FIH®

# FOXCONN INTERNATIONAL HOLDINGS LIMITED

*(Incorporated in the Cayman Islands with limited liability)*

Stock Code: 2038


ANNUAL REPORT 2006

# CONTENTS

# CORPORATE INFORMATION

## EXECUTIVE DIRECTORS

CHIN Wai Leung, Samuel
*(Chairman and Chief Executive Officer)*
DAI Feng Shuh
*(Chief Operating Officer)*

## NON-EXECUTIVE DIRECTORS

CHANG Ban Ja, Jimmy
GOU Hsiao Ling
LEE Jin Ming
LU Fang Ming

## INDEPENDENT NON–EXECUTIVE DIRECTORS

LAU Siu Ki
Edward Fredrick PENSEL
MAO Yu Lang

## COMPANY SECRETARY

TANG Wan Mui

## REGISTERED OFFICE

Scotia Centre, 4th Floor
P.O. Box 2804, George Town
Grand Cayman
Cayman Islands

## HEAD OFFICE

2, 2nd Donghuan Road
10th Yousong Industrial District
Longhua Town, Baoan
Shenzhen, Guangdong
People's Republic of China

## PRINCIPAL PLACE OF BUSINESS IN HONG KONG

16th Floor, Phase 1
Fountain Set Building
3A Hung Cheung Road
Tuen Mun
New Territories
Hong Kong

## AUDITORS

Deloitte Touche Tohmatsu

## LEGAL ADVISOR

Norton Rose

## PRINCIPAL BANKERS

ABN AMRO Bank N.V.
Agricultural Bank of China
Bank of America, N.A.
Bank of China
Bank SinoPac
China Construction Bank
Chinatrust Commercial Bank
Citibank N.A.
DBS Bank Ltd.
Industrial and Commercial Bank of China
Standard Chartered Bank
Taipei Fubon Bank
Taishin International Bank

## PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Butterfield Fund Services (Cayman) Limited
Butterfield House, 68 Fort Street
P.O. Box 705
George Town
Grand Cayman
Cayman Islands

## HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited
46th Floor, Hopewell Centre
183 Queen's Road East
Wanchai
Hong Kong

## STOCK CODE

2038

# CHAIRMAN'S STATEMENT

Dear Shareholders,

2006 marked another year of extraordinary performance for Foxconn International Holdings Limited ("FIH"). In addition to forging stronger partnerships with our key customers, we were successful in diversifying our customer base. The commitment and dedication exhibited by all of our employees worldwide has enabled us to reach and surpass lofty targets established at the beginning of the year.

On behalf of our global management team, it is my pleasure to present to you the operating results of FIH for the financial year ended 31 December 2006.

Revenue for the year surged beyond US$10 billion mark setting a record, by reaching US$10,381 million, representing an increase of US$4,017 million, or 63% over the prior year revenue of US$6,364 million. Net profit also reached a record high of US$718 million, representing an increase of 86% over the prior year amount of US$386 million.

In 2006 we witnessed the continued rapid growth of the handset industry with units sold exceeding one billion. FIH is a major player in this industry and we are proud that our growth has well exceeded the market growth rate, further widening the gap, yet again, with our competitors. This was achieved despite increased price pressures, and intensifying competition.

Much of the industry's growth was from emerging markets. With the favored trend of "being close to the customers", we too have focused our expansion in these markets. We have significantly expanded our operations and capacity with establishment of additional sites in Brazil, India and Mexico. For the Brazil and India sites, shipments to customers commenced in 2006 while shipments for the Mexico site will commence in the first quarter of 2007. Due to growth of the subscriber base, we anticipate significant increased activities in these countries.

China continues to be a very large sales territory, as well as a strategic operations site for all of our customers. Since our key manufacturing site in Shenzhen has reached its growth limit, we turned to Northern China for further expansion. We have commenced huge construction projects in Langfang and Taiyuan, areas which provide both efficient logistics and cost competitiveness for our customers in Beijing and Tianjian. With these investments, we believe FIH will have sufficient capacity to accommodate our growth for the upcoming years.

We have continued our focus on operational excellence for all of our sites and have implemented lean manufacturing and FPS (Foxconn Production System). These improvement processes along with our never ending efforts in tight cost control helped maintain an enviable cost structure. Coupled with the value added vertically integrated services, shortest component supply chain, early involvement in product development, and global ramp-up capabilities in tooling and production, we were able to maintain a reasonable profit level and provide a good return to our shareholders.

# CHAIRMAN'S STATEMENT

Responding to market directions, FIH has dramatically expanded its handset design and engineering teams in order to serve our customers and their wide range of technical needs. This is an area of strategic importance and I am pleased to inform you that we have made excellent progress by establishing strong teams in Taiwan, Japan, Korea and China. We have been awarded numerous full JDVM/JDSM projects, and the fruits of our efforts will become evident beginning in quarter three of 2007. The growth of the handset business has been fueled by technology advances and we continue to invest in engineering and technology so that we remain one of the dominating players in this industry.

Looking ahead, there are tremendous opportunities in 2007. Where there are opportunities, there are challenges such as: increased competition, price pressures, management of additional sites, accelerating the speed of product development, and accommodating the demands of additional customers. Our experienced management team supplemented by additions of new talents, coupled with the internal procedure of constantly reviewing our past successes and lessons learned, is well prepared for a successful 2007.

We are proud of our achievements in 2006. On behalf of the management team, I would like to take this opportunity to express our gratitude to those who have made these achievements possible, including but not limited to: all members of the Board for their valuable input and critical analysis; all employees for their efforts and dedication; and the families of the employees for their patience and sacrifices.

FIH is fortunate to be partners with the best customers in the world. We are thankful for their support and we are motivated to continue to serve them in the best way possible.

Last but not least, on behalf of the Board, we would like to thank our shareholders for their continued confidence in management. With your support, FIH was able to become a Hang Seng Index constituent stock in September 2006, only 18 months after our IPO. We will continue to do our utmost in maximizing the value of FIH.

With best regards,

**Chin Wai Leung, Samuel**
*Chairman & Chief Executive Officer*

## REVIEW OF RESULTS AND OPERATIONS

The year 2006 was another year of record-setting results, in revenues as well as in net profits. Revenue for the year reached US$10,381 million, which represents an increase of US$4,017 million, or 63% over the prior year revenue of US$6,364 million. Net profit also reached a record high of US$718 million, representing an increase of 86% over the prior year amount of US$386 million. Basic earnings per share for the period were US$10.31 cents.

Despite the global handset shipment number reaching one billion, we saw consolidation pressure persisting in the intensifying competitive global handset OEM market. With such a backdrop, the unique total end-to-end solution offered through Foxconn's eCMMS business model has been highly appreciated by our existing and new customers. Our integration of mechanical and electrical engineering capabilities, augmented by our affiliate, Hon Hai Group companies' optical and channel expertise, continues to be instrumental in helping our customers cope better with shorter handset product life cycles and ever demanding innovative product designs.

Attentive to our key customers' changing needs to cope with dynamic shifts in the market resulting from consumers' capricious tastes and elusive demand, we continuously expand both depth and scope of capabilities and services to our key customers, not only in material sciences and surface treatment for form factor needs, but also in molding/tooling and engineering support for time to market and time to volume. We strive to be the partner of choice for our customers' technically demanding projects. We also continue to streamline our business to improve our efficiency and competitiveness so as to provide optimal pricing to our customers. Our fast growing design teams have engaged multiple projects and serving multiple customers. Our efforts to expand and optimize our overseas operations also remained active during the period, we had already started mass production in India during the second half of 2006, while continuing to expand strategic investments into the BRIC end markets to satisfy our customers' demand for co-location and foster even closer partnerships with our key customers.

Our affiliation with Hon Hai Group, also proves to be increasingly beneficial in light of the growing dominance of Hon Hai Group in many 3C key components. We continue to work with Hon Hai Group to further enhance the world's shortest possible supply chain that we had been providing our customers. While Hon Hai Group continues its expansion of vast collections of expertise, our close tie will continue to yield significant synergistic value-adds to our key customers.

In 2007, the global handset market will be volatile and dynamic, due to further industry convergence and consolidation pressure. We believe this is the time our unique value can be greater appreciated by our customers. As market share competition among OEM customers intensifies, FIH's speed for product development, volume ramp-up, engineering services, and scale of global operations match perfectly with our customers' specific needs. We are excited with the growth opportunities ahead of us. We will continue to execute our success formula to further enhance our vertical integration capabilities and service quality to our expanding customer base. We are confident that we can grow our customer base. We believe handset outsourcing trend will continue and we will be able to grow further with our customers.

# MANAGEMENT DISCUSSION AND ANALYSIS

## LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2006, we had a cash balance of US$633 million. The cash balance is expected to finance our working capital and capital expenditure plans in light of our continuing fast growth. To reduce interest expenses, we used some of extra cash generated from operations to decrease net bank loans by US$36 million in 2006. Our gearing ratio, expressed as a percentage of interest bearing external borrowings of US$140 million over total assets of US$4,502 million, is 3.1%.

Net cash generated from operating activities in 2006 was US$859 million.

Net cash used in investing activities in 2006 was US$538 million. Our expenditures for investing activities were primarily for purchase of property, plant and equipment related to our facilities in our major sites in China and India.

Net cash used in financing activities in 2006 was US$14 million, primarily due to proceeds of US$22 million from the issue of shares to employees and was used to reduce bank loan by US$36 million in 2006.

## PLEDGE OF ASSETS

As at the balance sheet date, the Group pledged property, plant and equipment having a carrying value of approximately US$4.60 million (2005: US$19.73 million) to secure general banking facilities granted to the Group.

## CAPITAL COMMITMENTS

As at the balance sheet date, the capital commitment of the Group was US$57.39 million (2005: US$17.37 million).

## SIGNIFICANT INVESTMENTS

In 2006 we had invested in our key sites in Asia and Americas to enhance our capabilities and capacities in the various regions to serve our customers. These investments were instrumental in winning more business and enhance working partnership with our key customers. We expect more such investments in 2007.

## OUTLOOK

Looking forward, though we had again widening the gap between us and our peers, the Company is keenly aware of increased competition in the handset manufacturing business and complexity due to creative product designs and new technologies. We are keen to further strengthen the partnership with our existing customers, as well as diversifying our customer base. With this vision in mind, we will continue to expand our manufacturing base in Langfang, Taiyuan and India. With fundamental market growth intact, FIH is looking forward to another year of growth in 2007.

## EMPLOYEES

As at 31 December 2006, the Group had a total of 110,697 (2005: 59,070) employees. Total staff costs incurred during the year 2006 amounted to US$377.04 million (2005: US$298.25 million). The Group offers a comprehensive remuneration policy which is reviewed by the management on a regular basis.

The Company has adopted a share scheme and a share option scheme respectively. The share option scheme complies with the requirements of the rules of Chapter 17 of the Rules Governing the Listing of Securities ("Listing Rules") on the Stock Exchange.

# PROFILE OF DIRECTORS AND SENIOR MANAGEMENT

CHIN Wai Leung, Samuel, aged 56, joined the Company as Chairman and Chief Executive Officer in July 2003. Mr. Chin joined Hon Hai Precision Industry Company Limited ("Hon Hai"), a company listed on Taiwan Stock Exchange Corporation and the ultimate controlling shareholder of the Company, and its subsidiaries ("Hon Hai Group") in 2000, and had been one of the principal managers responsible for the handset manufacturing services business of the Hon Hai Group since July 2000, which is now wholly-owned and operated by the Company. He is also a director of Success World Holdings Limited, Foxconn DK ApS, Foxconn Oy and FIH Co., Limited. Before joining the Company, Mr. Chin held senior executive positions in EFA Corporation, Atari Corporation, Commodore Electronics Limited with responsibilities ranging from sales and marketing, global procurement, manufacturing, pricing, purchasing, contract negotiation, accounting and finance. With over 21 years of marketing, sales and operational experience in the global computer and electronics industries, he has worked in an international environment. Mr. Chin was awarded a Juris Doctor degree from the University of Pennsylvania Law School in 1976 and a Bachelor of Science degree in Economics from Wharton School, University of Pennsylvania, US in 1973.

DAI Feng Shuh, aged 55, joined the Company as Chief Operating Officer in February 2004. Dr. Dai joined the Hon Hai Group in July 1997, and had been one of the principal managers responsible for the handset manufacturing services of the Hon Hai Group since March 2000, which is now wholly-owned and operated by the Company. He is also a director of principal operating subsidiaries of the Company, Foxconn Precision Component (Beijing) Co., Ltd., Shenzhen Futaihong Precision Industrial Co., Ltd. and Honxun Electrical Industry (Hangzhou) Co., Ltd., as well as Success World Holdings Limited, S&B Industry, Inc., FIH Co., Limited, Foxconn India Private Limited and Foxconn India Developer Private Limited. Before joining the Company, Dr. Dai was a general manager for the PC Enclosure Group of Hon Hai and prior to that, he had held production engineering management positions with Toyota–Aisin Precision Instruments in Kentucky, the US, Thailand and Indonesia. With over 21 years of experience in production engineering and international business management, Dr. Dai has been instrumental in the growth of the Company since its inception. Dr. Dai received a Ph. D. in Mechanical Engineering from University of Tokyo, Japan in 1984.

CHANG Ban Ja, Jimmy, aged 63, joined the Company as a non-executive Director in December 2004. Mr. Chang is the executive vice president of Hon Hai following his assignments as the president of Foxconn Corporation in the US and managing director of Foxconn Singapore. Mr. Chang has been with Hon Hai since September 1989. He also spent over 31 years in internal audit, treasury, international investment analysis, controllership, sales and marketing functions. He had previously been associated with Arthur Young, Kaiser Aluminum & Chemical Corporation, Memorex and Atari Corporation. Mr. Chang obtained MBA from Santa Clara University, California, US in 1970.

GOU Hsiao Ling, aged 28, joined the Company as a non-executive Director in December 2004. Prior to taking up the directorship with the Company, Miss Gou worked for Hon Hai as a tax manager since September 2001. She was previously also a tax consultant at PricewaterhouseCoopers in Taipei, Taiwan and an analyst with Goldman Sachs International Limited, and has over 4 years of experience in the finance industry. Miss Gou received a Bachelor's degree in Economics from the University of California, Berkeley, US in 2001. Miss Gou is the daughter of Mr. Gou Tai Ming, the founder of Hon Hai. Mr. Gou is the present chairman of the board of directors and president of Hon Hai.

# PROFILE OF DIRECTORS AND SENIOR MANAGEMENT

LEE Jin Ming, aged 54, joined the Company as a non-executive Director in December 2004. He is also the chief accounting officer of Hon Hai. Prior to joining Hon Hai in October 1997, Mr. Lee was a senior financial manager with Philips and Chase Manhattan Bank. Mr. Lee has over 26 years of banking, corporate finance and accounting related international experience. Mr. Lee obtained a Bachelor of Arts degree from the National Chengchi University, Taiwan in 1974.

LU Fang Ming, aged 52, joined the Company as a non-executive Director in December 2004. He has been a director, an executive vice president and a general manager of Hon Hai since the intelligent hub and switch products ODM manufacturing company he founded was acquired by Hon Hai in May 2000. Prior to joining Hon Hai, he was a vice president and general manager at Cirrus Logic/Crystal Semiconductor in charge of its Asia Pacific operations. Prior to that, Mr. Lu spent 20 years with Hewlett-Packard in various positions including general manager of the HP Taiwan Computer System Group and QMS director of the HP Asia Pacific Test & Measurement Group. Mr. Lu graduated from Chung-Yuan University, Taiwan in 1980.

LAU Siu Ki, aged 48, joined the Company as an independent non-executive Director in December 2004. With over 25 years of experience in corporate finance, financial advisory and management, accounting and auditing, Mr. Lau is currently a financial advisory consultant running his own management consultancy firm, Hin Yan Consultants Limited. He is also a consultant to the corporate finance division of PCP CPA Limited, a medium sized certified public accountant firm in Hong Kong. Previously Mr. Lau worked at Ernst & Young for over 15 years. He graduated from Hong Kong Polytechnic in 1981. Mr. Lau is a member of both the Association of Chartered Certified Accountants ("ACCA") and The Hong Kong Institute of Certified Public Accountants. Mr. Lau is now a member of the World Council of ACCA. He has served on the executive committee of the Hong Kong branch of ACCA ("ACCA Hong Kong ") since 1995, and was the chairman of ACCA Hong Kong in 2000/2001. During these years he has helped raising the profile of ACCA Hong Kong. Mr. Lau also serves as an independent non-executive director of certain other listed companies.

