (Continued)

(b) *The Share Option Scheme* (Continued)

Movements in the number of share options outstanding and their related exercise prices are as follows:

	2006		2005	
	Exercise price in HK$ per share	No. of options (thousands)	Exercise price in HK$ per share	No. of options (thousands)
At 1 January	2.695	6,100	—	—
Granted	1.980	5,500	2.695	6,100
At 31 December		11,600		6,100

The fair value of options granted during the year determined using the Black-Scholes valuation model was US$215,000 (2005: US$503,000). The significant inputs into the model were share price of HK$1.75 (2005: HK$2.675) at the grant date, exercise price shown above, expected life of options of 2 years (2005: 2 years), expected dividend paid out rate of 10.86% (2005: 8.34%) and annual risk-free interest rate of 4.63% (2005: 3.086%). The volatility of 53.8% (2005: 58.47%), measured as the standard deviation of expected share price returns, is based on statistical analysis of daily share prices from 29 June 2005 to 28 June 2006, the option grant date.

Share options outstanding at the end of the year have the following expiry date and exercise prices:

Expiry date - 1 July	Exercise price HK$ per share	Number of options 2006 (thousands)	Number of options 2005 (thousands)
2008	2.695	6,100	6,100
2009	1.980	5,500	—
		11,600	6,100

23. Employee Compensation Scheme (Continued)

(c) *The Share Award Plan*

The Share Award Plan was adopted by the Company at an extraordinary general meeting held on 25 February 2004 and the Board on 19 March 2004 with an initial pool of 46,223,520 shares held by HSBC International Trustee Limited as Trustee for the benefit of the directors and employees.

Under the terms and condition of the grant, 40% of the shares will be vested 1 year from the grant date and the remaining 60% will be vested 2 years from the grant date. At 31 December 2006, a net 26,632,000 shares were reserved for named employees leaving a balance of 11,585,520 for future grant to directors and employees in 2007 and beyond.

Shares held by HSBC International Trustee Limited as Trustee under the Share Award Plan

	Number of shares
At 1 January 2006	47,055,520
Shares vested during the year	(8,838,000)
At 31 December 2006	38,217,520

The following is a summary of the shares granted, vested and forfeited during the year:

	Cumulative total		**No. of shares**	
		2006	2005	2004
Granted during the year	38,110,000	**17,650,000**	16,790,000	3,670,000
Vested during the year	(10,306,000)	**(8,838,000)**	(1,468,000)	—
Forfeiture of shares granted during the year	(1,172,000)	**(1,092,000)**	(80,000)	—
	26,632,000	**7,720,000**	15,242,000	3,670,000

The Group has used HKFRS 2 in the consolidated financial statements for the year ended 31 December 2005 and 2006 to account for the equity compensation expenses of the shares granted at the date of grant at fair value.

24. Reserves

(a) Group

	Share premium US$'000	Own shares held US$'000	Merger reserve US$'000	Exchange reserve US$'000	Equity compen-sation reserve US$'000	Retained earnings US$'000	Total US$'000
At 1 January 2005, as previously reported	86,394	—	2,082	(41)	—	55,865	144,300
Effect of changes in accounting policies	—	(1,338)	—	—	1,616	(77)	201
At 1 January 2005, as restated	86,394	(1,338)	2,082	(41)	1,616	55,788	144,501
Exchange difference	—	—	—	17	—	—	17
Exercise of share option	1,337	—	—	—	—	—	1,337
Dividends paid, net of portion for own shares held	—	—	—	—	—	(50,599)	(50,599)
Profit for the year	—	—	—	—	—	76,254	76,254
Equity compensation	—	—	—	—	3,143	—	3,143
Equity compensation transferred to share premium	1,624	733	—	—	(1,624)	(733)	—
At 31 December 2005	89,355	(605)	2,082	(24)	3,135	80,710	174,653
At 1 January 2006	89,355	(605)	2,082	(24)	3,135	80,710	174,653
Exchange difference	—	—	—	36	—	—	36
Dividends paid, net of portion for own shares held	—	—	—	—	—	(54,255)	(54,255)
Share repurchased	(1,387)	—	—	—	—	—	(1,387)
Profit for the year	—	—	—	—	—	22,418	22,418
Equity compensation	—	114	—	—	6,167	(114)	6,167
At 31 December 2006	87,968	(491)	2,082	12	9,302	48,759	147,632

