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## BOARD OF DIRECTORS

|                          |   |                   |
|--------------------------|---|-------------------|
| Mr. K. Ramachandra Reddy | - | Chairman & CEO    |
| Mr. C. Dayakar Reddy     | - | Managing Director |
| Mr. A. Ramesh            | - | Director          |
| Prof. Vijaya Chandru     | - | Director          |
| Mr. G. Prasad            | - | Director          |
| Dr. M. Rammohan Rao      | - | Director          |

## COMMITTEES OF THE BOARD

### Audit

|                      |   |          |
|----------------------|---|----------|
| Mr. G. Prasad        | - | Chairman |
| Mr. A. Ramesh        | - | Member   |
| Dr. M. Rammohan Rao  | - | Member   |
| Prof. Vijaya Chandru | - | Member   |

### Remuneration

|                      |   |          |
|----------------------|---|----------|
| Mr. G. Prasad        | - | Chairman |
| Mr. A. Ramesh        | - | Member   |
| Dr. M. Rammohan Rao  | - | Member   |
| Prof. Vijaya Chandru | - | Member   |

### Shareholders / Investor Grievance

|                      |   |          |
|----------------------|---|----------|
| Mr. A. Ramesh        | - | Chairman |
| Mr. G. Prasad        | - | Member   |
| Dr. M. Rammohan Rao  | - | Member   |
| Prof. Vijaya Chandru | - | Member   |

### Raj Kumar Singh

Company Secretary

### REGISTERED OFFICE

H. No: 8-2-685/1/1, Road No. 12,  
Banjara Hills, Hyderabad - 500034.  
Tel : 040-2337-9440  
Fax : 040-2337-9439

### BANKERS

IndusInd Bank Limited  
Corporation Bank  
HDFC Bank Limited  
ICICI Bank Limited

### BRANCH

3335, Kifer Road, Santa Clara, CA - 95051 USA

### AUDITORS

M/s Gokhale & Co  
Chartered Accountants  
3-6-322, Office No. 306, Mahavir House  
Basheerbagh, Hyderabad - 500 029

### REGISTRAR AND SHARE TRANSFER AGENTS

Sathguru Management Consultants Pvt. Limited  
Plot No.15, Hindi Nagar, Behind Saibaba Temple  
Punjagutta, Hyderabad - 500 034  
Tel : 040-2335-0586 / 040-2335-6507  
Fax : 040-2335-4042

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**NOTICE OF ANNUAL GENERAL MEETING**


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Notice is hereby given that the **Seventh Annual General Meeting** of MosChip Semiconductor Technology Limited will be held on **Friday, the 29 September 2006 at 10.30 hrs** at the Registered Office of the Company situated at 8-2-685/1/1, Road No.12, Banjara Hills, Hyderabad-500 034 to transact the following business:

**ORDINARY BUSINESS**

1. To receive, consider and adopt the Report of Directors, Profit and Loss Account for the financial year ended 31 March 2006 and the Balance Sheet as on that date and the report of Auditors thereon.
2. To appoint a Director in place of Mr. G. Prasad who retires by rotation and being eligible offers himself for re-appointment.
3. To appoint a Director in place of Dr. M. Rammohan Rao who retires by rotation and being eligible offers himself for re-appointment.
4. To appoint M/s Gokhale & Co., Chartered Accountants, Hyderabad as Auditors to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting and to authorize Board of Directors or any of its Committee(s) to fix their remuneration.

**SPECIAL BUSINESS**

5. ***To Consider and if thought fit, to pass with or without modifications, the following Resolution as a Special Resolution:***

"RESOLVED THAT in conformity with the provisions of Section 81(1A) and all other applicable provisions, if any, of the Companies Act, 1956; Listing Agreement entered with the Stock Exchange; Guidelines issued by RBI under FEMA 1999 and by SEBI on Preferential Issue of shares and its other regulations/guidelines, if any, and subject to the consent of all other concerned authorities and to the extent required and subject to such conditions and modifications as may be prescribed or imposed while according such consents, which may be considered appropriate by the Board of Directors of the company and/or a duly authorised committee thereof (hereinafter called as "the Board") in its absolute discretion, consent of the company be and is hereby conveyed to the Board to create, offer, issue, allot and deliver in one or

more tranches to (i) Mr. Achal Ghai (ii) Dr. Madhu Mohan Katikieni (iii) Mr. K. Ramachandra Reddy (iv) Mr. C. Dayakar Reddy, and (v) Mrs. Sandhya Reddy, 1,650,000 number of warrants where each warrant is convertible into one Equity share of the face value of Rs.10/- each, at a price of Rs. 31/- per share, (including premium of Rs. 21/-) resulting in the aggregate after conversion, exercise of rights attached to those instruments, not exceeding 1,650,000 equity shares of the company, on the following terms and conditions:-

- Conversion of option can be exercised in one or more tranches at any time within a period of 18 months from the date of issue of such warrants;
- An amount equal to 10 percent of the share price shall be payable on the date of issue of the warrants, with the balance amount being payable at the time of conversion;
- The amount paid on issue of warrants shall be forfeited if the warrants are not exercised within a period of 18 months from the date of issue of warrants;
- This preferential allotment is subject to the dematerialisation of entire pre preferential allotment shareholding of the proposed allottee;
- The entire pre preferential shareholding of the proposed allottee, if any, is subject to a lock-in from the relevant date i.e. 30 August 2006 up to a period of six (6) months from the date of preferential allotment.
- The proposed preferential allotment is void if the proposed allottee has sold its shares in the company during the six months period prior to the relevant date i.e. 30 August 2006.
- Other terms and conditions as may be prescribed by the Board at its absolute discretion consider fit.

RESOLVED FURTHER THAT the Relevant Date in relation to the issue of equity shares and shares resulting upon exercise of warrants for the purpose of determining the issue price under the SEBI Guidelines for Preferential Issues shall be 30 August, 2006.

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RESOLVED FURTHER THAT the equity shares so allotted upon conversion of warrants shall rank *pari passu* with the existing equity shares of the company in all respects.

RESOLVED FURTHER THAT the Board of Directors be and is hereby authorized to do all such acts, deeds and things as may be necessary for the purpose and to settle any questions, difficulties or doubts that may arise in this connection and incidental thereto, in their absolute discretion consider fit without being required to seek any further consent or approval of the company or otherwise to the end and intent that they shall be deemed to have given their approval thereto expressly by the authority of this resolution."