Edward Fredrick PENSEL, aged 54, joined as an independent non-executive Director in December 2004. Mr. Pensel has extensive background and over 20 years of experience in high technology industries. He retired from HP (Compaq) after serving 5 years as senior vice president of the supply chain. Prior to HP (Compaq) , he was a senior vice president of worldwide operations frameworks for Ingram Micro Inc., vice president of worldwide manufacturing operations for Data General Corporation and director of worldwide procurement for Apollo Computer Inc.. In addition, Mr. Pensel was with Nortel Networks Limited for 10 years, during which time the company grew from a US$4 billion company to a US$38 billion company.

# PROFILE OF DIRECTORS AND SENIOR MANAGEMENT

MAO Yu Lang, aged 63, joined the Company as an independent non-executive Director in December 2004. Mr. Mao was respectively the President and CEO of Nortel Networks Greater China and Alcatel-Lucent Greater China during 1995 to 2006. Prior to those positions, Mr. Mao was President and CEO of Alcatel Taisel in Taiwan, a telecom industrial joint venture between Alcatel and Chung Hwa Telecom. Mr. Mao is also a director of Winbond Electronics Corp., which listed on the Taiwan Stock Exchange Corporation, and of Hurray! Holdings Co., Ltd., which listed at Nasdaq, the US respectively. He has over 30 years of experience in the telecom and electronics industry. Mr. Mao obtained both a Bachelor of Metallurgical Engineering degree and a Master of Engineering (Materials) degree from Cornell University in the US in 1966 and 1967 respectively. He also received a Degree of Master of Science in Management from Sloan School of Massachusetts Institute of Technology, US in 1972.

## SENIOR MANAGEMENT

WU Koa Teh, Gordon, aged 59, joined the Company as senior vice president in July 2003. Prior to that, he held vice president position in Hon Hai starting in October 1998, as one of the principal managers responsible for the handset manufacturing services business. He was also a special assistant to the chief executive officer of Hon Hai, responsible for establishing and developing new business. Mr. Wu has over 28 years of experience in the mechanical engineering field, focusing on the development of computer peripherals, and more than 15 years spent in the management of desktop PC and PC notebook design. Before joining Hon Hai, Mr. Wu worked at Toshiba America Information System for 2 years where he managed the research and development team to develop the first desktop PC for Toshiba, and earned an achievement award for best design of the year during his time there. Prior to that, he spent 20 years with Digital Equipment Corporation, worked his way from design engineer to engineering manager throughout Asia and Europe. The last position he held at Digital was to start up a notebook research and development team and built the first under one inch thin and light PC notebook in the early nineties. Mr. Wu was awarded a Bachelor of Science in Industrial Engineering from Northeastern University, Illinois, US.

CHEN Hsu Tang, Tom, aged 42, joined the Company as vice president, business development in July 2003 and had been one of the principal managers responsible for the handset manufacturing services business of the Hon Hai Group since October 2001 when he became a vice president of Hon Hai. He is also a director of Foxconn Mexico Precision Industry, Co. SA de CV., one of the Company's principal operating subsidiaries. Mr. Chen joined Hon Hai in December 2000. Mr. Chen has over 16 years of experience in engineering, sales and general management in the telecommunication and components industries. Previously, Mr. Chen was the director of supply chain at Axxion Group Corporation in Texas, US. He was also the founder and chief executive officer of Jefferson Rubber Technologies in Texas, US. He had also worked at International Business Machines Corporation in New York as a telecommunications engineer. Mr. Chen obtained a Master of Science degree in Industrial Engineering from Columbia University, NY, US in 1991.

CHAO Shan Ping, Henry, aged 50, joined the Company as director of electronic parts production and assembly in June 2004, and had been one of the principal managers responsible for the handset manufacturing services business of the Hon Hai Group since March 2001. He is also a director of the Company's principal operating subsidiary, Honxun Electrical Industry (Hangzhou) Co., Ltd.. Before joining the Company, Mr. Chao was with Hon Hai since September 1996 and was responsible for SMT and computer motherboard manufacturing processes. Prior to that, Mr. Chao held various production and engineering management positions with Wang Computer and Delta Electronics. He has over 21 years of experience in engineering management. Mr. Chao received a Bachelor's degree in Industrial Engineering from National Taipei University of Technology, Taiwan in 1978.

KO Ming Chung, aged 44, joined the Company as a director of mechanical production in June 2004, and had been one of the principal managers responsible for the handset manufacturing services business of the Hon Hai Group since July 2000. Mr. Ko has close to 21 years of mechanical engineering and production management experience. Before joining the Company, he was with Hon Hai since July 1992. Prior to that, Mr. Ko held various positions in mechanical engineering and production with Philips and Matsushita Electric (Taiwan) Co., Ltd.. Mr. Ko received a Master of Science degree in Mechanical Engineering from National Taiwan University, Taiwan in 1992.

Michael SMITH, aged 42, joined the Company as vice president, Mexico operations in May 2004. Mr. Smith has over 13 years of experience in the high technology electronics manufacturing industry. Prior to joining the Company, he worked in Motorola, Inc. for over 11 years in various paging and cellular phone new product introduction and manufacturing capacities. Most recently, he was the site director of the Chihuahua Plant which the Company acquired in December 2003. Mr. Smith is a member of senior management of Foxconn Mexico Precision Industry, Co. SA de CV., one of the principal operating subsidiaries of the Company, which owns and operates the Chihuahua Plant. Mr. Smith obtained a Master of Science degree in Electrical Engineering from the University of South Florida in Tampa, Florida, US in 1991.

Timo HARJU, aged 53, joined the Company as executive vice president and chief financial officer, European operations in October 2003, and had been one of the principal managers responsible for the handset manufacturing services business of the Hon Hai Group. Mr. Harju has over 21 years of executive experience in global multinational businesses in the area of general and financial management, acquisition and integration management and had held directorships with several international companies. Before joining the Company, he served as president and chief executive officer of Foxconn Oy in the mobile telecommunications industry. Prior to that, he was vice president and regional director of Asia and South America of Ahlstrom Group, and was responsible for one of the Ahlstrom Group's global businesses for those regions. Mr. Harju had also served as vice president and chief financial officer of one of the global business groups of Ahlstrom Group being responsible for financial, strategic planning and information technology functions. Mr. Harju received a Master of Science degree from the University of Technology of Lappeenranta, Finland in 1981 and he also completed the International Executive Program at INSEAD, France in 1999.

# PROFILE OF DIRECTORS AND SENIOR MANAGEMENT

TSAU Li Ren, Aran, aged 53, joined the Company as director of human resources management in June 2004, and had been one of the principal managers responsible for the handset manufacturing services business of the Hon Hai Group since November 2001. Before joining the Company, Dr. Tsau joined Hon Hai in April 1997, and was responsible for connectors design and engineering analysis. He was also instrumental in the creation of product data system backbones as well as building the transceiver product design and manufacturing team. Prior to joining Hon Hai, Dr. Tsau was a professor of Department of Mechanical Engineering at Chung Cheng Institute of Technology, teaching courses such as CAD, CAM and computer-aided engineering. Dr. Tsau has over 26 years of experience and understanding of the product design and development process and production management. Dr. Tsau received a Ph. D. in Mechanical Engineering from the University of Minnesota, US in 1987.

HSU Chung Chang, Jonathan, aged 45, joined the Company as treasurer in June 2004, and had been one of the principal managers responsible for the handset manufacturing services business of the Hon Hai Group since October 2003. Mr. Hsu has over 16 years of experience working in finance related areas and more than 8 years of experience in the area of electronic industry finance. Before joining the Company, he worked at Macronix International Co., Ltd. as treasury manager for about 5 years. Prior to that, he worked at Nikko Securities Co., Ltd. and served as assistant vice president of corporate finance for five years. Mr. Hsu obtained MBA in Finance from George Washington University, US in 1993.

TONG Wen Hsin, Vincent, aged 41, joined the Company as director of investments and investor relations in July 2004. Mr. Tong has over 12 years of experience in the investment banking, finance and information technology fields. Before joining the Company, Mr. Tong worked at ABN AMRO Rothschild, where he was a director of the equity capital markets department, responsible for the underwriting of various equity and equity-linked issues of Asian corporate clients. Prior to that, he worked in the equity capital markets department of Jardine Fleming and Robert Fleming in Hong Kong and London, as well as in the marketing and sales departments of International Business Machines Corporation in Taiwan. Mr. Tong holds MBA degree from London Business School, United Kingdom, which he obtained in 1995.

TAM Kam Wah, Danny, aged 43, is the Company's qualified accountant. He is also the chief accounting officer of the Company. Mr. Tam joined the Company as senior manager of financial control in October 2004. Mr. Tam has over 19 years of experience in accounting and finance in Hong Kong and US international companies. Prior to joining the Company, he worked as a financial controller for ITT Industries and Hutchison Harbour Ring Ltd., and he also worked as an accounting manager for Coates Brothers (HK) Co. Ltd.. Mr. Tam is a fellow of the Association of Chartered Certified Accountants, an associate of Chartered Institute of Management Accountants and an associate of Hong Kong Institute of Certified Public Accountants. Mr. Tam received an BBA from Chinese University of Hong Kong in 1988, a Master of Applied Finance from Macquarie University, Australia in 1994, MBA from University of Ottawa, Canada in 1996, and a Master of Arts degree in Information System and a Master of Arts degree in Electronic Business from City University of Hong Kong in 1999 and 2002 respectively. Mr. Tam also received a Master of Accounting from Jinan University in 2005.

# REPORT OF THE DIRECTORS

The board of directors ("Board") of the Company is pleased to announce the audited consolidated results of the Company and its subsidiaries ("Group") for the year ended 31 December 2006.

## PRINCIPAL ACTIVITIES

The Company is an investment holding company. The activities of the principal subsidiaries are set out in the financial statements on pages 70 to 72. The Group is a vertically integrated manufacturing services provider for handset industry worldwide. It provides a full range of manufacturing services to its customers in connection with the production of handsets.

## RESULTS AND DIVIDENDS

The results of the Group for the year ended 31 December 2006 are set out in the financial statements on page 24. The Board does not recommend the payment of any dividends in respect of the year ended 31 December 2006.

## RESERVES

Movements in reserves of the Group during the year are set out on page 26.

## DISTRIBUTABLE RESERVES

As at 31 December 2006, the Company's reserves available for distribution amounted to US$923,592,000.

## SHARE CAPITAL

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

## FINANCIAL SUMMARY

A financial summary of the results and the balance sheet of the Group for the last five financial years is set out on page 73.

## PROPERTY, PLANT AND EQUIPMENT

Details of movements in property, plant and equipment of the Group during the year are set out in note 15 to the financial statements.

## BANK LOANS

Details of bank loans are set out in note 24 to the financial statements.

# REPORT OF THE DIRECTORS

## DIRECTORS

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

### Executive Directors

CHIN Wai Leung, Samuel
DAI Feng Shuh

### Non-executive Directors

CHANG Ban Ja, Jimmy
GOU Hsiao Ling
LEE Jin Ming
LU Fang Ming

### Independent non-Executive Directors

LAU Siu Ki
Edward Fredrick PENSEL
MAO Yu Lang

Having received written confirmation from each of the independent non-executive directors of their independence pursuant to rule 3.13 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules"), the Company considers each independent non-executive director to be independent.

Pursuant to article 112 of the articles of association of the Company ("Articles"), 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 exceeding one-third) shall retire from office by rotation at each annual general meeting of the Company provided that every director shall be subject to retirement by rotation at least once every three years. In accordance with article 112 of the Articles, Messrs. Dai Feng Shuh, Lee Jin Ming and Lu Fang Ming will retire from office by rotation at the annual general meeting and, being eligible, will offer themselves for re-election.

## SERVICE CONTRACTS

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

## DIRECTORS' INTERESTS IN CONTRACTS

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

## DISCLOSURE OF INTERESTS

### Directors' Interests and Short Positions in Shares, Underlying Shares and Debentures

As at 31 December 2006, the interests and short positions, if any, of each director and chief executive of the Company in the shares, underlying shares and debentures of the Company and any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) which were required to be notified to the Company and The Stock Exchange of Hong Kong Limited ("Stock Exchange") pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which the directors and chief executives were taken or deemed to have under such provisions of the SFO) or which were required to be and are recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO or as otherwise required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code") adopted by the Company were as follows:

| Name of director | Name of corporation | Capacity/ Nature of interest | Total number of ordinary shares | Approximate percentage of interest in the Company/ associated corporations |
|---|---|---|---|---|
| Chin Wai Leung, Samuel | Company | Personal Interest | 19,434,275 | 0.278% |
| | Hon Hai | Personal Interest | 393,182 | 0.008% |
| Dai Feng Shuh | Company | Personal Interest | 21,821,275 | 0.312% |
| | Hon Hai | Personal Interest | 265,036 | 0.005% |
| Chang Ban Ja, Jimmy | Hon Hai | Personal Interest | 1,887,892 | 0.036% |
| Lee Jin Ming | Hon Hai | Personal Interest | 1,006,794 | 0.019% |
| Lu Fang Ming | Hon Hai | Personal Interest | 1,506,715 | 0.029% |
| Mao Yu Lang | Hon Hai | Personal Interest | 472,399 | 0.009% |

Save as disclosed above, none of the directors or chief executives of the Company had, as at 31 December 2006, any interests or short positions in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which would have to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which the directors and chief executives were taken or deemed to have under such provisions of the SFO) or which were recorded in the register required to be kept by the Company under Section 352 of the SFO or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code.

## Substantial Shareholders' Interests and Short Positions in Shares and Underlying Shares

So far as is known to any director of the Company, as at 31 December 2006, shareholders (other than the directors or chief executives of the Company) who had interests and short positions in the shares and underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or which were recorded in the register required to be kept by the Company under Section 336 of the SFO were as follows:

| Name | Capacity/ Nature of interest | Total number of ordinary shares | Approximate percentage of interest in the Company |
|---|---|---|---|
| Foxconn (Far East) Limited | Beneficial owner | 5,081,034,525 | 72.69% |
| Hon Hai[(1)] | Interest of a controlled corporation | 5,081,034,525 | 72.69% |

*Note:*

(1) Foxconn (Far East) Limited is a direct wholly-owned subsidiary of Hon Hai, therefore, Hon Hai is deemed or taken to be interested in the 5,081,034,525 shares which are beneficially owned by Foxconn (Far East) Limited for the purposes of the SFO.

Save as disclosed above, as at 31 December 2006, the Company had not been notified by any persons (other than the directors or chief executives of the Company) who had interests or short positions in the shares or underlying shares of the Company which would be required to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or which were recorded in the register required to be kept by the Company under Section 336 of the SFO.

## CONTINUING CONNECTED TRANSACTIONS

The Group entered into the following continuing connected transactions with Hon Hai, the Company's ultimate controlling shareholder, its subsidiaries or associates ("Hon Hai Group"):

1. Product sales transactions between the Group and the Hon Hai Group *(Note 1)*;

2. Lease transactions between the Group and the Hon Hai Group *(Note 2)*;

3. General services transactions between the Group and the Hon Hai Group *(Note 3)*;

4. Research and development services transactions between the Group and the Hon Hai Group *(Note 4)*;

5. Subcontracting transactions between the Group and the Hon Hai Group *(Note 5)*;

6. Equipment sale and purchase transactions between the Group and the Hon Hai Group *(Note 6)*;

7. **Materials and components supply transactions between the Group and the Hon Hai Group *(Note 7); and***

8. **Design service transactions between the Group and the Hon Hai Group *(Note 8).***

*Notes:*

1. This refers to the sales of certain products to the Hon Hai Group pursuant to the framework product sales agreement dated 18 January 2005 and a supplemental agreement dated 28 February 2006. The total consideration for the year ended 31 December 2006 was US$253.333 million.

2. This refers to the properties leased from the Hon Hai Group pursuant to the framework lease agreement dated 18 January 2005 and supplemental agreements dated 12 January 2006 and 20 September 2006 respectively. The total consideration for the year ended 31 December 2006 was US$4.459 million.

3. This refers to the provision of utilities, support and other general services by the Hon Hai Group to the Group pursuant to the general services agreement dated 18 January 2005 and a supplemental agreement dated 12 January 2006. The total consideration for the year ended 31 December 2006 was US$32.725 million.