24. Reserves (Continued)

(b) Company

	Share premium US$'000	Equity compensation reserve US$'000	Retained earnings US$'000	Total US$'000
As 1 January 2005, as previously reported	112,008	—	42,336	154,344
Effect of changes in accounting policies	—	1,616	(222)	1,394
At 1 January 2005, as restated	112,008	1,616	42,114	155,738
Exercise of share options	1,337	—	—	1,337
Dividends paid	—	—	(51,567)	(51,567)
Profit for the year	—	—	67,675	67,675
Equity compensation	—	3,143	—	3,143
Equity compensation transferred to share premium	1,624	(1,624)	—	—
At 31 December 2005	114,969	3,135	58,222	176,326
At 1 January 2006	114,969	3,135	58,222	176,326
Dividends paid	—	—	(55,007)	(55,007)
Shares repurchased	(1,387)	—	—	(1,387)
Profit for the year	—	—	24,122	24,122
Equity compensation	—	6,167	—	6,167
At 31 December 2006	113,582	9,302	27,337	150,221

25. Trade and other payables - Group

	2006 US$'000	2005 US$'000
Trade payables	28,672	43,408
Accrued expenses	9,855	12,949
	38,527	56,357

At 31 December 2006, the ageing analysis of trade payables is as follows:

	2006 US$'000	2005 US$'000
0 - 30 days	28,442	42,650
31 - 60 days	50	728
61 - 90 days	180	30
	28,672	43,408

26. Obligations under finance leases - Group

	2006 US$'000	2005 US$'000
Wholly repayable within five years	**29**	39
Current portion	**(10)**	(10)
	19	29

At 31 December 2006, the Group's finance lease liabilities were repayable as follows:

	2006 US$'000	2005 US$'000
Within one year	**11**	11
In the second to fifth year	**22**	33
	33	44
Future finance charges on finance leases	**(4)**	(5)
Present value of finance lease liabilities	**29**	39
The present value of finance lease liabilities is as follows:		
Within one year	**10**	10
In the second to fifth year	**19**	29
	29	39

27. Deferred tax liabilities - Group

Deferred taxation is calculated in full on temporary differences under the liability method using a principal taxation rate of 17.5% (2005: 17.5%).

The movement on the deferred tax liabilities account is as follows:

	Group		Company	
	2006	2005	**2006**	2005
	US$'000	US$'000	**US$'000**	US$'000
Beginning of the year	**574**	29	**—**	—
Charged to consolidated income statement (Note 10)	**253**	545	**83**	—
End of the year	**827**	574	**83**	—

The components of deferred tax liabilities recognized in the consolidated balance sheet and the movements during the year are as follows:

	Group	**Company**
	Accelerated tax depreciation	**Accelerated tax depreciation**
	US$'000	US$'000
At 1 January 2005	29	—
Charged to consolidated income statement in 2005	545	—
At 31 December 2005 and 1 January 2006	574	—
Charged to consolidated income statement in 2006	253	83
At 31 December 2006	827	83

28. Banking facilities - Group

At 31 December 2006, the banking facilitates of the Group amounted to US$16,232,000 (2005: US$16,232,000).

29. Cash generated from operations - Group

(a) *Reconciliation of profit before taxation to cash generated from operations*

	2006 US$'000	2005 US$'000
Profit before taxation	28,595	92,016
Depreciation of property, plant and equipment	6,070	4,669
Share of results of associated companies	662	216
Finance costs	1	2
Provision for equity compensation	6,167	3,143
Provision for impairment loss of available-for-sale financial assets	1,367	—
Loss on disposal of property, plant and equipment	85	12
Interest income	(6,290)	(4,485)
Operating profit before working capital changes	36,657	95,573
Increase in trade and other receivables	(1,601)	(1,053)
Decrease in inventories	17,959	6,246
Decrease in trade and other payables	(17,830)	(7,042)
Cash generated from operations	35,185	93,724

(b) *Proceeds from sale of property, plant and equipment*

	2006 US$'000	2005 US$'000
Net book amount	85	18
Loss on sale of property, plant and equipment	(85)	(12)
Proceeds from sale of property, plant and equipment	—	6