**6. To Consider and if thought fit, to pass with or without modifications, the following Resolution as a Special Resolution:**

"RESOLVED THAT pursuant to the provisions of Section 198, 269, 302, 309, 310, 311 and Schedule XIII and other applicable provisions, if any, of the Companies Act, 1956 (including any statutory modifications or re-enactment thereof, for the time being in force) and subject to Central Government approval and other sanctions and approvals as may be necessary, approval of the Company be and is hereby accorded for the re-appointment of Mr. K. Ramachandra Reddy as Chairman and Chief Executive Officer of the company for a period of three years with effect from 1 September 2006, on a revised terms and conditions as mentioned below:

**Terms of remuneration**

Salary and Perquisites : Rs.350,000/- (Rupees Three Lakhs fifty thousand only) per month by way of Salary, Dearness Allowance and any other allowances and perquisites in the time scale of Rs. 350,000 - 50,000 - 450,000.

**Commission:**

Where the Company has sufficient profits, such percentage of Commission on the net profits of the company be paid in addition to salary and perquisites as may be determined by the Remuneration Committee/Board of Directors of the Company at

the end of each financial year; and such percentage of commission together with the salary and perquisites paid during the financial year shall not exceed 5% of the net profits.

Mr. K. Ramachandra Reddy, shall also be eligible for Gratuity payable at a rate not exceeding half a months salary for each completed year of service which shall not be included in the computation of the ceiling on remuneration specified above.

Notwithstanding anything contained herein, wherein any financial year during the currency of the tenure of the appointee, the Company has no profit or its profits are inadequate, the Company will pay to Mr. K. Ramachandra Reddy, remuneration by way of salary and perquisites as hereinabove mentioned as minimum remuneration.

FURTHER RESOLVED THAT the Board of Directors be and is hereby authorized to do all such acts,deeds,matters and things as may be necessary or desirable to give effect to these Resolutions".

**7. To Consider and if thought fit, to pass with or without modifications, the following Resolution as a Special Resolution:**

"RESOLVED THAT pursuant to the provisions of Section 198, 269, 302, 309, 310, 311 and Schedule XIII and other applicable provisions, if any, of the Companies Act, 1956 (including any statutory modifications or re-enactment thereof, for the time being in force) and subject to Central Government approval and other sanctions and approvals as may be necessary, approval of the Company be and is hereby accorded for the re-appointment of Mr. C. Dayakar Reddy as Managing Director of the company for a period of three years with effect from 1 September 2006, on a revised terms and conditions as mentioned below:

**Terms of remuneration**

Salary and Perquisites : Rs.350,000/- (Rupees Three Lakhs fifty thousand only) per month by way of Salary, Dearness Allowance and any other allowances and perquisites in the time scale of Rs. 350,000 - 50,000 - 450,000.

**Commission:**

Where the Company has sufficient profits, such percentage of Commission on the net profits of the company be paid in addition to salary and perquisites as may be determined by the Remuneration Committee/Board of Directors of the Company at the end of each financial year; and such percentage of commission together with the salary and perquisites paid during the financial year shall not exceed 5% of the net profits.

Mr. C. Dayakar Reddy, shall also be eligible for Gratuity payable at a rate not exceeding half a months salary for each completed year of service which shall not be included in the computation of the ceiling on remuneration specified above.

Notwithstanding anything contained herein, wherein any financial year during the currency of the tenure of

the appointee, the Company has no profit or its profits are inadequate, the Company will pay to Mr. C. Dayakar Reddy, remuneration by way of salary and perquisites as hereinabove mentioned as minimum remuneration.

FURTHER RESOLVED THAT the Board of Directors be and is hereby authorized to do all such acts, deeds, matters and things as may be necessary or desirable to give effect to these Resolutions".

By Order of the Board of Directors

Hyderabad  
04 September 2006

**Raj Kumar Singh**  
Company Secretary

**NOTES:**

1. A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote on a poll instead of him and such proxy need not be a member of the company. Proxies in order to be effective must be received by the company not less than 48 hours before the commencement of the meeting.
2. The Register of Members and Share Transfer Books of the company will remain closed from 23-09-2006 to 30-09-2006 (both days inclusive).
3. To avoid inconvenience to members and to facilitate smooth conduct of the meeting, entry to the place of meeting will be only for members / proxies and is regulated by the attendance slip appended to the proxy form. Members are requested to affix their signature on it and hand it over at the entrance.
4. Members, who hold shares in de-materialized form, are requested to bring their Client ID and DP Id No's for easier identification of attendance at the meeting.
5. A member desirous of getting any information on the accounts or operations of the company is requested to forward his/her queries to the company at least seven working days prior to the meeting, so that the required information can be made available at the meeting.
6. Members are requested to notify immediately any change in their address to the company or to the Share Transfer Agents and in case their shares are held in dematerialized form, this information should be passed onto their respective Depository Participants without any delay.
7. In all correspondence with the company, members are requested to quote their folio numbers and in case their shares are held in dematerialized form they must quote their Client ID Number and their DP ID Number.
8. Members are requested to carry their copies of Annual Report as these will not be supplied at the meeting.
9. Trading in the equity shares of the company is in the compulsory demat form. Those members who have not demated their shares are requested to open the demat accounts with the depositories and get the shares demated at the earliest.
10. Explanatory Statement Under Section 173(2) of the Companies Act, 1956 in relation to item Nos 5, 6 & 7 above is annexed hereto.

## EXPLANATORY STATEMENT UNDER SECTION 173(2) OF THE COMPANIES ACT, 1956

### Item No.5: Issue of Warrants on Private Placement Basis.

To build and strengthen business relationships and to provide adequate incentives to the Chairman & CEO and Managing Director and to a key employee of MosChip Semiconductor Technology, USA, your company is proposing to issue 1,650,000 numbers of warrants to (i) Mr. Achal Ghai (ii) Dr. Madhu Mohan Katikieni (iii) Mr. K. Ramachandra Reddy (iv) Mr. C. Dayakar Reddy, and (v) Mrs. Sandhya Reddy, on preferential allotment basis.

Mr. K. Ramachandra Reddy, Chairman & CEO and Mr. C. Dayakar Reddy, Managing Director are interested or concerned with the above resolution to the extent of their warrants.

Disclosure pursuant to Clause 13.1A of the SEBI Disclosure and Investor Protection Guidelines for Preferential Issues.

### Objects of the issue through preferential offer.

The object of the proposed issue of warrants to proposed allottees is to build and strengthen business relationships and to provide adequate incentives to the Chairman & CEO and Managing Director and to a key employee of MosChip Semiconductor Technology, USA.

### Intention of promoters/directors/key management persons to subscribe to the offer

Mr. K. Ramachandra Reddy, Chairman & CEO and Mr. C. Dayakar Reddy, Managing Director are intended to subscribe 500,000 warrants each to the offer.