4. This refers to the provision of research and development services by the Hon Hai Group to the Group pursuant to the research and development services agreement dated 19 January 2005 and a supplemental agreement dated 12 January 2006. The total consideration for the year ended 31 December 2006 was US$2.25 million.

5. This refers to subcontracting services providing to and provided by the Hon Hai Group pursuant to the framework subcontracting (income) agreement dated 18 January 2005 and a supplemental agreement dated 12 January 2006 and the framework subcontracting (expense) agreement dated 18 January 2005 and a supplemental agreement dated 12 January 2006. The total consideration for the year ended 31 December 2006 for subcontracting income and subcontracting expense was US$52.494 million and US$27.268 million respectively.

6. This refers to equipments purchased from and sold to the Hon Hai Group pursuant to the framework equipment purchase agreement dated 18 January 2005 and a supplemental agreement dated 12 January 2006 and the framework equipment sale agreement dated 18 January 2005 and a supplemental agreement dated 12 January 2006. The total consideration for the year ended 31 December 2006 for equipment purchase and equipment sale was US$23.337 million and US$35.565 million respectively.

7. This refers to the supply of materials and components by the Hon Hai Group pursuant to the framework materials and components supply agreement dated 19 January 2005 and a supplemental agreement dated 28 February 2006. The total consideration for the year ended 31 December 2006 was US$1,064.312 million.

8. This refers to the design services provided by the Hon Hai Group to the Group pursuant to the framework design sub-contracting service agreement dated 20 September 2006. The total consideration for the year ended 31 December 2006 was US$5.435 million.

**Pursuant to Rule 14A.38 of the Listing Rules, the Board engaged the auditors of the Company to perform certain agreed upon procedures in respect of the transactions of the Group to assist the directors to evaluate whether the transactions:**

1. **have received the approval from the Board;**

2. were in accordance with the pricing policies of the Group where the transactions involve provision of goods and services by the Group;

3. have been entered into in accordance with the relevant agreements governing the transactions; and

4. have not exceeded the caps disclosed in the relevant announcements.

The auditors of the Company have performed procedures in respect of the transactions in accordance with Hong Kong Standard on Related Services 4400 *Engagements to Perform Agreed Upon Procedures Regarding Financial Information.*

The auditors have reported their factual findings on these procedures to the Board. The independent non-executive directors of the Company have reviewed the transactions and the findings and confirmed that the transactions are:

1. in the ordinary and usual course of business of the Group;

2. on normal commercial terms; and

3. in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

## SHARE OPTION SCHEME AND SHARE SCHEME

A share option scheme ("Option Scheme") and a share scheme ("Share Scheme") were adopted by the Company on 12 January 2005. The Share Scheme was amended by the shareholders on the extraordinary general meeting of the Company held on 4 August 2006.

### Option Scheme

Movements of the share options granted under the Option Scheme during the year are as follows:-

| Outstanding at beginning of year | Date of grant during year | Granted during year | Vesting period | Exercise price | Exercised during year | Lapsed during year | Expired during year | Outstanding at end of year |
|---|---|---|---|---|---|---|---|---|
| 435,290,000 | – | 0 | each year on 25 July from 2006 to 2011 | HK$6.06 | 28,731,520 | 3,644,200 | 0 | 402,914,280 |
| 435,290,000 | | 0 | | | 28,731,520 | 3,644,200 | 0 | 402,914,280 |

## Summary of Principal Terms of the Option Scheme

The purpose of the Option Scheme is to attract skilled and experienced personnel, to incentivize them to remain with the Group and to give effect to the Group's customer-focused corporate culture, and to motivate them to strive for the future development and expansion of the Group, by providing them with opportunities to acquire equity interests in the Company.

Subject to the terms of the Option Scheme, the Board may, at its absolute discretion, offer any employees, management members and directors of the Company, or any of its subsidiaries, and third party service providers including employees of Hon Hai and its subsidiaries, options to subscribe for shares on the terms set out in the Option Scheme.

The total number of shares in respect of which options may be granted under the Option Scheme shall be 695,805,602 shares, representing approximately 9.93% of the issued share capital of the Company as at the date of this annual report.

The total number of shares issued and to be issued upon exercise of options granted and to be granted to each grantee in any 12-month period up to the date of the latest grant shall not exceed 1% of the issued share capital of the Company from time to time.

The period within which the options must be exercised will be specified by the Board at the time of grant, and must expire no later than 10 years from the effective date of the Option Scheme. An offer of grant of an option must be accepted being a date not more than 30 days after the date of the offer. The amount payable on acceptance of an offer is HK$1.00.

The subscription price for shares shall be not less than the highest of: (i) the closing price of the shares as stated in the Stock Exchange's daily quotations sheet on the date of grant, which must be a business day; and (ii) the average closing price of the shares as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant; and (iii) the nominal value of the shares.

## Information on the Share Scheme

The Share Scheme is not subject to the provisions of Chapter 17 of the Listing Rules. The trustee for the Share Scheme may either subscribe for new shares at nominal value or purchase shares from the market in accordance with the terms of the Share Scheme.

At the forthcoming annual general meeting of the Company, an ordinary resolution will be proposed to grant a general mandate to the directors of the Company to allot and issue shares under the Share Scheme not exceeding 2% of the issued share capital of the Company as at the date of such meeting ("Scheme Mandate").

# REPORT OF THE DIRECTORS

As at 11 April 2007, the issued share capital of the Company comprised 7,005,814,690 shares of US$0.04 each. Subject to the passing of an ordinary resolution approving the Scheme Mandate and on the basis that no further shares are issued or repurchased prior to the forthcoming annual general meeting, exercise in full of the proposed Scheme Mandate will result in 140,116,293 shares being allotted and issued under the Scheme Mandate. On the basis of the closing price of HK$25.30 per share as at 11 April 2007 and the Scheme Mandate being exercised in full, the aggregate market value of the 140,116,293 shares to be allotted and issued pursuant thereto would be approximately HK$3,544,942,212. The Company expects that the costs attributable to the grant of any shares under the Share Scheme will be accounted for by reference to the market value of such shares at the time of grant. The Company will give due consideration to any financial impact arising from the grant of shares under the Share Scheme before exercising the Scheme Mandate.

On 29 December 2006, the Company granted 5,748,145 award shares to 1,200 employees under the Share Scheme subject to lock-up periods of up to three years commencing from the date of grant, which varies from beneficiary to beneficiary.

Apart from the Option Scheme and the Share Scheme above, at no time during the year was the Company or any of its subsidiaries a party to any arrangement to enable the directors of the Company to acquire benefits by means of acquisitions of shares in, or debenture of, the Company or any other body corporate.

## MAJOR CUSTOMERS AND SUPPLIERS

During the year, sales to the Group's five largest customers accounted for approximately 94% of the Group's total sales for the year and sales to the Group's largest customer amounted to approximately 59%. Purchases from the Group's five largest suppliers accounted for approximately 55% of the Group's total purchases for the year and purchase from the Group's largest supplier amounted to approximately 47%.

None of the directors of the Company or any of their associates or any shareholders (which, to the best knowledge of the directors, own more than 5% of the issued share capital of the Company) had any interest in any of the Group's five largest customers and five largest suppliers.

## MANAGEMENT CONTRACTS

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

## SUFFICIENCY OF PUBLIC FLOAT

As at the latest practical date prior to the issue of this annual report, to the best knowledge of the directors and based on the information publicly available to the Company, there is sufficient public float as required by the Listing Rules.

## PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year ended 31 December 2006.

## PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the memorandum and the articles of association of the Company and the Companies Law of the Cayman Islands.

## PENSION SCHEMES

Details of the Group's pension scheme and the basis of calculation are set out in note 34 to the financial statements.

## AUDIT COMMITTEE

The Company has established an audit committee in accordance with the requirements of the Listing Rules and the Code on Corporate Governance Practices ("CCGP"). Its primary duties are to review and supervise the Company's financial reporting process and internal control system, nominate and monitor external auditors and provide advices and comments to the Board. The audit committee is comprised of three non-executive directors, two of whom are independent non-executive directors.

The audit committee has reviewed the audited financial statements of the Group for the year ended 31 December 2006.

## CORPORATE GOVERNANCE

None of the directors of the Company is aware of information that would reasonably indicate that the Company is not, or was not for any part of the year covered by the annual report, in compliance with the CCGP as set out in Appendix 14 of the Listing Rules save as disclosed in the corporate governance report in this report.

## AUDITORS

The financial statements have been audited by Deloitte Touche Tohmatsu who are due to retire and, being eligible, offer themselves for re-appointment as auditors of the Company.

On behalf of the Board
**Chin Wai Leung, Samuel**
*Chairman and Chief Executive Officer*

Hong Kong, 11 April 2007

Deloitte.
德勤

**TO THE SHAREHOLDERS OF FOXCONN INTERNATIONAL HOLDINGS LIMITED**
*(incorporated in the Cayman Islands with limited liability)*

We have audited the consolidated financial statements of Foxconn International Holdings Limited (the "Company") and its subsidiaries (collectively referred to as the "Group") set out on pages 24 to 72, which comprise the consolidated balance sheet as at 31 December 2006, and the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED 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 International Financial Reporting Standards 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 the consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 the true and fair presentation of the consolidated 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 consolidated 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 Group as at 31 December 2006 and of the Group's profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

**DELOITTE TOUCHE TOHMATSU**
*Certified Public Accountants*

Hong Kong, 11 April 2007

# CONSOLIDATED INCOME STATEMENT

*For the year ended 31 December 2006*

| | *NOTES* | **2006 US$'000** | 2005 US$'000 |
|---|---|---|---|
| Turnover | *6* | **10,381,236** | 6,364,497 |
| Cost of sales | | **(9,408,852)** | (5,783,942) |
| Gross profit | | **972,384** | 580,555 |
| Other income | *7* | **63,985** | 38,485 |
| Selling expenses | | **(15,197)** | (12,716) |
| General and administrative expenses | | **(150,700)** | (133,543) |
| Research and development expenses | | **(62,063)** | (30,419) |
| Restructuring costs | *8* | **(9,659)** | (9,203) |
| Interest expense on bank borrowings | | **(13,294)** | (13,901) |
| Profit before tax | *9* | **785,456** | 419,258 |
| Income tax expense | *12* | **(67,610)** | (36,324) |
| Profit for the year | | **717,846** | 382,934 |
| Attributable to: | | | |
| Equity holders of the parent | | **718,038** | 385,699 |
| Minority interests | | **(192)** | (2,765) |
| | | **717,846** | 382,934 |
| Earnings per share | *14* | | |
| Basic | | **US10.31 cents** | US5.64 cents |
| Diluted | | **US9.93 cents** | US5.62 cents |

# CONSOLIDATED BALANCE SHEET

*As at 31 December 2006*

| | NOTES | 2006 US$'000 | 2005 US$'000 |
|---|---|---|---|
| Non-current assets | | | |
| Property, plant and equipment | 15 | **1,003,904** | 661,792 |
| Prepaid lease payments | 16 | **102,817** | 6,306 |
| Available-for-sale investments | 17 | **1,010** | 1,028 |
| Goodwill | 18 | **63,075** | 63,075 |
| Deferred tax assets | 19 | **15,806** | 10,094 |
| Deposits for acquisition of property, plant and equipment | | **28,716** | 22,263 |
| | | **1,215,328** | 764,558 |
| Current assets | | | |
| Inventories | 20 | **744,198** | 513,999 |
| Investments held for trading | 21 | **565** | 7,193 |
| Trade and other receivables | 22 | **1,877,660** | 1,512,849 |
| Bank deposits | 29 | **31,567** | 48,925 |
| Bank balances and cash | 29 | **633,090** | 311,023 |
| | | **3,287,080** | 2,393,989 |
| Current liabilities | | | |
| Trade and other payables | 23 | **1,866,770** | 1,408,740 |
| Bank loans | 24 | **139,563** | 175,548 |
| Provision | 30 | **58,212** | 23,635 |
| Tax payable | | **54,952** | 20,856 |
| | | **2,119,497** | 1,628,779 |
| Net current assets | | **1,167,583** | 765,210 |
| Total assets less current liabilities | | **2,382,911** | 1,529,768 |
| Capital and reserves | | | |
| Share capital | 25 | **279,598** | 278,137 |
| Reserves | 26 | **2,089,384** | 1,236,833 |
| Equity attributable to equity holders of the parent | | **2,368,982** | 1,514,970 |
| Minority interests | | **12,020** | 12,047 |
| Total equity | | **2,381,002** | 1,527,017 |
| Non-current liabilities | | | |
| Deferred tax liabilities | 19 | **1,909** | 2,751 |
| | | **2,382,911** | 1,529,768 |

The consolidated financial statements on pages 24 to 72 were approved and authorised for issue by the board of directors on 11 April 2007 and are signed on its behalf by:

| DAI FENG SHUH | CHIN WAI LEUNG, SAMUEL |
|---|---|
| DIRECTOR | DIRECTOR |

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

*For the year ended 31 December 2006*

| | Attributable to equity holders of the parent | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Subscription monies | Special reserve | Legal reserve | Translation reserve | Share compensation reserve | Retained profits | Total | Minority interests | Total |
| | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 |
| | | | *(Note 25)* | *(Note 26)* | *(Note 26)* | | | | | | |
| Balance at 1 January 2005 | 238,800 | 129,980 | – | 15,514 | 23,679 | 22,469 | – | 200,367 | 630,809 | – | 630,809 |
| Profit for the year | – | – | – | – | – | – | – | 385,699 | 385,699 | (2,765) | 382,934 |
| Exchange differences arising on translation of foreign operations recognised directly in equity | – | – | – | – | – | (6,624) | – | – | (6,624) | – | (6,624) |
| Total recognised income for the year | – | – | – | – | – | (6,624) | – | 385,699 | 379,075 | (2,765) | 376,310 |
| Shares issued at premium *(Note 25)* | 39,337 | 455,265 | – | – | – | – | – | – | 494,602 | – | 494,602 |
| Subscription monies received for shares to be issued | – | – | 7,480 | – | – | – | – | – | 7,480 | – | 7,480 |
| Share issue expenses | – | (17,072) | – | – | – | – | – | – | (17,072) | – | (17,072) |
| Acquisition of a subsidiary *(Note 28)* | – | – | – | – | – | – | – | – | – | 25,389 | 25,389 |
| Acquisition of additional interest in a subsidiary | – | – | – | – | – | – | – | – | – | (10,577) | (10,577) |
| Profit appropriations | – | – | – | – | 49,477 | – | – | (49,477) | – | – | – |
| Recognition of equity-settled share based payment *(Note 35)* | – | – | – | – | – | – | 20,076 | – | 20,076 | – | 20,076 |
| Balance at 31 December 2005 | 278,137 | 568,173 | 7,480 | 15,514 | 73,156 | 15,845 | 20,076 | 536,589 | 1,514,970 | 12,047 | 1,527,017 |
| Profit for the year | – | – | – | – | – | – | – | 718,038 | 718,038 | (192) | 717,846 |
| Exchange differences arising on translation of foreign operations recognised directly in equity | – | – | – | – | – | 59,703 | – | – | 59,703 | 165 | 59,868 |
| Total recognised income for the year | – | – | – | – | – | 59,703 | – | 718,038 | 777,741 | (27) | 777,714 |
| Shares issued at premium *(Note 25)* | 185 | 7,295 | (7,480) | – | – | – | – | – | – | – | – |
| Issue of ordinary shares under Option Scheme and Share Scheme | 1,276 | 31,041 | – | – | – | – | (9,929) | – | 22,388 | – | 22,388 |
| Profit appropriations | – | – | – | – | 31,566 | – | – | (31,566) | – | – | – |
| Recognition of equity-settled share based payment *(Note 35)* | – | – | – | – | – | – | 53,883 | – | 53,883 | – | 53,883 |
| Balance at 31 December 2006 | 279,598 | 606,509 | – | 15,514 | 104,722 | 75,548 | 64,030 | 1,223,061 | 2,368,982 | 12,020 | 2,381,002 |