30. Commitments - Group

(a) *Capital commitments*

Capital expenditure for property, plant and equipment committed at the balance sheet date but not yet incurred is as follows:

	2006 US$'000	2005 US$'000
Contracted but not provided for	—	659

(b) *Operating lease commitments - where the Group is the lessee*

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2006 US$'000	2005 US$'000
Not later than 1 year	1,086	670
Later than 1 year and not later than 5 years	1,424	1,419
Later than 5 years	131	—
	2,641	2,089

31. Events after the balance sheet date

On 7 February 2007, options to subscribe for 22,600,000 new shares of the Company were granted by the Company to directors and employees of the Group under the Share Option Scheme. These options are exercisable at the exercise price of HK$1.43 per share, starting from 1 April 2009 and will lapse on 1 April 2012.

32. Approval of consolidated financial statements

The consolidated financial statements were approved by the Board of Directors on 26 March, 2007.

CORPORATE INFORMATION

Directors	**Executive Directors** Mr. LEUNG Kwong Wai (Managing Director) Mr. LAM Shun Fu, Percy Mr. HUANG Hsing Hua Mr. LAI Woon Ching Mr. LO Wai Ming
	Non-Executive Directors Dr. LAM Pak Lee Mr. CHANG Ching Yi, Steven
	Independent Non-Executive Directors Mr. SUN, Patrick (Chairman) Mr. CHOY Kwok Hung, Patrick Professor KAO Kuen, Charles Mr. WONG Yuet Leung, Frankie
Qualified Accountant/ Company Secretary	Mrs. FUNG Lui Kit Har, Keziah *FCMA FHKCPA ACS ACIS*
Corporate Development	Mr. John Leong
Principal Office	6/F., No.3 Science Park East Avenue Hong Kong Science Park Shatin, New Territories, Hong Kong Tel: (852) 2207 1111 Fax: (852) 2267 0800
Website	www.solomon-systech.com
Principal Bankers	The Hong Kong and Shanghai Banking Corporation Limited Hang Seng Bank Limited Standard Chartered Bank (Hong Kong) Limited Hua Nan Commercial Bank, Ltd DBS Bank (Hong Kong) Limited Bank of Tokyo-Mitsubishi UFJ JPMorgan Chase Bank, N.A.
Independent Auditor	PricewaterhouseCoopers
Solicitors	Richards Butler

Financial Calendar

Listing date	8 April 2004
Interim results announced	3 August 2006
The interim dividend paid	18 September 2006
Annual results announced	26 March 2007
Closure of register of members	27 April to 3 May 2007
Annual General Meeting	3 May 2007
Proposed final dividend payable	10 May 2007

Shareholder Information

Company Name	Solomon Systech (International) Limited
Listing Venue	Main Board of the Stock Exchange of Hong Kong Limited
Stock Code	2878
Constituent Stock	Hang Seng Composite Index MSCI Standard Index MSCI Small Cap Index
Business Classification	Industrials
Share Transfer and Registrars	Tricor Investor Services Limited 26/F Tesbury Centre 28 Queen's Road East Hong Kong Tel: (852) 2980 1333 Fax: (852) 2810 8185 Website: www.tricor.com.hk
Corporate Communications	Ms. Yvonne Chan, Corporate Communications Manager Solomon Systech (International) Limited 6/F., No.3 Science Park East Avenue Hong Kong Science Park, Shatin, New Territories Hong Kong Tel: (852) 2207 1111 Fax: (852) 2207 1372 Website: www.solomon-systech.com
Listing Date & Price	8 April 2004 / HKD1.75
Financial Year End	December 31
Trading Currency	HKD
Authorized Shares	5,000,000,000
Issued Shares	2,502,654,351 (as at 31 December 2006)
Par Value	HKD0.10
Board Lots	2,000

2004 Annual Report

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2005 International ARC Awards

2005 Annual Report

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2006 International ARC Awards

Design: The Design Associates www.tda.com.hk PR Consultant: Strategic Financial Relations Limited The Annual Report is printed on environmental friendly paper.

Solomon Systech (International) Limited
6/F., No.3 Science Park East Avenue
Hong Kong Science Park
Shatin, New Territories, Hong Kong
Tel: (852) 2207 1111 Fax: (852) 2267 0800

www.solomon-systech.com