### Shareholding pattern before and after the issue

| Category   | Before the offer |               | After the offer |               |
|--|------------------|---------------|-----------------|---------------|
|  | No. of shares    | %             | No. of shares   | %             |
| <b>A. Shareholding of Promoter &amp; Promoter Group</b>                        |                  |               |                 |               |
| <b>1. Indian</b>   |                  |               |                 |               |
| - Individuals/Hindu Undivided Family   | 19600            | 0.05          | 19600           | 0.04          |
| - PAC  | 330000           | 0.76          | 330000          | 0.73          |
| <b>Sub - Total (A) (1)</b>   | <b>349600</b>    | <b>0.81</b>   | <b>349600</b>   | <b>0.78</b>   |
| <b>2. Foreign</b>  |                  |               |                 |               |
| - Individuals (NRI's/Foreign individuals)                                      | 4868235          | 11.22         | 5868235         | 13.03         |
| - PAC  | 5614257          | 12.94         | 5764257         | 12.80         |
| <b>Sub - Total (A) (2)</b>   | <b>10482492</b>  | <b>24.16</b>  | <b>11632492</b> | <b>25.83</b>  |
| <b>Total Shareholding of Promoter &amp; Promoter Group(A)=(A)(1) + (A) (2)</b> | 10832092         | 24.97         | 11982092        | 26.61         |
| <b>B. Public Share Holdings</b>  |                  |               |                 |               |
| <b>1. Institutions</b>   |                  |               |                 |               |
| - Financial Institutions/Banks   | 4650             | 0.01          | 4650            | 0.01          |
| - FIs  | 679146           | 1.57          | 679146          | 1.51          |
| <b>Sub- Total (B) (1)</b>  | <b>683796</b>    | <b>1.58</b>   | <b>683796</b>   | <b>1.52</b>   |
| <b>2. Non-Institutions</b>   |                  |               |                 |               |
| - Bodies Corporate   | 5949482          | 13.71         | 5949482         | 13.21         |
| - Individuals  |                  |               |                 |               |
| - Individuals-Shareholders holding nominal share capital up to Rs. 1 Lakh      | 17132280         | 39.49         | 17132280        | 38.04         |
| - Shareholders holding nominal share capital in excess of Rs. 1 Lakh           | 3375444          | 7.78          | 3375444         | 7.50          |
| - Non-Resident's /OCB  | 5410423          | 12.47         | 5910423         | 13.12         |
| <b>Sub- Total (B) (2)</b>  | <b>31867629</b>  | <b>73.46</b>  | <b>32367629</b> | <b>71.87</b>  |
| <b>(B). Total Public Shareholding (B)=(B)(1) + (B) (2)</b>                     | <b>32551425</b>  | <b>75.03</b>  | <b>33051425</b> | <b>73.39</b>  |
| <b>GRAND TOTAL (A+B)</b>   | <b>43383517</b>  | <b>100.00</b> | <b>45033517</b> | <b>100.00</b> |

**Proposed time within which the allotment shall be completed.**

The allotment shall be completed within 15 (Fifteen) days from the date of passing of the resolution Provided that where the allotment on preferential basis is pending on account of pendency of any approval of such allotment by any regulatory authority of the Central Government, the allotment shall be completed within 15 (Fifteen) days from the date of such approval.

**The identity of the proposed allottees and the percentage of post-preferential issue capital that may be held by them.****The proposed allottee is:**

| Sl No | Name of the allottee      | Existing Holding | No. of warrants allotted | Percentage of post issue capital |
|-------|---------------------------|------------------|--------------------------|----------------------------------|
| 01    | Mr. Achal Ghai            | -                | 300,000                  | 0.67                             |
| 02    | Dr. Madhu Mohan Katikieni | -                | 200,000                  | 0.44                             |
| 03    | Mr. K. Ramachandra Reddy  | 3,040,537        | 500,000                  | 1.11                             |
| 04    | Mr. C. Dayakar Reddy      | 577,420          | 500,000                  | 1.11                             |
| 05    | Mrs. Sandhya Reddy        | -                | 150,000                  | 0.34                             |

Mr. K. Ramachandra Reddy and Mr. C. Dayakar Reddy falls under the category of promoter.

Mrs. Sandhya Reddy is an employee of MosChip Semiconductor Technology, USA, a Wholly Owned Subsidiary of the Company. She falls under the category of Persons Acting in Concert.

Mr. K. Ramachandra Reddy, Chairman & CEO and Mr. C. Dayakar Reddy, Managing Director are interested or concerned with the above resolution to the extent of their warrants.

**Item No.6: Re-appointment of Mr. K. Ramachandra Reddy as Chairman & CEO**

Mr. K. Ramachandra Reddy was initially appointed as the Chairman & CEO with effect from 24 July 2000 for a period of 5 years and was reappointed w.e.f. 24 July 2005 as Chairman & CEO on revised remuneration. As a part of the initiative to create enduring leadership for the company, the Board of Directors of the company on 31 August 2006 has resolved to re-appoint Mr. K. Ramachandra Reddy as Chairman & CEO for a period of 3 years commencing from 01 September 2006 on revised terms and conditions.

The appointment is subject to the approval of members and the Central Government. The terms and conditions of his appointment are as follows:

1. Period of appointment: 3 years beginning 01 September 2006 and ending on 31 August 2009.
2. Details of remuneration: As provided in resolution will be paid for a period of 3 years with effect from 01 September 2006.

3. Mr. K. Ramachandra Reddy shall perform such duties as shall from time to time be entrusted to him, subject to the superintendence, guidance and control of the Board of Directors and he shall perform such other duties as shall from time to time be entrusted to him by the Board of Directors of the company.

The terms of re-appointment of Mr. K. Ramachandra Reddy as stated in this notice may be treated as the abstract under Section 302 of the Companies Act, 1956. The Board accordingly recommends the resolution for approval of the members.

**Disclosure pursuant to provisions of Schedule XIII****1. General Information:**

- a. Nature of Industry: Software Development (ASIC Designing and IP Development)
- b. Date of commencement of commercial production: 01 August 2000.
- c. Financial performance based on given indicators:

| Particulars   | (Rs. in Lakhs)       |              |                      |              |                      |              |
|---|----------------------|--------------|----------------------|--------------|----------------------|--------------|
|   | For the year 2003-04 |              | For the year 2004-05 |              | For the year 2005-06 |              |
|   | MosChip India        | Consolidated | MosChip India        | Consolidated | MosChip India        | Consolidated |
| Total Income from operations                                | 26.60                | 1263.86      | 232.90               | 1790.56      | 498.98               | 2286.93      |
| Operating Profit before Interest, Depreciation & Tax (PBIT) | -1054.12             | -913.02      | -752.42              | -419.53      | -558.55              | -434.78      |
| Less: Depreciation  | 149.05               | 226.62       | 240.05               | 363.61       | 278.73               | 372.39       |
| Interest  | 13.17                | 13.17        | 9.03                 | 9.03         | -                    | -            |
| Operating profit before tax                                 | -1216.34             | -1152.81     | -1001.50             | -792.17      | -837.28              | -807.17      |
| Add: Other Income   | 17.22                | 23.71        | 31.27                | 29.50        | 184.26               | 172.84       |
| Profit before tax (PBT)                                     | -1199.12             | -1129.10     | -970.24              | -762.67      | -653.02              | -634.33      |
| Less: Provision for Income Tax                              | -                    | -            | -                    | -            | 3.14                 | 3.14         |
| Profit after tax (PAT)                                      | -1199.12             | -1129.10     | -970.24              | -762.67      | -656.16              | -637.47      |
| Earnings per share (EPS)                                    |                      |              |                      |              |                      |              |
| Basic   | -4.72                | -4.44        | -2.95                | -2.32        | -1.54                | -1.50        |
| Diluted   | -4.72                | -4.44        | -2.95                | -2.32        | -1.54                | -1.50        |

d. Export performance and net foreign exchange collaborations:

- Foreign Exchange Earnings of the Company ( From the date of incorporation to 31 March 2006) : Rs. 952.30 lakhs
- Deficit in Export Obligation as on 31 March 2006 : Rs. 1994.00 lakhs.
- Net Foreign Exchange Earnings of the Company ( From the date of incorporation to 31 March 2006) : Rs. (466.55) lakhs
- Deficit in Net Foreign Exchange Earnings as on 31 March 2006 : Rs. 15 lakhs

e. Foreign Investments or collaborators, if any: 38.15% equity shares are held by Non-residents and there is no foreign collaboration.

**2.. Information about Mr. K. Ramachandra Reddy:**

- a. Background details: Mr. K. Ramachandra Reddy aged 57, is a graduate in Electronics Engineering from IIT, Madras and M.S.E.E. from University of Wisconsin, Madison, Wisconsin, USA. He has over 24 years of experience in Silicon Valley in the area of design, manufacturing and marketing of various integrated circuits (ICs). He has successfully

started semiconductor design companies and sold them to larger companies in the last 19 years. His companies were Lotus Designs Corp., Silicon Logic and Startech Semiconductor. All these companies were based in Silicon Valley, USA. Prior to starting his first company in 1982, he worked as a Section Manager at American Micro Systems in Santa Clara, California. Mr. Ramachandra Reddy has extensive experience in sub contracting manufacturing needs of semiconductors and marketing these products worldwide. His customer list included major PC manufacturers such as Compaq Computers and communication technology companies such as Nokia Systems out of Finland.

- b. Past remuneration: Rs. 250,000/- per month.
- c. Recognition or awards: He was responsible for designing the world's first DSP chip.
- d. Job profile and his suitability: As CEO and Chairman of the Company, Mr. K. Ramachandra Reddy, is the person responsible for giving business direction to the company and its wholly owned subsidiary and the overall performance.

Mr. K. Ramachandra Reddy has over 20 years of experience in the semiconductor industry in USA.

e. Remuneration proposed:

Salary and Perquisites : Rs. 350,000/- (Rupees Three Lakhs fifty thousand only) per month by way of Salary, Dearness Allowance and any other allowances and perquisites in the time scale of Rs. 350,000 - 50,000 - 450,000.

**Commission:**

Where the Company has sufficient profits, such percentage of Commission on the net profits of the company be paid in addition to salary and perquisites as may be determined by the Remuneration Committee/Board of Directors of the company at the end of each financial year; and such percentage of commission together with the salary and perquisites paid during the financial year shall not exceed 5% of the net profits.

f. Comparative remuneration profile with respect to industry, size of the company, profile of the position and persons:

The remuneration package of Rs. 350,000/- in the time scale of Rs. 350,000 - 50,000 - 450,000 is very reasonable vis-a-vis the semiconductor industry standards.

g. Pecuniary relationship directly or indirectly with the company or relationship with the managerial personnel, if any: Mr. K. Ramachandra Reddy holds 8.16% of equity shares in the Company.

**3. Other Information:**

a. Reasons of loss or inadequate profits

As a fabless semiconductor company, MosChip Semiconductor Technology Limited (MosChip India) designs products and develops ASIC software and outsources the manufacturing to ASIC Service Providers. The ASIC software is licensed to its wholly owned subsidiary MosChip Semiconductor Technology, USA (MosChip USA), which subcontracts the manufactured chip through its distribution network worldwide.

MosChip USA collects the entire revenue from sale of the products, MosChip USA pays a Licence fee to MosChip India for the license of the software, which fee is linked to the gross margins on the products designed and developed by MosChip India.

The Products that were launched by the Company during its initial years of commercial operations had some compatibility issues. These had to be rectified and were again released for customer sampling subsequently.

The Compatibility problems and the inordinate delays completion of new product designs have been mainly because of the lack of experience of Indian engineers on development of Asics, resulting in ASIC designs that did not address these issues adequately.

The sales of the products designed by the company were not large enough for the Company to become profitable.

b. Steps taken or proposed to be taken for improvement

This gap has now been plugged by hiring few senior engineers in India who have had several years of experience in development of ASICs in the Silicon Valley, USA. This has resulted in remarkable improvement.

The company has taken up custom development of products and also development of IP for overseas customers. That has helped the Company to increase its revenues and reduce losses. The Company also plan to take up ASIC design services as a business activity, while continuing to develop and launch new products with higher market potential.

c. Expected increase in productivity and profits in measurable terms.

The Company is expected to achieve consolidated sales of Rs. 40 crores and become profitable at the consolidated level for the financial year 2006-07.

Except Mr. K. Ramachandra Reddy, none of the Directors is interested or concerned with the above resolution.

**Item No.7: Re-appointment of Mr. C. Dayakar Reddy as Managing Director.**

Mr. C. Dayakar Reddy was initially appointed as the Managing Director with effect from 24 July 2000 for a period of 5 years and was reappointed w.e.f. 24 July 2005 as Managing Director on revised remuneration. As a part of the initiative to create enduring leadership for the company, the Board of Directors of the company on 31 August 2006 has resolved to re-appoint Mr. C. Dayakar Reddy as Managing Director for a period of 3 years commencing from 01 September 2006 on revised terms and conditions.

The appointment is subject to the approval of members and the Central Government. The terms and conditions of his appointment are as follows:

1. Period of appointment: 3 years beginning 01 September 2006 and ending on 31 August 2009.
2. Details of remuneration: As provided in resolution will be paid for a period of 3 years with effect from 01 September 2006.
3. Mr. C. Dayakar Reddy shall perform such

duties as shall from time to time be entrusted to him, subject to the superintendence, guidance and control of the Board of Directors and he shall perform such other duties as shall from time to time be entrusted to him by the Board of Directors of the company.