# CONSOLIDATED CASH FLOW STATEMENT

*For the year ended 31 December 2006*

| | NOTE | 2006 US$'000 | 2005 US$'000 |
|---|---|---|---|
| OPERATING ACTIVITIES | | | |
| Profit before tax | | **785,456** | 419,258 |
| Adjustments for: | | | |
| Interest expense | | **13,294** | 13,901 |
| Depreciation and amortisation | | **134,967** | 72,566 |
| Interest income | | **(10,585)** | (8,889) |
| Impairment loss for property, plant and equipment | | **3,892** | 7,966 |
| (Write back) allowances for doubtful debts | | **(658)** | 852 |
| Write down of inventories | | **28,107** | 20,328 |
| Gain on disposal of certain assets and liabilities of a subsidiary | | **(1,209)** | – |
| Loss on disposal of property, plant and equipment | | **737** | 244 |
| Increase in fair value of investments held for trading | | **(310)** | (129) |
| Share-based payment expense | | **57,312** | 20,076 |
| Operating cash flows before movements in working capital | | **1,011,003** | 546,173 |
| Increase in inventories | | **(242,860)** | (36,981) |
| Increase in trade and other receivables | | **(295,897)** | (805,453) |
| Increase in trade and other payables | | **392,288** | 542,345 |
| Increase in provision | | **33,211** | 17,869 |
| Decrease in investments held for trading | | **6,938** | 5,612 |
| Cash generated from operations | | **904,683** | 269,565 |
| Income taxes paid | | **(42,956)** | (23,243) |
| Interest paid | | **(13,294)** | (13,901) |
| Interest received | | **10,585** | 8,889 |
| NET CASH FROM OPERATING ACTIVITIES | | **859,018** | 241,310 |
| INVESTING ACTIVITIES | | | |
| Purchase of property, plant and equipment | | **(494,418)** | (312,110) |
| Prepaid lease payments made | | **(95,132)** | (3,342) |
| Increase in deposits for acquisition of property, plant and equipment | | **(6,453)** | (2,077) |
| Proceeds on disposal of property, plant and equipment | | **32,279** | 15,646 |
| Decrease (increase) in bank deposits for investing purpose | | **17,358** | (4,546) |
| Proceeds on disposal of certain assets and liabilities of a subsidiary | | **8,580** | – |
| Acquisition of subsidiaries | *28* | **–** | (74,741) |
| Acquisition of additional interest in subsidiaries | | **–** | (27,183) |
| NET CASH USED IN INVESTING ACTIVITIES | | **(537,786)** | (408,353) |
| FINANCING ACTIVITIES | | | |
| Bank loans repaid | | **(2,526,229)** | (1,813,666) |
| Bank loans raised | | **2,490,244** | 1,345,733 |
| Proceeds from issue of shares | | **22,388** | 502,082 |
| Share issue expenses | | **–** | (17,072) |
| NET CASH (USED IN) FROM FINANCING ACTIVITIES | | **(13,597)** | 17,077 |

# CONSOLIDATED CASH FLOW STATEMENT

*For the year ended 31 December 2006*

| | 2006<br>US$'000 | 2005<br>US$'000 |
|---|---|---|
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | **307,635** | (149,966) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF THE YEAR | **311,023** | 455,047 |
| EFFECT OF FOREIGN EXCHANGE RATE CHANGES | **14,432** | 5,942 |
| CASH AND CASH EQUIVALENTS AT END OF THE YEAR | **633,090** | 311,023 |
| ANALYSIS OF THE BALANCES OF CASH AND CASH EQUIVALENTS | | |
| Bank balances and cash | **633,090** | 311,023 |

## 1. GENERAL

The Company was incorporated in the Cayman Islands as an exempted company with limited liability on 8 February 2000 under the Companies Law of the Cayman Islands. The Company's shares have been listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 3 February 2005. The Company's parent company is Foxconn (Far East) Limited (incorporated in the Cayman Islands) and its ultimate holding company is Hon Hai Precision Industry Company Limited ("Hon Hai") (incorporated in Taiwan and its shares are listed on Taiwan Stock Exchange). The addresses of the registered office and principal place of business of the Company are disclosed in the section headed "Corporate Information" to the annual report.

The Company and its subsidiaries (hereinafter collectively referred to as the "Group") are principally engaged in the manufacture of complete mobile phone handset systems and modules for mobile phone handsets.

The consolidated financial statements are presented in United States Dollars ("US$") which is also the functional currency of the Company.

## 2. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

In the current year, the Group has applied, for the first time, a number of new standards, amendments and interpretations (hereinafter collectively referred to as "new IFRSs") issued by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC"), which are either effective for accounting periods beginning on or after 1 December 2005 or 1 January 2006. The adoption of the new IFRSs had no material effect on how the results and financial positions for the current or prior accounting periods have been prepared and presented. Accordingly, no prior period adjustment has been required.

The Group has not early applied the following new IFRSs that have been issued but are not yet effective.

| | |
|---|---|
| IAS 1 (Amendment) | Capital Disclosures[1] |
| IFRS 7 | Financial Instruments: Disclosures[1] |
| IFRS 8 | Operating Segments[2] |
| IFRIC 7 | Applying the Restatement Approach under IAS 29 *Financial Reporting in Hyperinflationary Economies*[3] |
| IFRIC 8 | Scope of IFRS 2[4] |
| IFRIC 9 | Reassessment of Embedded Derivatives[5] |
| IFRIC 10 | Interim Financial Reporting and Impairment[6] |
| IFRIC 11 | IFRS 2 – Group and Treasury Share Transactions[7] |
| IFRIC 12 | Service Concession Arrangements[8] |

[1] Effective for annual periods beginning on or after 1 January 2007
[2] Effective for annual periods beginning on or after 1 January 2009
[3] Effective for annual periods beginning on or after 1 March 2006
[4] Effective for annual periods beginning on or after 1 May 2006
[5] Effective for annual periods beginning on or after 1 June 2006
[6] Effective for annual periods beginning on or after 1 November 2006
[7] Effective for annual periods beginning on or after 1 March 2007
[8] Effective for annual periods beginning on or after 1 January 2008

The directors of the Company anticipate that the application of these new IFRSs will have no material financial impact on the consolidated financial statements of the Group, except for IFRS 8. They have commenced considering the potential impact of IFRS 8 but is not yet in a position to determine whether IFRS 8 would have a significant impact on how its results of operations and financial position are prepared and presented.

## 3. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair values, as explained in the accounting policies set out below.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards. In addition, the consolidated financial statements include applicable disclosures required by the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") and by the Hong Kong Companies Ordinance.

### Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities (including special purpose entities) controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Minority interests in the net assets (excluding goodwill) of consolidated subsidiaries are presented separately from the Group's equity therein. Minority interests in the net assets consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

### Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 "Business Combinations" are recognised at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 "Non-Current Assets Held for Sale and Discontinued Operations", which are recognised and measured at fair value less costs to sell.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Business combinations *(Continued)*

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

### Goodwill

Goodwill arising on an acquisition of a subsidiary represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the relevant subsidiary at the date of acquisition. Such goodwill is carried at cost less any accumulated impairment losses.

Capitalised goodwill arising on an acquisition of a subsidiary is presented separately in the consolidated balance sheet.

For the purposes of impairment testing, goodwill arising from an acquisition is allocated to each of the relevant cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the acquisition. A cash-generating unit to which goodwill has been allocated is tested for impairment annually, and whenever there is an indication that the unit may be impaired. For goodwill arising on an acquisition in a financial year, the cash-generating unit to which goodwill has been allocated is tested for impairment before the end of that financial year. When the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated to reduce the carrying amount of any goodwill allocated to the unit first, and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognised directly in the consolidated income statement. An impairment loss for goodwill is not reversed in subsequent periods.

On subsequent disposal of a subsidiary, the attributable amount of goodwill capitalised is included in the determination of the profit or loss on disposal.

### Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and sales related taxes.

Sales of goods are recognised when goods are delivered and title has passed.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Revenue recognition *(Continued)*

Service income is recognised when services are provided.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

### Property, plant and equipment

Property, plant and equipment, other than construction in progress, are stated at cost less accumulated depreciation and any identified impairment loss at the balance sheet date.

Depreciation is provided to write off the cost of items of property, plant and equipment over their estimated useful lives and after taking into account of their estimated residual value, using the straight-line method.

Construction in progress represents property, plant and equipment in the course of construction for production or for its own use purposes. Construction in progress is carried at cost less any recognised impairment loss. Construction in progress is classified to the appropriate category of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other assets, commences when the assets are ready for their intended use.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the consolidated income statement in the year in which the item is derecognised.

### Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

#### *The Group as lessee*

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are recognised as a reduction of rental expense over the lease term on a straight-line basis.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Foreign currencies

In preparing the financial statements of each individual group entity, transactions in currencies other than the functional currency of that entity (foreign currencies) are recorded in the respective functional currency (i.e. the currency of the primary economic environment in which the entity operates) at the rates of exchanges prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the translation of monetary items, are recognised in profit or loss in the period in which they arise, except for exchange differences arising on a monetary item that forms part of the Company's net investment in a foreign operation, in which case, such exchange differences are recognised in equity in the consolidated financial statements.

For the purposes of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into the presentation currency of the Group (i.e. US$) at the rate of exchange prevailing at the balance sheet date, and their income and expenses are translated at the average exchange rates for the year, unless exchange rates fluctuate significantly during the period, in which case, the exchange rates prevailing at the dates of transactions are used. Exchange differences arising, if any, are recognised as a separate component of equity (the translation reserve). Such exchange differences are recognised in profit or loss in the period in which the foreign operation is disposed of.

Goodwill and fair value adjustments arising on an acquisition of a foreign operation on or after 1 January 2005 are treated as assets and liabilities of the foreign operation and translated at the rate of exchange prevailing at the balance sheet date. Exchange differences arising are recognised in the translation reserve.

### Borrowing costs

All borrowing costs are recognised in the period incurred.

### Retirement benefit costs

Payments to defined contribution retirement benefit plans are charged as an expense when employees have rendered service entitling them to the contributions.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Retirement benefit costs *(Continued)*

For defined benefit retirement benefit plans, the cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses which exceed 10% of the greater of the present value of the Group's pension obligations and the fair value of plan assets are amortised over the expected average remaining working lives of the participating employees. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the amended benefits become vested.

The amount recognised in the consolidated balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised actuarial gains and losses and unrecognised past service cost, and as reduced by the fair value of plan assets. Any asset resulting from this calculation is limited to unrecognised actuarial losses and past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

### Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax base used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Taxation *(Continued)*

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

### Research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly-defined project will be recovered through future commercial activity. The resultant asset is amortised on a straight-line basis over its useful life, and carried at cost less subsequent accumulated amortisation and any accumulated impairment losses.

The amount initially recognised for internally-generated intangible asset is the sum of the expenditure incurred from the date when the intangible asset first meets the recognition criteria. Where no internally-generated intangible asset can be recognised, development expenditure is charged to profit or loss in the period in which it is incurred.

Subsequent to initial recognition, internally-generated intangible asset is reported at cost less accumulated amortisation and accumulated impairment losses.

### Impairment losses (other than goodwill and available-for-sale investments)

At each balance sheet date, the Group reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

### Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is calculated using the first-in, first-out basis.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Financial instruments

Financial assets and financial liabilities are recognised on the Group's balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

#### *Financial assets*

The Group's financial assets are classified into one of the three categories, including financial assets at fair value through profit or loss, loans and receivables and available-for-sale financial assets. All regular way purchases or sales of financial assets are recognised and derecognised on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace. The accounting policies adopted in respect of each category of financial assets are set out below.

*Financial assets at fair value through profit or loss*

The Group's financial assets at fair value through profit or loss are financial assets held for trading.

At each balance sheet date subsequent to initial recognition, financial assets at fair value through profit or loss are measured at fair value, with changes in fair value recognised directly in profit or loss in the period in which they arise.

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables (including trade and other receivables), bank deposits and bank balances are carried at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Financial instruments *(Continued)*

#### *Financial assets (Continued)*

*Available-for-sale financial assets*

Available-for-sale equity investments that do not have a quoted market price in an active market and whose fair value cannot be reliably determined are measured at cost less any identified impairment losses at each balance sheet date subsequent to initial recognition. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired. The amount of the impairment loss is measured as the difference between the carrying amount of the asset and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses will not reverse in subsequent periods.

#### *Financial liabilities and equity*

Financial liabilities and equity instruments issued by a group entity are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument.

An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities. The accounting policies adopted in respect of financial liabilities and equity instruments are set out below.

*Financial liabilities*

Financial liabilities including bank loans, trade and other payables are subsequently measured at amortised cost, using the effective interest method.

*Equity instruments*

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

*Derivative financial instruments*

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately. Derivative financial instruments that are not designated as effective hedging instruments are classified as held for trading.

#### *Derecognition*

Financial assets are derecognised when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss.

## 3. SIGNIFICANT ACCOUNTING POLICIES *(Continued)*

### Financial instruments *(Continued)*

#### *Derecognition (Continued)*

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expired. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

### Provisions

Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

### Share-based payment transactions

#### *Equity-settled share-based payment transactions*

The fair value of services received determined by reference to the fair value of share options or ordinary shares granted at the grant date is expensed on a straight-line basis over the vesting period or recognised as an expense in full at the grant date when the share options or ordinary shares granted vest immediately, with a corresponding increase in equity (share compensation reserve).

At each balance sheet date, the Group revises its estimates of the number of options or ordinary shares that are expected to ultimately vest. The impact of the revision of the estimates, if any, is recognised in profit or loss with a corresponding adjustment to share compensation reserve.

At the time when the share options are exercised, the amount previously recognised in share compensation reserve will be transferred to share premium. When the share options are forfeited after the vesting date or are still not exercised at the expiry date, the amount previously recognised in share compensation reserve will be transferred to retained profits.

#### *Cash-settled share-based payment transactions*

For cash-settled share-based payments, the Group measures the goods or services acquired and the liability incurred at the fair value of the liability. At each balance sheet date, the liability is remeasured at its fair value until the liability is settled, with any changes in fair value recognised in profit or loss.

### Government grants

Government grants are recognised as income over the periods necessary to match them with the related costs. Grants related to depreciable assets are presented as deferred income and are released to income over the useful lives of the assets. Grants related to expense items are recognised in the same period as those expenses are charged in the consolidated income statements and are reported separately as other income.

## 4. KEY SOURCES OF ESTIMATION UNCERTAINTY

The management had made the following estimates and assumptions in the process of applying the Group's accounting policies, which are described in note 3, that have a significant risk of causing a material adjustment to the carrying amounts of the assets and liabilities as discussed below.

### Impairment of goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the present value. Where the actual future cash flows are less than expected, a material impairment loss may arise. In May 2005, the Company acquired Chi Mei Communications Systems Inc. ("CMCS"), a company which specialises in ODM business, and the carrying amount of goodwill at the balance sheet date was US$63,075,000. Details of the impairment testing are provided in note 18.

### Provision

Provision has been made for value-added costs to repair or replace defective goods, such as labour (whether incurred internal or external) and material costs, and also costs that may not be recoverable from suppliers for the rework, either in accordance with contractual terms or the Group's policy. The provision requires the management to estimate the extent of repairs and replacements with reference to past experience, technology needs and industry averages for defective products. The estimation may be adversely affected by many factors, including additional variations to the plans requested by the customers or because of technical needs, and unforeseen problems and circumstances. Any of these factors may affect the extent of repair or replacement required and therefore ultimate repair and replacement costs to be incurred in the future period.

## 5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's financial instruments include investments held for trading, bank loans, trade and other receivables, trade and other payables, bank and bank deposits. Details of these financial instruments are disclosed in the respective notes. The risks associated with these financial instruments and the policies applied by the Group to mitigate these risks are set out below. Management monitors these exposures to ensure appropriate measures are implemented in a timely and effective manner.

## 5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(Continued)*

### Credit risk

The Group's maximum exposure to credit risk in the event of the counterparties' failure to perform their obligations as at 31 December 2006 in relation to each class of recognised financial assets is the carrying amount of those assets as stated in the consolidated balance sheet. A major portion of the Group's trade debts are receivable from industry leaders or multinational customers with solid financial background. Meanwhile, in order to minimise the credit risk, the management of the Group has delegated a team responsible for determination of credit limits and monitoring procedures to ensure that follow-up action is taken to recover overdue debts. In addition, the Group reviews the recoverable amount of each individual trade debt at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts. In this regard, the directors of the Company consider that the Group's credit risk is significantly reduced.

Credit risk in mobile phone handset industry is concentrated on a few global handset manufacturers. However, with the strong financial background and good creditability of the global handset manufacturers, the management considers there is no significant credit risk. In determining whether there is objective evidence of impairment loss, the Group takes into consideration of the estimation of the future cash flows.

The credit risk on liquid funds is limited because the counterparties are banks with higher credit-ratings assigned by international credit-rating agencies and long-term partners of the Group.

### Currency risk

Certain subsidiaries of the Company transact in foreign currencies, which expose the Group to foreign currency risk. In order to mitigate the foreign currency risk, the Group manages its foreign currency exposure by non-financial techniques such as managing the transaction currency, and leading and lagging payments and receivable management. In addition, the Group sometimes obtains bank loans in various foreign currencies and enters into short-term foreign currency forward contracts (less than three months) for hedging purpose. Currently the Group does not designate its forward foreign currency contracts as a hedging instrument for the purpose of hedging the currency risk of its foreign operations. However, the management monitors foreign exchange exposure and will consider hedging significant foreign currency exposure should the need arises.

### Interest rate risk

In the past, the Group had applied interest rate swaps to manage its exposure to interest rate fluctuations on its long-term bank borrowings. Currently, a majority of the Group's borrowings are raised on short term basis and therefore the related fair value interest rate risk is considered limited. No additional derivatives were used during the current year for hedging short-term interest rate exposure.

## 5. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES *(Continued)*

### Fair value

The fair value of financial assets and financial liabilities are determined as follows:

(i) the fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market bid prices and ask prices respectively; and

(ii) the fair value of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis or using prices from observable current market transactions.

## 6. BUSINESS AND GEOGRAPHICAL SEGMENTS

The directors consider that the Group is in a single business segment as the turnover and profit are derived entirely from the end-to-end handset manufacturing service to the customers.

Segment information regarding the Group's sales by geographical market, irrespective of the origin of the goods/services, and other analysis by geographical area is presented below.

**INCOME STATEMENT**

| | Year ended 31 December 2006 | | | |
|---|---|---|---|---|
| | Asia US$'000 | Europe US$'000 | America US$'000 | Consolidated US$'000 |
| TURNOVER | | | | |
| External sales | 6,435,691 | 1,464,947 | 2,480,598 | 10,381,236 |
| RESULTS | 614,980 | 114,193 | 239,502 | 968,675 |
| Unallocated income | | | | 42,838 |
| Unallocated expenses | | | | (212,763) |
| Unallocated interest expense on bank borrowings | | | | (13,294) |
| Profit before tax | | | | 785,456 |
| Income tax expense | | | | (67,610) |
| Profit for the year | | | | 717,846 |

## 6. BUSINESS AND GEOGRAPHICAL SEGMENTS *(Continued)*

**INCOME STATEMENT** *(Continued)*

| | Year ended 31 December 2005 | | | |
|---|---|---|---|---|
| | Asia | Europe | America | Consolidated |
| | US$'000 | US$'000 | US$'000 | US$'000 |
| TURNOVER | | | | |
| External sales | 3,276,160 | 1,012,050 | 2,076,287 | 6,364,497 |
| RESULTS | 285,782 | 99,261 | 182,284 | 567,327 |
| Unallocated income | | | | 29,794 |
| Unallocated expenses | | | | (163,962) |
| Unallocated interest expense on bank borrowings | | | | (13,901) |
| Profit before tax | | | | 419,258 |
| Income tax expense | | | | (36,324) |
| Profit for the year | | | | 382,934 |

Segment information regarding the Group's assets and liabilities by locations of customers are as follows:

**BALANCE SHEET**

| | **As at 31 December 2006** | | | |
|---|---|---|---|---|
| | **Asia** | **Europe** | **America** | **Consolidated** |
| | **US$'000** | **US$'000** | **US$'000** | **US$'000** |
| ASSETS | | | | |
| Segment assets | **1,014,917** | **366,396** | **669,250** | **2,050,563** |
| Unallocated assets | | | | **2,451,845** |
| Consolidated total assets | | | | **4,502,408** |
| LIABILITIES | | | | |
| Segment liabilities | **–** | **68,545** | **181,400** | **249,945** |
| Unallocated liabilities | | | | **1,871,461** |
| Consolidated total liabilities | | | | **2,121,406** |

## 6. BUSINESS AND GEOGRAPHICAL SEGMENTS *(Continued)*

**BALANCE SHEET** *(Continued)*

| | As at 31 December 2005 | | | |
|---|---|---|---|---|
| | Asia | Europe | America | Consolidated |
| | US$'000 | US$'000 | US$'000 | US$'000 |
| ASSETS | | | | |
| Segment assets | 847,318 | 413,733 | 587,645 | 1,848,696 |
| Unallocated assets | | | | 1,309,851 |
| Consolidated total assets | | | | 3,158,547 |
| LIABILITIES | | | | |
| Segment liabilities | – | 80,143 | 140,972 | 221,115 |
| Unallocated liabilities | | | | 1,410,415 |
| Consolidated total liabilities | | | | 1,631,530 |

**OTHER INFORMATION**

| | **Year ended 31 December 2006** | | | | |
|---|---|---|---|---|---|
| | **Asia** | **Europe** | **America** | **Corporate** | **Consolidated** |
| | **US$'000** | **US$'000** | **US$'000** | **US$'000** | **US$'000** |
| Capital additions | **–** | **22,589** | **27,315** | **444,514** | **494,418** |
| Depreciation and amortisation | **–** | **11,114** | **20,696** | **103,157** | **134,967** |
| Impairment losses on property, plant and equipment | **–** | **3,892** | **–** | **–** | **3,892** |
| (Gain) loss on disposal of property, plant and equipment | **–** | **(612)** | **880** | **469** | **737** |
| (Write back) allowances for doubtful debts | **(1,103)** | **(484)** | **929** | **–** | **(658)** |
| Write-down of inventories | **–** | **1,887** | **10,020** | **16,200** | **28,107** |

## 6. BUSINESS AND GEOGRAPHICAL SEGMENTS *(Continued)*

**OTHER INFORMATION** *(Continued)*

| | Year ended 31 December 2005 | | | | |
|---|---|---|---|---|---|
| | Asia | Europe | America | Corporate | Consolidated |
| | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 |
| Capital additions | – | 66,185 | 38,458 | 236,842 | 341,485 |
| Depreciation and amortisation | – | 15,898 | 12,941 | 43,727 | 72,566 |
| Impairment losses on property, plant and equipment | – | 7,966 | – | – | 7,966 |
| Loss on disposal of property, plant and equipment | – | – | – | 244 | 244 |
| Allowances (write back) for doubtful debts | 688 | 230 | (66) | – | 852 |
| Write-down of inventories | – | 3,447 | – | 16,881 | 20,328 |

The following is an analysis of the carrying amount of segment assets, and additions to property, plant and equipment, analysed by the geographical area in which the assets are located:

| | **Carrying amount of segment assets as at 31 December** | | **Additions to property, plant and equipment for the year ended 31 December** | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | **US$'000** | US$'000 | **US$'000** | US$'000 |
| Asia | **3,142,498** | 2,002,108 | **444,514** | 236,842 |
| Europe | **384,937** | 435,307 | **22,589** | 66,185 |
| America | **959,167** | 711,038 | **27,315** | 38,458 |
| | **4,486,602** | 3,148,453 | **494,418** | 341,485 |

## 7. OTHER INCOME

An analysis of the Group's other income is as follows:

| | 2006<br>US$'000 | 2005<br>US$'000 |
|---|---|---|
| Interest income from bank | **10,585** | 8,889 |
| Service and subcontracting income | **21,147** | 8,691 |
| Sales of materials, scraps and moldings | **14,906** | 17,618 |
| Net foreign exchange gain | **8,975** | – |
| Gain on disposal of certain assets and liabilities of a subsidiary *(Note)* | **1,209** | – |
| Others | **7,163** | 3,287 |
| | **63,985** | 38,485 |

*Note:* On 31 July 2006, Dynacept Corporation ("Dynacept"), a wholly-owned subsidiary of the Company, entered into two agreements with MRP Real Estate Holdings, LLC and MRP Brewster, LLC (the "Purchasers") pursuant to which Dynacept disposed certain of its assets and liabilities at a cash consideration of US$8,580,000. The Purchasers are beneficially owned by a director of Dynacept and a relative of that director. The Group recorded a gain, net of costs, of approximately US$1,209,000 as a result of the disposal.

## 8. RESTRUCTURING COSTS

| | 2006<br>US$'000 | 2005<br>US$'000 |
|---|---|---|
| Impairment losses on property, plant and equipment | **3,892** | 6,230 |
| Redundancy costs | **5,767** | 2,973 |
| | **9,659** | 9,203 |

The amount represents those costs incurred and provision made in connection with the Group's restructuring and relocating its European operations during the year.

## 9. PROFIT BEFORE TAX

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Profit before tax has been arrived at after charging (crediting): | | |
| (Write back) allowance for doubtful debts | **(658)** | 852 |
| Write down of inventories | **28,107** | 20,328 |
| Amortisation of prepaid lease payments (included in general and administrative expense) | **337** | 132 |
| Auditor's remuneration | **830** | 550 |
| Cost of inventories recognised as expense | **9,319,422** | 5,741,546 |
| Provision for warranty | **61,323** | 22,068 |
| Depreciation of property, plant and equipment | **134,630** | 72,434 |
| Impairment losses on property, plant and equipment | **3,892** | 7,966 |
| Net foreign exchange (gain) loss | **(8,975)** | 5,826 |
| Increase in fair value of investments held for trading | **(310)** | (129) |
| Staff costs | | |
| Directors' remuneration | **1,457** | 1,457 |
| Retirement benefit scheme contributions (excluding directors) | **18,258** | 17,710 |
| Equity-settled share-based payments | **53,883** | 20,076 |
| Cash-settled share-based payments | **3,429** | – |
| Other staff costs | **300,016** | 259,007 |
| | **377,043** | 298,250 |
| Loss on disposal of property, plant and equipment | **737** | 244 |
| Gain on disposal of certain assets and liabilities of a subsidiary | **(1,209)** | – |

## 10. DIRECTORS' REMUNERATION

The emoluments paid or payable to each of the nine (2005: nine) directors were as follows:

| | | Other emoluments | | | |
|---|---|---|---|---|---|
| | **Fees** | **Basic salaries and allowances** | **Performance related incentive payments** | **Retirement benefit scheme contributions** | **Total 2006** |
| | **US$'000** | **US$'000** | **US$'000** | **US$'000** | **US$'000** |
| Chin Wai Leung, Samuel | **–** | **1,200** | **–** | **–** | **1,200** |
| Dai Feng Shuh | **–** | **180** | **–** | **–** | **180** |
| Chang Ban Ja, Jimmy | **–** | **–** | **–** | **–** | **–** |
| Gou Hsiao Ling | **–** | **–** | **–** | **–** | **–** |
| Lee Jin Ming | **–** | **–** | **–** | **–** | **–** |
| Lu Fang Ming | **–** | **–** | **–** | **–** | **–** |
| Lau Siu Ki | **23** | **8** | **–** | **–** | **31** |
| Edward Fredrick Pensel | **23** | **–** | **–** | **–** | **23** |
| Mao Yu Lang | **23** | **–** | **–** | **–** | **23** |
| | **69** | **1,388** | **–** | **–** | **1,457** |

| | | Other emoluments | | | |
|---|---|---|---|---|---|
| | Fees | Basic salaries and allowances | Performance related incentive payments | Retirement benefit scheme contributions | Total 2005 |
| | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 |
| Chin Wai Leung, Samuel | – | 1,200 | – | – | 1,200 |
| Dai Feng Shuh | – | 180 | – | – | 180 |
| Chang Ban Ja, Jimmy | – | – | – | – | – |
| Gou Hsiao Ling | – | – | – | – | – |
| Lee Jin Ming | – | – | – | – | – |
| Lu Fang Ming | – | – | – | – | – |
| Lau Siu Ki | 23 | 8 | – | – | 31 |
| Edward Fredrick Pensel | 23 | – | – | – | 23 |
| Mao Yu Lang | 23 | – | – | – | 23 |
| | 69 | 1,388 | – | – | 1,457 |

*Note*: The performance related incentive payment is determined by reference to the individual performance of the directors and approved by the Remuneration Committee.

## 11. EMPLOYEES' EMOLUMENTS

The aggregate emoluments of the five highest paid individuals included one (2005: one) executive director of the Company, whose emoluments are included in note 10 above. The emoluments of the remaining four (2005: four) individuals were as follows:

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Salaries and other benefits | **352** | 547 |
| Retirement benefits scheme contributions | **–** | – |
| Performance-related incentive payments | **4,561** | 2,152 |
| | **4,913** | 2,699 |

Their emoluments were within the following bands:

| | **Number of employees** | |
|---|---|---|
| | **2006** | 2005 |
| HK$4,500,001 to HK$5,000,000 | **–** | 1 |
| HK$5,000,001 to HK$5,500,000 | **–** | 2 |
| HK$6,000,001 to HK$6,500,000 | **–** | 1 |
| HK$8,000,001 to HK$8,500,000 | **1** | – |
| HK$9,000,001 to HK$9,500,000 | **2** | – |
| HK$11,500,001 to HK$12,000,000 | **1** | – |
| | **4** | 4 |

## 12. INCOME TAX EXPENSE

| | 2006<br>US$'000 | 2005<br>US$'000 |
|---|---|---|
| Current tax: | | |
| People's Republic of China ("PRC") | **72,867** | 38,429 |
| Other jurisdictions | **2,655** | 1,963 |
| | **75,522** | 40,392 |
| Overprovision in prior years: | | |
| PRC | **(90)** | – |
| Other jurisdictions | **(1,208)** | (186) |
| | **(1,298)** | (186) |
| Deferred tax: *(note 19)*: | | |
| Current year | **(6,614)** | (3,992) |
| Attributable to a decrease in tax rate | **–** | 110 |
| | **(6,614)** | (3,882) |
| | **67,610** | 36,324 |

Tax charge mainly consists of income tax in the PRC attributable to the assessable profits of the Company's subsidiaries established in the PRC. The tax charge is calculated at the applicable rates prevailing in the PRC's Economic and Technological Development Zones ranging from 15% to 16.5%. Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

The Company's subsidiaries operating in the PRC are eligible for certain tax holiday and concession. The tax holiday and concession normally are in the form of two years tax exemption from the first profitable year, followed by a 50% reduction of the applicable tax rate in the following three years.

## 12. INCOME TAX EXPENSE *(Continued)*

The taxation for the year can be reconciled to the profit before tax per the consolidated income statement as follows:

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Profit before tax | **785,456** | 419,258 |
| Tax at the PRC income tax rate of 15% for the year | **117,818** | 62,889 |
| Effect of different tax rates of subsidiaries | **(338)** | (1,814) |
| Effect of tax exemptions granted to subsidiaries | **(49,768)** | (32,366) |
| Tax effect of expenses not deductible for tax purpose | **14,991** | 7,141 |
| Tax effect of income not taxable for tax purpose | **(5,098)** | (934) |
| Tax effect of tax losses not recognised | **244** | 1,484 |
| Decrease in opening deferred tax assets (liabilities) resulting from a decrease in applicable tax rate *(note a)* | **–** | 110 |
| Tax effect of income tax credits granted to a PRC subsidiary on acquisition of certain qualified equipment *(note b)* | **(6,261)** | – |
| Tax refund for reinvestment in a PRC subsidiary | **(2,680)** | – |
| Overprovision in prior years | **(1,298)** | (186) |
| Tax expense for the year | **67,610** | 36,324 |

*Notes:*

(a) The decrease in opening deferred tax assets/liabilities was mainly attributable to changes in tax rates in Mexico and certain European countries.

(b) Pursuant to the relevant tax rules and regulations, PRC subsidiaries of the Company can claim PRC income tax credits on 40% of the acquisition cost of certain qualified equipment manufactured in the PRC. Such PRC income tax credits are allowed as deduction from current income tax expenses when relevant conditions are fulfilled and tax approval is obtained from the tax bureau.

## 13. DIVIDEND

No dividend was paid or proposed during 2006 (2005: Nil), nor has any dividend been proposed since the balance sheet date.

## 14. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit for the year attributable to equity holders of parent of US$718,038,000 (2005: US$385,699,000) and the weighted average number of 6,966,517,747 (2005: 6,843,816,118) shares in issue.

The weighted average number of shares for the purpose of calculating the basic earnings per share for the year ended 31 December 2005 is adjusted for 4,640,000 shares for which their subscriptions have become unconditional on 29 December 2005.