The terms of re-appointment of Mr. C. Dayakar Reddy as stated in this notice may be treated as the abstract under Section 302 of the Companies Act, 1956. The Board accordingly recommends the resolution for approval of the members.

**Disclosure pursuant to provisions of Schedule XIII****1. General Information:**

- a. Nature of Industry: Software Development (ASIC Designing and IP Development)
- b. Date of commencement of commercial production: 01 August 2000.
- c. Financial performance based on given indicators:

(Rs. in Lakhs)

| Particulars   | For the year 2003-04 |              | For the year 2004-05 |              | For the year 2005-06 |              |
|---|----------------------|--------------|----------------------|--------------|----------------------|--------------|
|   | MosChip India        | Consolidated | MosChip India        | Consolidated | MosChip India        | Consolidated |
| Total Income from operations                                | 26.60                | 1263.86      | 232.90               | 1790.56      | 498.98               | 2286.93      |
| Operating Profit before Interest, Depreciation & Tax (PBIT) | -1054.12             | -913.02      | -752.42              | -419.53      | -558.55              | -434.78      |
| Less: Depreciation  | 149.05               | 226.62       | 240.05               | 363.61       | 278.73               | 372.39       |
| Interest  | 13.17                | 13.17        | 9.03                 | 9.03         | -                    | -            |
| Operating profit before tax                                 | -1216.34             | -1152.81     | -1001.50             | -792.17      | -837.28              | -807.17      |
| Add: Other Income   | 17.22                | 23.71        | 31.27                | 29.50        | 184.26               | 172.84       |
| Profit before tax (PBT)                                     | -1199.12             | -1129.10     | -970.24              | -762.67      | -653.02              | -634.33      |
| Less: Provision for Income Tax                              | -                    | -            | -                    | -            | 3.14                 | 3.14         |
| Profit after tax (PAT)                                      | -1199.12             | -1129.10     | -970.24              | -762.67      | -656.16              | -637.47      |
| Earnings per share (EPS)                                    |                      |              |                      |              |                      |              |
| Basic   | -4.72                | -4.44        | -2.95                | -2.32        | -1.54                | -1.50        |
| Diluted   | -4.72                | -4.44        | -2.95                | -2.32        | -1.54                | -1.50        |

- d. Export performance and net foreign exchange collaborations:
- Foreign Exchange Earnings of the Company ( From the date of incorporation to 31 March 2006 ) : Rs. 952.30 lakhs
  - Deficit in Export Obligation as on 31 March 2006 : Rs. 1994.00 lakhs.
  - Net Foreign Exchange Earnings of the Company ( From the date of incorporation to 31 March 2006 ) : Rs. (466.55) lakhs
  - Deficit in Net Foreign Exchange Earnings as on 31 March 2006 : Rs. 15 lakhs
- e. Foreign Investments or collaborators, if any: 38.15% equity shares are held by Non-residents and there is no foreign collaboration.

**2. Information about Mr. C. Dayakar Reddy**

- a. Background details: Dayakar is a post-graduate in Electronics Engineering from California State University, San Jose, USA (1985). He has over 21 years of experience in the semiconductor industry out of which 15 years are in Silicon Valley, USA. He started his career with Cirrus Logic, Fremont, USA and held Senior Management positions in Engineering.. He founded his own company in 1994, Future Integrated Systems. He sold his company to National Semiconductors in 1997 and worked with them as Director of Systems Engineering till early 1999.
- b. Past remuneration: Rs. 250,000/- per month.
- c. Recognition or awards: He has developed several graphics controllers, which helped Cirrus Logic in becoming the leading supplier of graphics controllers. He had filed for 10 patents in 10 years during his stint with the company. He had also filed for 2 patents in the field of LCD display technology with the company he founded.
- d. Job profile and his suitability: The Managing Director shall have, subject to the supervision, control and directions of the Board, the management of the whole of the business of

the Company and all of its affairs and shall exercise all powers and perform all duties in relation to the management of the affairs and transactions of the company, except such powers and duties as are required by law or by these presents to be exercised or done by the Company in General Meeting or by the Board of Directors and also subject to such conditions or restrictions, imposed by the Companies Act, 1956 or these presents. Further, Managing Director of the Company shall exercise all the powers as set out in the Articles of Association of the Company except those which are by law or by these presents or by any resolutions of the Board required to be done by the Company in General Meeting or by the Board.

- e. Remuneration proposed:

Salary and Perquisites : Rs. 350,000/- (Rupees Three Lakhs fifty thousand only) per month by way of Salary, Dearness Allowance and any other allowances and perquisites in the time scale of Rs. 350,000 - 50,000 - 450,000.

**Commission:**

Where the Company has sufficient profits, such percentage of Commission on the net profits of the company be paid in addition to salary and perquisites as may be determined by the Remuneration Committee/Board of Directors of the company at the end of each financial year; and such percentage of commission together with the salary and perquisites paid during the financial year shall not exceed 5% of the net profits.

- h. Comparative remuneration profile with respect to industry, size of the company, profile of the position and persons:

The remuneration package of Rs. 350,000/- in the time scale of Rs. 350,000 - 50,000 - 450,000 is very reasonable vis-a-vis the semiconductor industry standards.

- i. Pecuniary relationship directly or indirectly with the company or relationship with the managerial personnel if any: Mr. C. Dayakar Reddy holds 2.55 % of equity shares in the Company.

**3. Other Information:**

a. Reasons of loss or inadequate profits

As a fabless semiconductor company, MosChip Semiconductor Technology Limited (MosChip India) designs products and develops ASIC software and cut sources the manufacturing to ASIC Service Providers. The ASIC software is licensed to its wholly owned subsidiary MosChip Semiconductor Technology, USA (MosChip USA), which subcontracts the manufactured chip through its distribution network worldwide.

MosChip USA collects the entire revenue from sale of the products, MosChip USA pays a Licence fee to MosChip India for the license of the software, which fee is linked to the gross margins on the products designed and developed by MosChip India.

The Products that were launched by the Company during its initial years of commercial operations had some compatibility issues. These had to be rectified and were again released for customer sampling subsequently.

The Compatibility problems and the inordinate delays completion of new product designs have been mainly because of the lack of experience of Indian engineers on development of Asics, resulting in ASIC designs that did not address these issues adequately.

The sales of the products designed by the company were not large enough for the Company to become profitable.

b. Steps taken or proposed to be taken for improvement

This gap has now been plugged by hiring few senior engineers in India who have had several years of experience in development of ASICs in the Silicon Valley, USA. This has resulted in remarkable improvement.

The company has taken up custom development of products and also development of IP for overseas customers. That has helped the Company to increase its revenues and reduce losses. The Company also plan to take up ASIC design services as a business activity, while continuing to develop and launch new products with higher market potential.

c. Expected increase in productivity and profits in measurable terms.