The calculation of the diluted earnings per share attributable to the equity holders of the parent is based on the following data:

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| **Earnings** | | |
| Earnings for the purposes of basic and diluted earnings per share (profit for the year attributable to equity holders of the parent) | **718,038** | 385,699 |
| **Number of shares** | | |
| Weighted average number of ordinary shares for the purposes of basic earnings per share | **6,966,517,747** | 6,843,816,118 |
| Effect of dilutive potential ordinary shares: | | |
| Share options | **266,877,813** | 24,596,130 |
| Weighted average number of ordinary shares for the purposes of diluted earnings per share | **7,233,395,560** | 6,868,412,248 |

## 15. PROPERTY, PLANT AND EQUIPMENT

| | Land and buildings US$'000 | Plant and machinery US$'000 | Fixtures and equipment US$'000 | Construction in progress US$'000 | Total US$'000 |
|---|---|---|---|---|---|
| COST | | | | | |
| At 1 January 2005 | 122,585 | 292,875 | 18,012 | 18,935 | 452,407 |
| Exchange adjustments | (3,695) | (6,757) | (363) | (11) | (10,826) |
| Acquisition of a subsidiary | 16,202 | 8,188 | 4,985 | – | 29,375 |
| Additions | 28,512 | 187,653 | 19,296 | 76,649 | 312,110 |
| Disposals | (6,997) | (29,705) | (3,704) | – | (40,406) |
| Transfers | 9,730 | 37,921 | 5,768 | (53,419) | – |
| At 31 December 2005 | 166,337 | 490,175 | 43,994 | 42,154 | 742,660 |
| Exchange adjustments | 8,626 | 20,642 | 1,693 | 3,880 | 34,841 |
| Additions | 21,019 | 348,162 | 58,360 | 66,877 | 494,418 |
| Disposals | (10,479) | (86,855) | (2,652) | – | (99,986) |
| Transfers | 18,245 | 15,193 | 48 | (33,486) | – |
| **At 31 December 2006** | **203,748** | **787,317** | **101,443** | **79,425** | **1,171,933** |
| DEPRECIATION AND IMPAIRMENT | | | | | |
| At 1 January 2005 | 5,653 | 20,035 | 5,046 | – | 30,734 |
| Exchange adjustments | (633) | (5,052) | (65) | – | (5,750) |
| Charge for the year | 6,719 | 58,238 | 7,477 | – | 72,434 |
| Impairment loss | – | 7,966 | – | – | 7,966 |
| Eliminated on disposals | (2,763) | (19,965) | (1,788) | – | (24,516) |
| At 31 December 2005 | 8,976 | 61,222 | 10,670 | – | 80,868 |
| Exchange adjustments | 1,235 | 8,344 | 653 | – | 10,232 |
| Charge for the year | 10,330 | 106,079 | 18,221 | – | 134,630 |
| Impairment loss | – | 3,892 | – | – | 3,892 |
| Eliminated on disposals | (2,506) | (57,830) | (1,257) | – | (61,593) |
| **At 31 December 2006** | **18,035** | **121,707** | **28,287** | **–** | **168,029** |
| CARRYING VALUES | | | | | |
| **At 31 December 2006** | **185,713** | **665,610** | **73,156** | **79,425** | **1,003,904** |
| At 31 December 2005 | 157,361 | 428,953 | 33,324 | 42,154 | 661,792 |

## 15. PROPERTY, PLANT AND EQUIPMENT *(Continued)*

Included in the land and buildings are freehold land, located in Hungary, Finland, Brazil, the United States of America, Mexico, India and Taiwan, having a cost of approximately US$29,493,000 (2005: US$17,119,000) in aggregate.

Certain property, plant and equipment are pledged to secure banking facilities granted to the Group as at the balance sheet dates (see note 36).

The impairment loss on property, plant and equipment provided during the year ended 31 December 2005 and 2006 mainly arose in connection with the Group's restructuring plan for its plant facilities in Europe. The recoverable amount is determined based on fair value less costs to sell. The fair values of these plant and machinery have been determined by the management by reference to recent market prices for similar plant and machinery.

The above items of property, plant and equipment are depreciated using the straight-line method, after taking into account their estimated residual value, over the following periods:

| | |
|---|---|
| Freehold land | Nil |
| Buildings | 20-40 years |
| Plant and machinery | 5-10 years |
| Fixtures and equipment | 3-5 years |

## 16. PREPAID LEASE PAYMENTS

The amount represents land use rights in the PRC amortised over their relevant lease term ranging from 40 to 70 years.

## 17. AVAILABLE-FOR-SALE INVESTMENTS

| | **2006**<br>**US$'000** | 2005<br>US$'000 |
|---|---|---|
| Unlisted overseas equity investments, at cost | **1,010** | 1,028 |

The above unlisted investments represent investments in unlisted equity securities issued by private entities incorporated in Taiwan and Finland. They are measured at cost less impairment at each balance sheet date because the range of reasonable fair value estimates is so significant that the directors of the Company are of the opinion that their fair values cannot be reliably measured.

*For the year ended 31 December 2006*

## 18. GOODWILL

| | 2006 | 2005 |
|---|---|---|
| | US$'000 | US$'000 |
| At 1 January | **63,075** | – |
| Arising on acquisition of a subsidiary | **–** | 46,469 |
| Arising on acquisition of additional interest in a subsidiary | **–** | 16,606 |
| At 31 December | **63,075** | 63,075 |

The amount represents goodwill arising on the acquisition of 56.48% interest in CMCS (see note 28) in May 2005 and an additional 19.86% interest in CMCS subsequently acquired by the Group by end of 2005.

Goodwill has been allocated to one single cash generating unit, CMCS. At the end of 2006, the Group appointed a professional valuer to perform an appraisal of the value in use of CMCS. The recoverable amount has been determined based on a value in use calculation. That calculation uses cash flow projections based on financial budgets approved by management covering a 5-year period, and discount rate of 16.02%. Cash flows beyond the 5-year period has been extrapolated in perpetuity using a steady 5.5% growth rate. This growth rate is based on the relevant industry growth forecasts and does not exceed the average long-term growth rate for the relevant industry. Another key assumption for the value in use calculations is the budgeted gross margin, which is determined based on the unit's past performance and management's expectations for the market development. Management believes that any reasonably possible change in any of these assumptions would not cause the aggregate carrying amount to exceed the aggregate recoverable amount.

## 19. DEFERRED TAXATION

The following are the major deferred tax liabilities and assets recognised and movements thereon for the year:

| | Allowances for inventories, trade and other receivables | Warranty provision | Accelerated tax depreciation | Tax losses | Prepaid expenses | Others | Total |
|---|---|---|---|---|---|---|---|
| | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 | US$'000 |
| At 1 January 2005 | – | – | 1,911 | (8,961) | 8,612 | (1,972) | (410) |
| Acquisition of a subsidiary | – | – | – | (3,121) | – | – | (3,121) |
| Charge (credit) to income for the year | (279) | – | 950 | 2,968 | (8,612) | 981 | (3,992) |
| Exchange differences | – | – | 5 | 65 | – | – | 70 |
| Effect of change in tax rate – charge to the income statement | – | – | 57 | 53 | – | – | 110 |
| At 31 December 2005 | (279) | – | 2,923 | (8,996) | – | (991) | (7,343) |
| Charge (credit) to income for the year | (4,237) | (7,483) | (1,114) | 6,501 | – | (281) | (6,614) |
| Exchange differences | – | (29) | 100 | (34) | – | 23 | 60 |
| **At 31 December 2006** | **(4,516)** | **(7,512)** | **1,909** | **(2,529)** | **–** | **(1,249)** | **(13,897)** |

For the purposes of balance sheet presentation, certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Deferred tax assets | **(15,806)** | (10,094) |
| Deferred tax liabilities | **1,909** | 2,751 |
| | **(13,897)** | (7,343) |

## 19. DEFERRED TAXATION *(Continued)*

At the balance sheet date, the Group has unused tax losses of US$21,617,000 (2005: US$34,072,000) available for offset against future profits. A deferred tax asset has been recognised in respect of approximately US$10,115,000 (2005: US$24,175,000) of such losses. No deferred tax asset has been recognised in respect of the remaining US$11,502,000 (2005: US$9,897,000) either due to the unpredictability of future profit streams or because it is not probable that the unused tax losses will be available for utilisation before their expiry. The unrecognised tax losses will expire before 2011.

By reference to financial budgets, management believes that there will be sufficient future profits or taxable temporary differences available in the future for the realisation of deferred tax assets which have been recognised in respect of tax losses and other temporary differences.

The Group did not have material temporary differences associated with undistributed earnings of subsidiaries as at the balance sheet date. In addition, the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such difference will not reverse in the foreseeable future.

## 20. INVENTORIES

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Raw materials | **346,264** | 255,383 |
| Work-in-progress | **126,561** | 113,970 |
| Finished goods | **271,373** | 144,646 |
| | **744,198** | 513,999 |

## 21. INVESTMENTS HELD FOR TRADING

The amount represents investment in listed bond funds on the Taiwan Stock Exchange held for trading purpose. The fair values are determined based on the quoted market bid prices available on the Taiwan Stock Exchange as at 31 December 2006.

## 22. TRADE AND OTHER RECEIVABLES

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Trade receivables | **1,814,813** | 1,488,078 |
| Other receivables, deposits and prepayments | **62,847** | 24,771 |
| | **1,877,660** | 1,512,849 |

The Group normally allows an average credit period of 30 to 90 days to its trade customers.

## 22. TRADE AND OTHER RECEIVABLES *(Continued)*

The following is an aged analysis of trade receivables at the balance sheet date:

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| 0-90 days | **1,806,005** | 1,485,673 |
| 91-180 days | **8,352** | 2,042 |
| 181-360 days | **385** | 288 |
| Over 360 days | **71** | 75 |
| | **1,814,813** | 1,488,078 |

The fair value of the Group's trade and other receivables at the balance sheet dates approximates to the corresponding carrying amount.

## 23. TRADE AND OTHER PAYABLES

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Trade payables | **1,540,285** | 1,202,338 |
| Accruals and other payables | **326,485** | 206,402 |
| | **1,866,770** | 1,408,740 |

The following is an aged analysis of trade payables at the balance sheet date:

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| 0-90 days | **1,468,343** | 1,192,824 |
| 91-180 days | **62,039** | 2,055 |
| 181-360 days | **7,053** | 5,563 |
| Over 360 days | **2,850** | 1,896 |
| | **1,540,285** | 1,202,338 |

The fair value of the Group's trade and other payables at the balance sheet dates approximates to the corresponding carrying amount.

## 24. BANK LOANS

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Unsecured | **139,563** | 175,548 |

The loans as at 31 December 2006 are obtained with original maturity of six months, denominated in US$ and carry interest at fixed interest rates at 0.2% plus LIBOR (2005: 0.4% plus LIBOR) per annum at the time the loans are raised.

The fair value of the Group's bank borrowings at the balance sheet dates approximates to the corresponding carrying amount.

## 25. SHARE CAPITAL

| | **Number of shares** | **Amount** |
|---|---|---|
| | | US$'000 |
| Ordinary shares of US$0.04 each, authorised: | | |
| Balance at 31 December 2005 and 31 December 2006 | 20,000,000,000 | 800,000 |
| Ordinary shares of US$0.04 each, issued and fully paid: | | |
| Balance at 1 January 2005 | 5,970,000,025 | 238,800 |
| Issued on 2 February 2005 | 869,400,000 | 34,776 |
| Issued on 28 February 2005 | 87,101,000 | 3,484 |
| Issued on 19 August 2005 | 26,915,000 | 1,077 |
| Balance at 31 December 2005 | 6,953,416,025 | 278,137 |
| Issued on 4 January 2006 | 4,640,000 | 185 |
| Exercise of share options *(note 35(a))* | 28,731,520 | 1,149 |
| Issued pursuant to a share scheme *(note 35(c))* | 3,168,000 | 127 |
| Balance at 31 December 2006 | 6,989,955,545 | 279,598 |

Pursuant to the Company's global offering, the Company issued 869,400,000 and 87,101,000 shares of US$0.04 each for consideration of HK$3.88 (equivalent to US$0.5) per share on 2 February 2005 and 28 February 2005, respectively. The Company's shares were listed on the Stock Exchange on 3 February 2005.

On 19 August 2005, the Company allotted and issued a total of 26,915,000 shares of US$0.04 each to certain employees of CMCS for cash consideration of HK$5.065 (equivalent to US$0.6) per share. These shares rank pari passu in all respects with the then existing shares in issue.

## 25. SHARE CAPITAL *(Continued)*

On 15 December 2005, the Company entered into subscription agreements (the "Subscription Agreements") with certain employees of CMCS, pursuant to which the Company agreed to allot and issue an aggregate of 4,640,000 new shares of US$0.04 each for cash consideration of HK$12.5 (equivalent to US$1.6) per share. These shares rank pari passu in all respects with the then existing shares in issue. Pursuant to the Subscription Agreements, the subscriptions have become unconditional as at 29 December 2005 and the 4,640,000 new shares were subsequently issued on 4 January 2006. The subscription price received of HK$58,000,000 (equivalent to US$7,480,000) is included as equity of the Company as at 31 December 2005.

During the year, the Company issued 3,168,000 shares pursuant to a share scheme adopted on 12 January 2005. Details of the share scheme are disclosed in note 35 to the consolidated financial statements.

## 26. RESERVES

The Group's special reserve represents the difference between the paid-in capital of the subsidiaries acquired pursuant to group reorganisation in 2004 and the nominal value of the Company's shares issued in exchange therefrom.

The Group's legal reserve represents statutory reserve attributable to the Company's subsidiaries in the PRC. As required by the laws in the PRC, appropriations are made from the profit of these subsidiaries to the legal reserve until the balance reaches 50% of the registered capital of the subsidiaries. This reserve can only be used to make up losses incurred or to increase capital.

## 27. DERIVATIVES

### Currency derivatives

The Group utilises currency derivatives to hedge significant future transactions and cash flows. The Group is a party of utilising a variety of forward foreign currency contracts in the management of its exchange rate exposures. The instruments adopted are primarily to hedge the currencies used in the Group's principal markets.

At the balance sheet date, total notional amount of outstanding forward foreign exchange contracts that the Group has committed are as below.

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Forward foreign exchange contracts | **29,069** | 15,152 |

As at 31 December 2006, the fair value of the Group's currency derivatives is estimated to be approximately US$384,000 liabilities (2005: US$203,000 assets), based on market values provided by the banks of equivalent instruments, and is included as other payables (2005: other receivables) at the balance sheet date. The contracts mainly related to buying of Japanese Yen and Euro with maturities in January 2007.

## 27. DERIVATIVES *(Continued)*

### Interest rate swaps

The Group uses interest rate swaps to manage its exposure to interest rate movements on certain of its bank borrowings.

As at 31 December 2006, contracts with nominal values of US$6,600,000 (2005: US$9,500,000) have fixed interest payments at an average rate of 4 per cent for periods until 2007 (2005: until 2008) and have floating interest receipts based on The Bond Market Association Municipal Swap Index.

The fair value of the swaps is estimated at approximately US$7,000 liabilities (2005: US$188,000 liabilities) and is included as other payables at the balance sheet date. These amounts are based on market values provided by the bank of equivalent instruments at the balance sheet date.

## 28. ACQUISITION OF SUBSIDIARIES

On 12 May 2005, Transworld Holdings Limited entered into two sale and purchase agreements with two vendors respectively to acquire 56.48% interest in CMCS. The acquisition of CMCS was completed after approval was obtained from the Investment Commission of the Ministry of Economic Affairs of Taiwan on 30 May 2005.

These transactions have been accounted for by the purchase method of accounting. The fair value of net assets acquired in the transactions, and the goodwill arising, are as follows:

| | 2005<br>US$'000 |
|---|---|
| Property, plant and equipment | 29,375 |
| Available-for-sale investments | 955 |
| Deferred tax assets | 3,121 |
| Inventories | 19,295 |
| Trade and other receivables | 25,756 |
| Investments held for trading | 13,182 |
| Bank balances and cash | 4,678 |
| Trade and other payables | (25,187) |
| Provision | (5,766) |
| Tax payable | (1,105) |
| Bank loans | (5,965) |
| Net assets acquired | 58,339 |
| Minority interests | (25,389) |
| Goodwill arising on the acquisition | 46,469 |
| | 79,419 |
| Total consideration, satisfied by: | |
| Cash | 79,419 |
| Net cash outflow arising on acquisition: | |
| Cash consideration paid | 79,419 |
| Bank balances and cash acquired | (4,678) |
| | 74,741 |

## 28. ACQUISITION OF SUBSIDIARIES *(Continued)*

The directors had completed an evaluation of the fair value of assets and liabilities acquired pursuant to the acquisition of CMCS and concluded that the carrying amount of the net assets acquired before the combination approximates it fair value.

The goodwill arising on the acquisition of CMCS is attributable to the anticipated future operating synergies from the combination. CMCS is a Taiwan-based original design manufacturer of handsets. The directors believe that the acquisition of CMCS will enhance the Group's design capabilities, reinforce the Group's vertical integration business strategy and strengthen the provision of value-added services to its existing customers.

CMCS contributed approximately US$42,681,000 of turnover and loss for the year attributable to equity holders of the parent of US$4,659,000 for the period between the date of acquisition and 31 December 2005.

If the acquisition of CMCS had been completed on 1 January 2005, total group turnover for 2005 would have been US$6,471,027,000, and the profit for 2005 would have been US$386,320,000. The proforma information is for illustrative purposes only and is not necessarily an indicative turnover and results of the Group that actually would have been achieved had the acquisition been completed on 1 January 2005, nor is it intended to be a projection of future results.

## 29. BANK DEPOSITS AND BANK BALANCES AND CASH

Bank deposits carry at prevailing market interest rate of 1.98% (2005: 1.94%) per annum with original maturity of over three months.

Bank balances and cash comprise cash held by the Group and short term bank deposits with an original maturity of three months or less. The deposits carry at prevailing market interest rate of 2.43% (2005: 1.70%) per annum.

The fair value of bank deposits and bank balances at balance sheet dates approximates to the corresponding carrying amount.

## 30. PROVISION

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| At 1 January | **23,635** | – |
| Exchange adjustments | **1,366** | – |
| Acquired on an acquisition of a subsidiary | **–** | 5,766 |
| Provision for the year | **61,323** | 22,068 |
| Utilisation of provision | **(28,112)** | (4,199) |
| At 31 December | **58,212** | 23,635 |

The warranty provision represents management's best estimate of the Group's liability under twelve to twenty-four months' warranty granted on handset products, based on prior experience and industry averages for defective products.

## 31. CAPITAL COMMITMENTS

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Commitments for the acquisition of property, plant and equipment contracted but not provided for | **57,389** | 17,369 |

## 32. OPERATING LEASE ARRANGEMENTS

### The Group as lessee

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Minimum lease payments under operating leases in respect of premises recognised for the year | **12,296** | 2,765 |

At the balance sheet date, the Group had outstanding commitments under non-cancellable operating leases in respect of premises, which fall due as follows:

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Within one year | **9,018** | 2,059 |
| In the second to fifth years inclusive | **4,394** | 491 |
| | **13,412** | 2,550 |

Leases are negotiated, and rentals are fixed, for an average term of one to three years.

## 33. RELATED PARTY TRANSACTIONS

(a) During the year, the Group entered into the following transactions with related parties, including Hon Hai, the Company's ultimate holding company, and subsidiaries and associates of Hon Hai other than members of the Group:

| | **2006** | 2005 |
|---|---|---|
| | **US$'000** | US$'000 |
| Hon Hai | | |
| Sales of goods | **6,006** | 359 |
| Purchase of goods | **51,466** | 11,322 |
| Purchase of property, plant and equipment | **10,592** | 2,952 |
| Sales of property, plant and equipment | **975** | 2,141 |
| Subcontracting income | **10,614** | 2,638 |
| Lease expense | **8** | 68 |
| Research and development expense | **–** | 18 |
| Subcontracting expense | **525** | 41 |
| General service expense | **190** | – |
| Design service | **5,435** | – |
| Subsidiaries and associates of Hon Hai | | |
| Sales of goods | **247,327** | 74,618 |
| Purchase of goods | **1,012,846** | 433,503 |
| Purchase of property, plant and equipment | **12,745** | 14,446 |
| Sales of property, plant and equipment | **34,590** | 6,698 |
| Lease expense | **4,451** | 1,683 |
| Subcontracting income | **41,880** | 994 |
| Subcontracting expense | **26,743** | 16,802 |
| General service expense | **32,535** | 17,103 |
| Research and development expense | **2,250** | 4,724 |

## 33. RELATED PARTY TRANSACTIONS *(Continued)*

(b) At the balance sheet date, the Group has the following balances due from/to related parties included in:

| | 2006 US$'000 | 2005 US$'000 |
|---|---|---|
| Trade receivables: | | |
| Hon Hai | **14,802** | 344 |
| Subsidiaries and associates of Hon Hai | **92,130** | 47,203 |
| | **106,932** | 47,547 |
| Other receivables: | | |
| Hon Hai | **5** | 27 |
| Subsidiaries and associates of Hon Hai | **587** | 768 |
| | **592** | 795 |
| | **107,524** | 48,342 |
| Trade payables: | | |
| Hon Hai | **46,328** | 2,476 |
| Subsidiaries and associates of Hon Hai | **255,473** | 202,427 |
| | **301,801** | 204,903 |
| Other payables: | | |
| Hon Hai | **5,479** | 184 |
| Subsidiaries and associates of Hon Hai | **6,873** | 10,367 |
| | **12,352** | 10,551 |
| | **314,153** | 215,454 |

Balances due from/to related parties are unsecured, interest free and are repayable within one year.

### (c) Compensation of key management personnel

The remuneration of directors and other members of key management during the year was as follows:

| | 2006 US$'000 | 2005 US$'000 |
|---|---|---|
| Short-term benefits | **2,173** | 2,102 |
| Share-based payments | **7,039** | 2,645 |
| | **9,212** | 4,747 |

## 34. RETIREMENT BENEFITS PLANS

Majority of the employees of the Company's subsidiaries are members of state-managed retirement benefit schemes operated by the government in the PRC. These subsidiaries in the PRC are required to contribute a specified percentage ranging from 5% to 20% of their payroll costs to the retirement benefit schemes to fund the benefits. The only obligation of the Group with respect to the retirement benefit schemes is to make the specified contributions.

Certain subsidiaries of the Company operate defined benefit plans in Taiwan and Korea. Under the schemes, the employees are entitled to retirement benefits on attainment of a retirement age ranging from 55 to 60. The most recent actuarial valuations of plan assets and the present value of the defined benefit obligation were carried out at 31 December 2006 by 徐茂欽精算師, 中華民國精算師協會 (Hsu Mao-Chin Actuary, The Actuarial Institute of the Republic of China), 蔡惠玲精算師, 中華民國精算師協會 (Tsai Hui-Ling, The Actuarial Institute of the Republic of China) and Watson Wyatt Philippines Inc., respectively. The present value of the defined benefit obligation, the related current service cost and past service cost were measured using the projected unit credit method.

The main actuarial assumptions used were as follows:

| | **2006** | 2005 |
|---|---|---|
| Discount rate | **2.5% – 5.0%** | 3.5% |
| Expected return on plan assets | **2.5% – 5.0%** | 3.5% |
| Expected rate of salary increases | **2.0% – 5.0%** | 3.0% |
| Future pension increases | **–** | – |

The actuarial valuation showed that the market value of plan assets was US$1,954,000 (2005: US$582,000) and that the actuarial value of these assets represented 39% (2005: 95%) of the benefits that had accrued to members.

Amounts recognised in the consolidated income statement in respect of the defined benefit plans are as follows:

| | **2006**<br>**US$'000** | 2005<br>US$'000 |
|---|---|---|
| Current service cost | **265** | 150 |
| Interest cost | **121** | 23 |
| Expected return on plan assets | **(41)** | (15) |
| Net actuarial (gains)/losses | **–** | – |
| Past service cost | **165** | 15 |
| | **510** | 173 |

Of the charge for the year, US$433,000 (2005: US$75,000) has been included in cost of sales and US$77,000 (2005: US$98,000) has been included in administrative expenses.

The actual return on plan assets was US$14,000 (2005: US$4,000) as at 31 December 2006.

## 34. RETIREMENT BENEFITS PLANS *(Continued)*

The amount included in the consolidated balance sheet arising from the Group's obligation in respect of its defined benefit retirement benefit plans is as follows:

| | 2006 | 2005 |
|---|---|---|
| | US$'000 | US$'000 |
| Present value of funded defined benefit obligations | **4,989** | 610 |
| Fair value of plan assets | **(1,954)** | (582) |
| | **3,035** | 28 |
| Present value of unfunded defined benefit obligations | – | – |
| Deficit | **3,035** | 28 |
| Net actuarial gains and losses not recognised | **90** | 208 |
| Past service cost not recognised | **(3,373)** | (206) |
| Net (asset) liability arising from defined benefit obligations | **(248)** | 30 |

The Group also operates a number of defined contribution schemes in other overseas locations. Arrangements for these staff retirement benefits vary from country to country and are made in accordance with local regulations and custom.

## 35. SHARE-BASED PAYMENT TRANSACTIONS

### (a) Equity-settled share option scheme

On 12 January 2005, the Company adopted a share option scheme (the "Option Scheme") for the primary purpose of attracting skilled and experienced personnel and incentivizing them to remain with the Group. Under the Option Scheme, the board of directors of the Company may grant options to eligible employees, including directors of the Company and its subsidiaries, to subscribe for shares in the Company. Additionally, the Company may, from time to time, grant share options to third party service providers for services provided by them to the Group. The Option Scheme will expire on 3 February 2015.

Under the Option Scheme, the directors of the Company may at their discretion grant options to any eligible person to subscribe for shares in the Company. The directors may at their discretion determine the specific exercise period which should expire in any event no later than ten years from the effective date of the Option Scheme.

## 35. SHARE-BASED PAYMENT TRANSACTIONS *(Continued)*

### (a) Equity-settled share option scheme *(Continued)*

The total number of shares which may initially be issued upon the exercise of all options to be granted under the Option Scheme and any other share option scheme(s) adopted by the Company must not in aggregate exceed 10% of the total number of issued shares of the Company as of the date of listing its shares on the Stock Exchange, i.e. must not exceed 683,940,003 shares. Subject to the approval of the shareholders of the Company in general meeting, the limit may be refreshed to 10% of the total number of shares in issue as at the date of approval of the refreshed limit. Notwithstanding the foregoing, the maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Option Scheme and any other share option scheme(s) of the Company must not in aggregate exceed 30% of the number of issued shares of the Company from time to time. Pursuant to an ordinary resolution passed at the Company's annual general meeting held on 8 June 2006, the 10% scheme limit was refreshed to 695,805,602 shares, representing 10% of the total number of issued shares of the Company as at the date of passing of the resolution. The maximum number of shares of the Company in respect of which options granted and to be granted to each eligible person under the Option Scheme of the Company in any 12-month period up to the date of the latest grant shall not exceed 1% of the total number of issued shares of the Company from time to time. The maximum number of shares issued and to be issued upon exercise of options granted and to be granted (including options exercised, cancelled and outstanding) to a substantial shareholder and/or an independent non-executive director, or their respective associates, in the 12-month period up to and including the date of such grant in aggregate over 0.10% of total number of issued shares of the Company from time to time and have an aggregate value exceeding HK$5,000,000 must be approved by the shareholders of the Company in general meeting.

Options granted must be taken up within 30 days after the date of grant, upon payment of HK$1.0 per offer. The Option Scheme does not contain any minimum period for which an option must be held before it can be exercised, though such minimum period may be specified by the board of directors of the Company at the time of grant. The exercise price is determined by the board of directors of the Company, and will not be less than the higher of (i) the closing price of the Company's shares on the date of grant; (ii) the average closing price of the shares for the five business days immediately preceding the date of grant; and (iii) the nominal value of the Company's share.

On 25 July 2005, 435,599,000 share options were granted at an exercise price of HK$6.06. The options are granted with vesting period ranging from one to six years from the date of grant. The share options are exercisable from the vesting date to 31 December 2011, the maturity date for these options, subject to the terms and conditions of the Option Scheme. The estimated fair value of the options granted on 25 July 2005 was US$104,038,000.

The closing price of the shares immediately before 25 July 2005, the date of grant of options, was HK$5.75.

## 35. SHARE-BASED PAYMENT TRANSACTIONS *(Continued)*

### (a) Equity-settled share option scheme *(Continued)*

The following table discloses movements of the Company's share options held by employees during the year ended 31 December 2006:

| Option type | Outstanding at 1/1/2006 | Granted during year | Exercised during year | Lapsed during year | Expired during year | Outstanding at 31/12/2006 |
|---|---|---|---|---|---|---|
| **2005** | **435,290,000** | **–** | **(28,731,520)** | **(3,644,200)** | **–** | **402,914,280** |

The following table discloses movements of the Company's share options held by employees during the year ended 31 December 2005:

| Option type | Outstanding at 1/1/2005 | Granted during year | Exercised during year | Lapsed during year | Expired during year | Outstanding at 31/12/2005 |
|---|---|---|---|---|---|---|
| 2005 | – | 435,599,000 | – | (309,000) | – | 435,290,000 |

44,795,010 share options are exercisable as at 31 December 2006 (2005: Nil).

In respect of the share options exercised during the year, the weighted average share price at the dates of exercise is US$3.01 (equivalent to HK$23.41).

The Group recognised total expense of US$32,448,000 (2005: US$17,274,000) for the year ended 31 December 2006 in relation to the share options granted by the Company.

The fair value of the share options was calculated using the Black-Scholes option pricing model. The inputs into the model were as follows:

| | |
|---|---|
| Share price on date of grant | US$0.76 (equivalent to HK$5.95) |
| Exercise price | US$0.76 (equivalent to HK$6.06) |
| Expected volatility | 30% |
| Expected life | Vesting period plus 1.5 years |
| Risk free rate | 3.3925% |
| Dividend yield | 0% |

Because the Black-Scholes option pricing model requires the input of highly subjective assumptions, including the volatility of share prices, changes in subjective input assumptions can materially affect the fair value estimate.

Expected volatility was determined by calculating the historical volatility of the Company's share price over the period from 3 February 2005 (date of listing) to grant date. The expected life in the model has been adjusted, based on management's best estimate, for the effect of non transferability, exercise restrictions and behavioral considerations.

## 35. SHARE-BASED PAYMENT TRANSACTIONS *(Continued)*

### (b) Cash-settled share-based payments

During the year ended 31 December 2006, the Group issued to certain employees share appreciation rights ("SAR") at exercise prices ranging from HK$12.00 to HK$26.05 with vesting period ranging from one to three years from the grant date. The SARs require the Group to pay the intrinsic value of the SAR to the employee at the date of exercise. At 31 December 2006, the Group has recorded liabilities of US$3,429,000 (2005: Nil) and recorded total expenses of US$3,429,000 (2005: Nil) for the year then ended. The fair value of the SARs is determined using the Black-Scholes pricing model with expected volatility of 44.27%, risk free rate of 4.33% and dividend yield of 0%. The SARs granted have not been vested up to 31 December 2006.

### (c) Other share-based payment plan

Pursuant to a share scheme adopted by the Company on 12 January 2005 (the "Share Scheme"), the Company may grant free shares to the directors, employees of the Company or its subsidiaries or third party service providers including employees of Hon Hai and its other subsidiaries.

On 29 December 2006, the Company awarded 5,748,145 ordinary shares to certain employees pursuant to the share scheme, of which 3,010,427 shares awarded were vested immediately, while the remaining shares are granted with lock-up periods ranging from one to three years from the grant date. No consideration is payable on the grant of the shares and the shares were subsequently issued on 2 February 2007.

On 31 December 2005, the Company awarded 3,273,000 shares to its employees pursuant to the share scheme, of which 1,723,000 shares awarded were vested immediately, while the remaining shares are granted with lock-up periods ranging from one to three years from the grant date. No consideration is payable on the grant of the shares. During the current year, the rights to 105,000 shares awarded are waived by employees upon their termination of employment, and the remaining 3,168,000 ordinary shares are issued on 26 September 2006.

The Group recognised total expense of US$21,435,000 (2005: US$2,802,000) for the year ended 31 December 2006 in relation to the ordinary shares awarded by the Company under the Share Scheme.

## 36. PLEDGE OF ASSETS

As at the balance sheet date, the Group pledged property, plant and equipment having a carrying value of approximately US$4,603,000 (2005: US$19,727,000) to secure general banking facilities granted to the Group. The bank facilities were unutilised as at 31 December 2006.