The Company is expected to achieve consolidated sales of Rs.40 crores and become profitable at the consolidated level for the financial year 2006-07.

Except Mr. C. Dayakar Reddy, none of the Directors is interested or concerned with the above resolution.

By Order of the Board of Directors

Hyderabad  
04 September 2006

**Raj Kumar Singh**  
Company Secretary

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**BRIEF PROFILE OF DIRECTORS SEEKING RE-ELECTION AT THE ENSUING ANNUAL GENERAL MEETING****Mr. G. Prasad**

Mr. Gajjala Prasad is a Chartered Accountant by profession. He is a partner of Nataraja Iyer and Co., Chartered Accountants based at Hyderabad. Mr. Prasad has got over 27 years of professional experience in audit and taxation matters of medium and large Corporates.

**Dr. M. Rammohan Rao**

Dr. M. Rammohan Rao is the Dean of Indian School of Business at Hyderabad. He was Professor Emeritus in the area of Quantitative Methods and Information Systems, Indian Institute of Management Bangalore (IIMB) till June 30, 2004. He was the Director of IIMB during the period March 1997 to May 2002. Dr. Rao holds a Ph.D. and M.S. in Industrial Administration from Carnegie Mellon University, Master of Engineering (Industrial) from Cornell University, and Bachelor of Engineering (Mechanical) from University of Madras. Prior to getting his Ph.D., he worked as an Associate Research Engineer at U.S. Steel Applied Research Lab in Pittsburgh, USA. Dr. Rao was a Research Fellow at the Centre for Operations Research and Econometrics at Leuven, Belgium and also at the International Institute of Management, Berlin. He has taught at the University of Rochester, University of Tennessee,

and was a Tenured Professor at New York University. Dr. Rao has published over 85 articles in various professional journals and has been a consultant to several companies. His teaching and research interests are in the area of Optimization and Financial Derivatives. Dr. Rao was the President of the Operations Research Society of India. Dr. Rao is the recipient of the Fulkerson Prize awarded to him in August 2000. The prize is sponsored by the Mathematical Programming Society and the American Mathematical Society. The Indian Institute of Materials Management has conferred on him the Chief Executive of the Year 2000-2001 Award for his outstanding achievements and significant contribution to the Materials Management Profession. He has been awarded the 2002 Institute of Marketing & Management Award for Excellence as Top Management Educator. He is a member of the Advisory Board of Citigroup and Cornucopia Private Limited. He is a member of the Board in Satyam Computer Services Limited, Krishna Fabrications Private Limited, APIDC Venture Capital Limited and Bharat Electronics Limited. He is member of Audit Committee of Satyam Computer Services Limited. He is the Chairman of the Audit Committee of Bharat Electronics Limited.

By Order of the Board of Directors

Hyderabad  
4 September 2006

**Raj Kumar Singh**  
Company Secretary

## DIRECTORS' REPORT

To the members,

Your Directors have pleasure in presenting the Seventh Annual Report together with the Audited Accounts (including consolidated accounts) of the company for the year ended 31 March 2006.

### Financial Results

(Rs. in Lakhs)

| Particulars  | For the year ended 31 March 2006 |             |              | For the year ended 31 March 2005 |             |              |
|--|----------------------------------|-------------|--------------|----------------------------------|-------------|--------------|
|  | MosChip India                    | MosChip USA | Consolidated | MosChip India                    | MosChip USA | Consolidated |
| Total income from operations                                 | 498.98                           | 2037.92     | 2286.93      | 232.90                           | 1649.96     | 1790.56      |
| Operating Profit before Interest, Depreciation & Tax (PBIDT) | -558.55                          | 123.77      | -434.78      | -752.43                          | 332.90      | -419.53      |
| Less: Depreciation   | 278.73                           | 93.66       | 372.39       | 240.05                           | 123.56      | 363.61       |
| Less: Interest   | -                                | 16.64       | -            | 9.03                             | 16.10       | 9.03         |
| Operating profit before tax                                  | -837.28                          | 13.47       | -807.17      | -1001.51                         | 193.24      | -792.17      |
| Add: Other income  | 184.26                           | 5.22        | 172.84       | 31.27                            | 14.33       | 29.50        |
| Profit before tax (PBT)                                      | -653.02                          | 18.69       | -634.33      | -970.24                          | 207.57      | -762.67      |
| Less: Provision for Income Tax                               | 3.14                             | -           | 3.14         | -                                | -           | -            |
| Profit after tax (PAT)                                       | -656.16                          | 18.69       | -637.47      | -970.24                          | 207.57      | -762.67      |
| Earnings Per Share (EPS)                                     |                                  |             |              |                                  |             |              |
| Basic  | -1.54                            | 0.11        | -1.50        | -2.95                            | 1.29        | -2.32        |
| Diluted  | -1.54                            | 0.11        | -1.50        | -2.95                            | 1.29        | -2.32        |

### Operations

The consolidated turnover of the company went up from Rs. 17.91 crores to Rs. 22.87 crores and the consolidated loss reduced from Rs. 7.63 crores to Rs. 6.34 crores.

#### MosChip India

The Company's products, which were launched by the US subsidiary during the last two years, are under volume production and have generated royalty income during the year under review. The Company has also earned revenue from development of Intellectual Property and services related to custom products.

The company's total income from operations was Rs. 4.99 crores while the net loss was Rs. 6.56 crores.

#### MosChip USA, a wholly owned subsidiary

MosChip Semiconductor Technology, USA (MosChip USA) the wholly owned subsidiary has recorded nearly 24 percent growth in revenue from Rs. 16.50 crores in 2004-05 to Rs. 20.38 crores during the year ended 31 March 2006. The company has made a profit of Rs. 0.18 crores during the year ended 31 March 2006 as against Rs. 2.08 crores during the previous financial year.

**Dividend**

The company has not declared any dividend during the year under review.

**Increase in Share Capital**

The Company has made the following allotments during the financial year 2005-06

| Particulars                           | No. of Shares    | Price Per Share |
|---------------------------------------|------------------|-----------------|
| On exercise of Employee Stock Options | 38,326           | 26.75           |
| On exercise of Employee Stock Options | 3,000            | 30.50           |
| On exercise of Employee Stock Options | 76,125           | 31.00           |
| On exercise of Employee Stock Options | 100,050          | 33.00           |
| In lieu of shares underlying GDRs     | 9,107,454        | 34.95           |
| On exercise of Employee Stock Options | 1,000            | 40.50           |
| On exercise of Employee Stock Options | 1,000            | 42.85           |
| <b>Total</b>                          | <b>9,326,955</b> |                 |

The Company has made the following allotments during the financial year 2006-07 till the date of this report:

| Particulars                           | No. of Shares | Price Per Share |
|---------------------------------------|---------------|-----------------|
| On exercise of Employee Stock Options | 1,500         | 26.75           |
| On exercise of Employee Stock Options | 6,000         | 30.50           |
| On exercise of Employee Stock Options | 6,000         | 31.00           |
| <b>Total</b>                          | <b>13,500</b> |                 |

In view of the above allotments, the total outstanding paid-up equity share capital of the company has increased from 34,043,062 equity shares from the previous year 2004-05 to 43,383,517 equity shares as on date.

**Marketing and distribution**

The manufacturing and sale of products developed by the company is handled by MosChip USA, which has appointed distributors in all the major markets for its semiconductor products. MosChip USA opened a branch office in Hong Kong during the Financial Year 2005-06. This has enabled the company to get closer access to customers in China and Hong Kong, which are the major markets for our products. We expect this to help in increasing the sales volume in these markets. MosChip USA has also started focusing on the European markets for some of its key products and have achieved some success with new design wins.

**Employee Stock Option Plan**

During the year under report the company has five schemes in operation as mentioned below, for granting stock options

to the employees of the company and its wholly owned subsidiary in accordance with Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines 1999.

- (a) MosChip Stock Option Plan - 2001
- (b) MosChip Stock Option Plan - 2002
- (c) MosChip Stock Option Plan - 2004
- (d) MosChip Stock Option Plan - 2005(MI)
- (e) MosChip Stock Option Plan - 2005(WOS)

Disclosures pursuant to para 12 of the above referred SEBI guidelines are set out as Annexure - A, to this report.

The prices, at which the stock options have been granted to the employees till date under the five schemes, are equal to the Market Price as defined in the SEBI guidelines in vogue.

**Fixed Deposits**

The company has not accepted any fixed deposits in terms of Section 58A of the Companies Act, 1956 from the public.

**Directors**

Pursuant to the provisions of Article 133 of the Articles of Association of the company, Mr. G. Prasad and Dr. M. Rammohan Rao, Directors retire by rotation in the ensuing Annual General Meeting and being eligible, offer themselves for re-appointment. Pursuant to the provisions of clause 49 of the Listing Agreement entered with BSE, brief particulars of these directors are provided as an annexure to Notice convening Annual General Meeting.

**Auditors**

The Auditors of the company M/s Gokhale & Co., Chartered Accountants, who retire at the ensuing Annual General Meeting of the company, are eligible for reappointment as Statutory Auditors of the company till the next Annual General Meeting. The company has received their willingness for re-appointment as auditors of the company and also a Certificate under Section 224 (1B) of the Companies Act, 1956.

**Qualification on the accounts and Boards clarification**

Pursuant to the provisions of sub-section (3) of Section 217 of Companies Act, 1956, qualification of auditors in their report dated 28 June, 2006 on the accounts of the company and Board's clarification on the same are furnished below:

**Qualification in Auditors Report**

The company has made a total investment of Rs. 375,579,087/- in its wholly owned unlisted subsidiary company MosChip Semiconductor Technology, USA (formerly NetMos Technology Inc, USA). The investment is being carried at cost. The difference between the investment amount of Rs. 375,579,087/- and the Networth amount of Rs 98,504,982/- of MosChip Semiconductor Technology, USA, at book value, as on 31 March 2006 has not been charged to the Profit & Loss Account.

**Board's clarification**

The Board is of the opinion that the difference between the investment amount and the net worth amount of MosChip Semiconductor Technology, USA, at book value, as on 31 March 2006 is not a reflection in the diminution

of the value of the investment. The fair market value of MosChip USA, which is based on expected future cash flows over several years and other intangible assets (intellectual property developed and owned by it, the international distribution network, customer base, foundry relationships, etc.), is much higher than its net worth at book value. The book value does not capture the real intrinsic worth of an investment. The decline in fair market value of investment in MosChip USA, if any, is temporary in nature and hence no provision has been made in the books of accounts.

**Conservation of energy, research and development, technology absorption, foreign exchange earnings and outgo**

The particulars as prescribed pursuant to Section 217 (1) (e) of the Companies Act, 1956, read with the Companies (Disclosure of particulars in the report of Board of Directors) Rules, 1988, as amended from time to time, are set out as Annexure - B to this report.

**Particulars of Employees**

The particulars of employees that are required to be disclosed in this report pursuant to the provisions of Section 217 (2A) of the Companies Act, 1956, read with the Companies (Particulars of employees) Rules, 1975, as amended from time to time is set out as Annexure - C to this report.

**Management Discussion & Analysis**

Pursuant to the provisions of Clause 49 of the Listing Agreement, a report on Management Discussion & Analysis is set out as Annexure - D to this report.

**Directors' Responsibility statement as per Section 217 (2AA) of the Companies Act, 1956**

The Board of Directors of MosChip states that:

- a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
- b) they had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year 2005-06 and of the profit or loss of the company for that period;

- c) they had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the Companies Act, 1956 for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities; and
- d) the annual accounts were prepared on the basis of a going concern.

**Corporate Governance**

Pursuant to the provisions of Clause 49 of the Listing Agreement and Section 292A of the Companies Act 1956, a Report on the Corporate Governance, which, *inter alia*, includes the composition and constitution of audit committee, is featuring as a part of Annual Report. Your company will continue to adhere in letter and spirit to the good Corporate Governance policies. Pursuant to the provisions of Clause 49 (vii)(1) of the Listing Agreement, a certificate from a practicing Company Secretary on the compliance of the Clause is set out in Annexure - E to this report.

**CEO'S Declaration**

Pursuant to the provision of Clause 49 (I) (D) (ii) of the Listing Agreement, a declaration by the Chairman and CEO of the Company declaring that all the members of

the Board and the Senior Management Personnel of the Company have affirmed compliance with the Code of Conduct of the Company, is set out as an Annexure - F to this report.

**Acknowledgements**

Your Directors thank the company's bankers, investors and vendors for their unstinted support during the year. Your Directors also appreciate the contribution made by the employees at all levels, who through their hard work, perseverance and competence, are taking the company in the right direction.

Your directors also thank the Government of India, particularly the Customs and Excise Departments, Software Technology Park - Hyderabad, Department of Industrial Policy & Promotion under the Ministry of Commerce & Industry, Department of Company Affairs, Reserve Bank of India, Department of Telecommunications and all other agencies for their support, and wish their continued support in future.

For and on behalf of the Board of Directors

Hyderabad  
31 August 2006

**K. Ramachandra Reddy**  
Chairman & CEO

**ANNEXURE 'A'**

Disclosures pursuant to Para 12 of Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines 1999.

During the year under report the company has five schemes in operation i.e. MosChip Stock Option Plan - 2001, MosChip Stock Option Plan - 2002, MosChip Stock Option Plan - 2004, MosChip Stock Option Plan - 2005(MI) and MosChip Stock Option Plan - 2005(WOS) for issue and grant of stock options to its employees and employees of its wholly owned subsidiary, in accordance with the provisions of SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines 1999.