*For the year ended 31 December 2006*

## 37. PRINCIPAL SUBSIDIARIES

The Company has the following principal subsidiaries as at 31 December 2006:

| Name of subsidiary | Form of business structure | Place of incorporation/ establishment | Issued and fully paid share capital/ registered capital | Attributable equity interest held by the Company Directly | Indirectly | Principal activities |
|---|---|---|---|---|---|---|
| CMCS | Limited company | Taiwan | NT$1,500,000,000 | – | 76.332% | Design and manufacture of handsets |
| S&B USA Inc. (formerly Dynacept Corporation) | Limited company | United States of America ("USA") | US$1,000 | – | 100% | Inactive |
| Foxconn Pecs Kft | Limited company | Hungary | EUR735,000 | – | 100% | Inactive |
| FIH Co., Limited | Limited company | Taiwan | NT$1,000,000 | 100% | – | Provision of services to group companies |
| Foxconn Beijing Trading Co., Ltd. | Limited company | British Virgin Islands ("BVI") | US$1 | 100% | – | Trading of handsets |
| Foxconn DK ApS | Limited Company | Denmark | DKK2,100,000 | – | 100% | Research development and project management |
| Foxconn Hungary Kft | Limited company | Hungary | HUF10,039,000,000 | – | 100% | Manufacture of handsets |
| Foxconn Mexico Precision Industry, Co. SA de CV. | Limited company | Mexico | MXN969,094,000 | – | 100% | Manufacture of handsets |
| Foxconn Oy | Limited company | Finland | EUR1,558,800 | – | 100% | Manufacture of handsets |
| 富士康精密組件(北京)有限公司 (Foxconn Precision Component (Beijing) Co., Ltd.) | Wholly foreign owned enterprise | PRC | US$68,800,000 | – | 100% | Manufacture of handsets |
| 宏訊電子工業(杭州)有限公司 (Honxun Electrical Industry (Hangzhou) Co., Ltd.) | Wholly foreign owned enterprise | PRC | US$68,800,000 | – | 100% | Manufacture of handsets |

## 37. PRINCIPAL SUBSIDIARIES *(Continued)*

| Name of subsidiary | Form of business structure | Place of incorporation/ establishment | Issued and fully paid share capital/ registered capital | Attributable equity interest held by the Company Directly | Indirectly | Principal activities |
|---|---|---|---|---|---|---|
| S&B Industry, Inc. | Limited company | USA | US$31,594,767 | – | 100% | Plastics manufacturing |
| S&B Industry Technologies Limited Partnership | Limited company | USA | US$7,218,280 | – | 100% | Repair Center |
| 深圳富泰宏精密工業有限公司 (Shenzhen Futaihong Precision Industrial Co., Ltd.) | Wholly foreign owned enterprise | PRC | US$178,520,000 | – | 100% | Manufacture of handsets |
| Success World Holdings Limited | Limited company | Hong Kong | HK$388,525,000 | 100% | – | Investment holding |
| Sutech Industry Inc. | Limited company | USA | US$10,000 | – | 100% | Provision of logistics services to group companies |
| Sutech Trading Limited | Limited company | BVI | US$1 | – | 100% | Trading of handsets |
| 富士康(天津)精密工業有限公司 (Foxconn (Tianjin) Precision Industry Co., Ltd.) | Wholly foreign owned enterprise | PRC | US$19,800,000 | – | 100% | Manufacture of handsets |
| Foxconn do Brasil Indústria e Comércio de Electrônicos Ltda. (formerly Triple S Cosmoplast da Amazonia, Ltda.) | Limited company | Brazil | BRL$23,828,402 | – | 100% | Manufacture of handsets |
| Foxconn India Private Limited | Limited company | India | INR19,999,900 | – | 100% | Manufacturing, import, export distribution and assembly |
| 富士康精密電子(烟台)有限公司 (Foxconn Precision Electronics (Yantai) Co., Ltd.) | Wholly foreign owned enterprise | PRC | USD8,000,000 | – | 100% | Manufacture of handsets |

## 37. PRINCIPAL SUBSIDIARIES *(Continued)*

| Name of subsidiary | Form of business structure | Place of incorporation/ establishment | Issued and fully paid share capital/ registered capital | Attributable equity interest held by the Company | | Principal activities |
|---|---|---|---|---|---|---|
| | | | | Directly | Indirectly | |
| 富士康精密電子(太原)有限公司 (Foxconn Precision Electronics (Taiyuan) Co., Ltd.) | Wholly foreign owned enterprise | PRC | USD52,500,000 | – | 100% | Manufacture of handsets |
| 富泰京精密電子(北京)有限公司 (Futaijing Precision Electronics (Beijing) Co., Ltd.) | Wholly foreign owned enterprise | PRC | USD15,000,000 | – | 100% | Manufacture of handsets |
| 廊坊全義電子有限公司 | Wholly foreign owned enterprise | PRC | RMB190,000,000 | – | 100% | Manufacture of handsets |
| Foxconn Reynosa S.A. De C.V. | Limited company | Mexico | MXN50,000 | – | 100% | Inactive |
| FIH Technology Korea Ltd. | Limited company | Korea | KRW51,700,000 | – | 100% | Research development and project management |

None of the subsidiaries had issued any debt securities at the end of the year.

The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

# FINANCIAL SUMMARY

| | For the year ended 31 December | | | | |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2004 | 2005 | **2006** |
| | *(US$'million)* | *(US$'million)* | *(US$'million)* | *(US$'million)* | ***(US$'million)*** |
| **Results** | | | | | |
| Turnover | 272.41 | 1,090.62 | 3,308.27 | 6,364.50 | **10,381.24** |
| Profit from operations | 36.82 | 106.00 | 195.10 | 433.15 | **798.75** |
| Interest expenses on bank borrowings | (0.02) | (1.17) | (7.37) | (13.90) | **(13.29)** |
| Loss on disposal of subsidiaries | – | – | (0.60) | – | **–** |
| Profit before tax | 36.80 | 104.83 | 187.13 | 419.25 | **785.46** |
| Income tax expense | (1.79) | (3.33) | (5.81) | (36.32) | **(67.61)** |
| Profit after tax and before minority interests | 35.01 | 101.50 | 181.32 | 382.93 | **717.85** |
| Minority interests | – | 0.10 | – | 2.77 | **0.19** |
| Net profit for the year | 35.01 | 101.60 | 181.32 | 385.70 | **718.04** |

| | As at 31 December | | | | |
|---|---|---|---|---|---|
| | 2002 | 2003 | 2004 | 2005 | **2006** |
| | *(US$'million)* | *(US$'million)* | *(US$'million)* | *(US$'million)* | ***(US$'million)*** |
| **Assets and liabilities** | | | | | |
| Total assets | 168.61 | 1,071.86 | 2,119.56 | 3,158.55 | **4,502.41** |
| Total liabilities | (123.63) | (870.82) | (1,488.75) | (1,631.53) | **(2,121.41)** |
| Minority interests | – | (1.96) | – | (12.05) | **(12.02)** |
| Capital and reserves | 44.98 | 199.08 | 630.81 | 1,514.97 | **2,368.98** |

The results for the year ended 31 December 2002, which were extracted from the Company's prospectus dated 24 January 2005, have been prepared on a combined basis as if the Group Reorganisation had been effective and the Group had been in existence throughout those years.

# CORPORATE GOVERNANCE REPORT

The Company has complied with all the code provisions set out in the CCGP contained in Appendix 14 of the Listing Rules throughout the accounting year ended 31 December 2006 except for code provision A.2.1, which requires that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual.

Under code provision A.2.1 of the CCGP, the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. Mr. Chin Wai Leung, Samuel currently holds both positions. Given that handset industry is going through a 3C convergence and consolidation period and taking into account the continuation in the implementation of business plan and formulation of business strategies, the Board considers that the present arrangement for Mr. Chin, the chairman, to hold the office of chief executive officer of the Company is beneficial and in the interests of the Company and its shareholders as a whole. However, in the spirit of corporate governance, the Board will continue to review in the current year the roles of chairman and chief executive officer and, if considered appropriate, separate the two roles in compliance with code provision A.2.1 of the CCGP.

## THE BOARD

The Board is responsible for the leadership and control of the Company and oversees the Group's overall businesses, strategic decisions and performances. The Board has delegated power to the management for the daily management and operations of the Group. In addition, the Board has also delegated its powers to the Board committees. The Board currently has two committees namely the remuneration committee and the audit committee, each of which discharges its functions and duties in accordance with the respective terms of reference proposed with reference to the relevant provisions under the CCGP.

The Board currently consists of two executive directors, four non-executive directors and three independent non-executive directors.

*Executive directors*
Chin Wai Leung, Samuel *(Chairman and Chief Executive Officer)*
Dai Feng Shuh *(Chief Operating Officer)*

*Non-executive directors*
Chang Ban Ja, Jimmy
Gou Hsiao Ling
Lee Jin Ming
Lu Fang Ming

*Independent non-executive directors*
Lau Siu Ki *(chairman of the remuneration committee and the audit committee)*
Edward Fredrick Pensel
Mao Yu Lang

During the year, five board meetings were held and the attendance of each director is set out below:

| Name of director | Number of board meetings attended in 2006 |
|---|---|
| Chin Wai Leung, Samuel | 5/5 |
| Dai Feng Shuh | 4/5 |
| Chang Ban Ja, Jimmy | 3/5 |
| Gou Hsiao Ling | 5/5 |
| Lee Jin Ming | 1/5 |
| Lu Fang Ming | 2/5 |
| Lau Siu Ki | 5/5 |
| Edward Fredrick Pensel | 3/5 |
| Mao Yu Lang | 3/5 |

The Board meets regularly and the board meetings are held at least four times a year. At least fourteen days notice is given to all directors and they can include matters for discussion in the agenda. An agenda and accompanying board papers are sent to all directors at least three days before the intended date of a board meeting. Every board member is entitled to have access to board papers and related materials and has access to the advice and services of the Company Secretary. They can also request to seek independent professional advice. The minutes books are kept by the company secretary.

## CHAIRMAN AND CHIEF EXECUTIVE OFFICER

Under code provision A.2.1 of the CCGP, the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. Mr. Chin Wai Leung, Samuel currently holds both positions. Given that handset industry is going through a 3C convergence and consolidation period and taking into account the continuation in the implementation of business plan and formulation of business strategies, the Board considers that the present arrangement for Mr. Chin, the Chairman, to hold the office of chief executive officer of the Company is beneficial and in the interests of the Company and its shareholders as a whole. However, in the spirit of corporate governance, the Board will continue to review in the current year the roles of chairman and chief executive officer and, if considered appropriate, separate the two roles in compliance with code provision A.2.1 of the CCGP.

The Chairman is responsible for leadership and for ensuring that directors receive adequate information in a timely manner and are briefed on issues arising at board meetings.

## APPOINTMENTS, RE-ELECTION AND REMOVAL OF DIRECTOR

The Company entered into a letter of appointment with each of the non-executive directors for a term of three years commencing from 1 December 2004 subject to re-election at each annual general meeting of the Company in accordance with article 112 of the articles of association of the Company. All the directors of the Company are subject to retirement by rotation at least once every three years.

## REMUNERATION COMMITTEE

The Company established a remuneration committee with written terms of reference by reference to the provisions of the CCGP.

The remuneration committee consists of one non-executive director and two independent non-executive directors. The members are:

Lau Siu Ki *(chairman)*
Edward Fredrick Pensel
Lee Jin Ming

The principal duties of the remuneration committee are to make recommendation to the Board of the Company on the policy and structure for the remuneration of the directors and senior management, and to consider and approve remuneration for the directors and senior management by reference to corporate goals and objectives. The committee shall meet at least once a year if necessary. For the year ended 31 December 2006, the remuneration committee met once, in particular, to approve the remuneration of the directors of the Company and to review the share grant program of the Company. The attendance of each member of the remuneration committee is shown below:

| **Name of director** | **Number of remuneration committee meeting attend in 2006** |
|---|---|
| Lau Siu Ki | 1/1 |
| Edward Fredrick Pensel | 1/1 |
| Lee Jin Ming | 1/1 |

## AUDIT COMMITTEE

The Company established an audit committee with written terms of reference by reference to the provisions of the CCGP.

The audit committee consists of one non-executive director and two independent non-executive directors. The members are:

Lau Siu Ki *(chairman)*
Edward Fredrick Pensel
Lee Jin Ming

The principal duties of the audit committee are to review the Group's financial reporting and accounting policies and practices as well as financial controls, internal control and risk management systems. It also makes recommendations on the appointment, re-appointment and removal of external auditor, and approves the remuneration and terms of engagement of the external auditor. It will also review and monitor the external auditor's independence and objectivity as well as the effectiveness of the audit process.

For the year ended 31 December 2006, the audit committee met twice, in particular, to review and discuss the auditing and financial reporting, and to review the unaudited interim results and the audited financial statements. The attendance of each member of the audit committee is shown below:

| Name of director | Number of audit committee meetings attended in 2006 |
|---|---|
| Lau Siu Ki | 2/2 |
| Edward Fredrick Pensel | 2/2 |
| Lee Jin Ming | 2/2 |

Full minutes of the audit committee are kept by the Company Secretary. Draft and final versions of minutes of the audit committee are sent to all members of the committee for their comment and records respectively within a reasonable time after the meeting.

## NOMINATION OF DIRECTORS

The Company does not have a nomination committee. The Board is responsible for the appointment of its members and for considering appropriate candidates for re-election by shareholders at annual general meeting.

The Board, in accordance with the articles of association of the Company, considers, nominates and recommend, candidates for directorship. A board meeting was held at which the directors considered and approved, among other things, noting and considering the re-election of directors at the forthcoming annual general meeting.

## AUDITORS' REMUNERATION

The responsibility of the auditors is to form an independent opinion, based on its audit, on those financial statements and to report its opinion solely to the Company, as a body, and for no other purpose.

During the year, the following remuneration paid to the Company's auditors, Deloitte Touche Tohmatsu, is set out below:

| Services rendered | Fee paid |
|---|---|
| | US$000 |
| **Audit services** | 830 |
| **Non-audit services** | 178 |

## DIRECTORS' RESPONSIBILITY FOR FINANCIAL STATEMENTS

The directors acknowledge their responsibility for preparing the financial statements of the Group and ensure that the financial statements are in accordance with statutory requirements and applicable accounting standards.

# CORPORATE GOVERNANCE REPORT

## ACCOUNTABILITY AND AUDIT

The Board is responsible for overseeing the preparation of accounts of each financial period, which gives a true and fair view of the financial position and operating results of the Group. In preparing the 2006 financial statements, the directors have selected suitable accounting policies and have applied them in a consistent manner, have made reasonable judgments and estimates, and have prepared the accounts on the going concern basis.

The Board is responsible for ensuring effectiveness of the system of internal control within the Group so that objectives of the Group can be achieved. The internal control system, which includes a defined management structure with well-defined level of authority and proper segregation of duty and physical control, is designed to provide reasonable assurance regarding the achievement of objectives including effectiveness and efficiency of operations, reliability of financial reporting, safeguarding of assets and compliance with applicable laws and regulations. As the system is designed to manage the Group's risks within an acceptable risk profile, there is no absolute assurance against material misstatement or loss. The Group has established an on-going process of monitoring the system of controls which includes reviewing adequacy of internal controls by an internal audit team.

Risk management is a central part of the Group's strategic management, and is the process whereby the Group methodically identifies and manages key risks to the achievement of the Group's overall objectives. It marshals the understanding of the potential upside and downside of all those factors which can affect the organization. The process includes strategic planning, budgetary control, appointment of senior management, performance measurement and reward, assigning responsibility throughout the Group, people management, control over capital expenditure and proper treasury management.

The Board is of the view that the system of internal controls in place for the year under review is sound and is sufficient to safeguard the interests of shareholders, customers, creditors and employees.

## MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

Following specific enquiry made by the Company, all the directors of the Company have confirmed that they have complied with the required standards as set out in the Model Code as set out in Appendix 10 to the Listing Rules throughout the past year.

## EFFECTIVE COMMUNICATION

At the 2006 annual general meeting, separate resolutions were proposed for shareholders' consideration and approval in respect of each of the key matters, including the re-election of directors, which required approval by the shareholders.

The chairman of the Board, the chairman of the audit committee and the remuneration committee attended the 2006 annual general meeting to answer questions from the shareholders at the meeting.

## VOTING BY POLL

At the 2006 annual general meeting, the procedures for demanding a poll by the shareholders were incorporated in the annual general meeting circular. The procedures for demanding a poll by shareholders and for conducting a poll were also explained by the chairman of the Board at the annual general meeting.