No Stock Options were granted under MosChip Stock Option Plan - 2005(MI) and MosChip Stock Option Plan - 2005(WOS).

The requisite disclosures of particulars in respect of these Schemes during the year 2005-06 are as under.

|  | Plan<br>2001   | Plan<br>2002 | Plan<br>2004 |
|--|--|--------------|--------------|
| (a) Options granted during the year  | 40,000   | 14,000       | 7,23,000     |
| (b) The Pricing formula  | Market Price as defined in SEBI<br>(ESOS&ESPS) Guidelines,1999 in vogue. |              |              |
| (c) Options Vested   | 1,69,375   | 2,40,776     | 18,750       |
| (d) Options exercised  | 1,08,375   | 1,08,376     | 1,000        |
| (e) The total number of shares arising as a result of<br>exercise of options:  | 1,08,375   | 1,08,376     | 1,000        |
| (f) Options lapsed<br>(As per the plan, options lapsed i.e., unexercised options on<br>account of resignation et., shall become available for<br>future grants under the existing plans) | 53,000   | 72,074       | 72,000       |
| (g) Variation of terms of options  | Nil  | Nil          | Nil          |
| (h) Money realized by exercise of options  | 33,60,381  | 34,07,808    | 42,850       |
| (i) Total number of options in force   | 1,65,625   | 3,89,579     | 7,25,000     |
| (j) Employee wise details of options granted to  |  |              |              |
| (1) Senior Managerial Personal   | Nil  | Nil          | Nil          |
| (2) Any other employee who received a grant in any one<br>year of option amounting to 5% or more of option<br>granted during the year  |  |              |              |
| 1) LV Pavan Kumar Vemparla   | 4,000  | Nil          | Nil          |
| 2) B Ramakrishna Sandilya  | 4,000  | Nil          | Nil          |
| 3) B Venkat Ramesh   | 4,000  | Nil          | Nil          |
| 4) Ekta Taneja   | 4,000  | Nil          | Nil          |
| 5) Rohit Mathur  | 6,000  | Nil          | Nil          |
| 6) R. Jeevan Reddy   | 4,000  | Nil          | Nil          |
| 7) Amit Jitendra Sheth   | 4,000  | Nil          | Nil          |
| 8) M.R. Pallavi  | 4,000  | Nil          | Nil          |
| 9) Raj Kumar Singh   | 6,000  | Nil          | Nil          |
| 10) CA Harish Varma  | Nil  | 6,000        | Nil          |
| 11) M Vamsi Krishna  | Nil  | 4,000        | Nil          |
| 12) A. Ravinder  | Nil  | 4,000        | Nil          |
| 13) Prem Talreja (an employee of Wholly Owned Subsidiary)  | Nil  | Nil          | 2,50,000     |

- |  |     |     |     |
|--|-----|-----|-----|
| <p>(3) identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;</p> | Nil | Nil | Nil |
|--|-----|-----|-----|
- (k) Diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of option calculated in accordance with Accounting Standard 20. Rs. -1.54
- (i) The exercise price at which the company has granted stock options is equal to the Market Price as defined in SEBI (ESOS&ESPS) Guidelines, 1999 in vogue, and hence the Intrinsic Value of the stock options is nil. Therefore, the employee compensation cost based on the Intrinsic Value is also nil. If the company had used the Fair Value of the option using the Black Scholes Method, the employee compensation cost for the year ended 31 March 2006 would have been Rs. 8,983,663, which would have increased the loss from Rs. 65,615,961 to Rs. 74,599,624. The Basic and Diluted Earnings Per Share would be Rs. -1.75 and Rs. -1.75 instead of Rs. -1.54 and Rs.-1.54 respectively, which have been reported in the Balance Sheet.
- (l) Weighted average exercise price and weighted average-fair value of options granted where the exercise price is equal to the Market Price as on the date of grant:  
 Weighted average exercise price: Rs. 37.63  
 Weighted average fair value of options: Rs. 17.29  
 The company does not have any options where the market price was higher/lower than the exercise price.
- (m) The fair value of the options have been computed using the Black Scholes method, where the following assumptions were made:
- a) Risk free interest rate was assumed between 5.6369% and 6.8129%, depending on the timing of grant and vesting period of the option, for the options granted during the year.
  - b) The expected life of the option is taken as the vesting period of the option.
  - c) The expected volatility has been computed using the daily share price movements of 240 trading days prior to the grant date. For annualizing the standard deviation, it is assumed that there are 240 trading days in a year. The standard deviation, a measure of volatility, worked out to 92.67% (on 21 August 2002), 91.48% (on 31 October 2002) 80.30% (on 29 January 2003), 67.24%(on 27 June 2003) and 76.37%(On 19 February 2004), 73.93% (on 26 August 2004), 69.61% (on 18 November 2004) 65.11% (on 31 January 2005), 53.39%(on 30 June 2005), 59.77%(on 23 September 2005) and 58.53% (on 24 January 2006).
  - d) Since the company has been making losses, we have not assumed any dividend payments.
  - e) The Market Price of the shares on the grant dates was as follows: Rs. 31.00 on 21 August 2002, Rs. 23.95 on 31 October 2002, Rs. 26.75 on 29 January 2003, Rs.33.00 on 27 June 2003 being the closing prices on the date of grant; Rs.40.51 on 19 February 2004, being the average of the two weeks high and low price of the share preceding the date of grant of option; and Rs.30.50 on 26 August 2004, Rs.42.85 on 18 November 2004, Rs.44.25 on 31 January 2005, Rs.35.75 on 30 June 2005, Rs.45.60 on 23 September 2005 and Rs.41.50 on 24 January 2006 being the previous days closing price preceding the date of grant of options.

For and behalf of the Board of Directors

Hyderabad  
31 August 2006

**K. Ramachandra Reddy**  
Chairman & CEO

**ANNEXURE 'B'**

Particulars pursuant to Companies (Disclosure of Particulars in the report of the Board of Directors) Rules, 1988

**1. Conservation of Energy**

The Company's operations require low energy consumption. Adequate measures are taken to conserve energy, wherever possible.

**2. Technology Absorption on Form B**

Research & Development (R&D)

**1. Specific areas in which R&D work has been done by the Company**

The company has been working on IP development for HDMI, SATA. In addition to these, the company has also been developing two new products. The company has also developed system software expertise to support the new products. The IP development has been in the areas of HDMI & SATA controllers.

**2. Benefits derived/expected from the R&D work**

Due to the portfolio of IP's that have been developed, the company has been able to leverage and complete development of two products (MCS7840 & MCS7820). These products have come back and worked very well. They are being sampled to customers. Another complex SOC product has been under development and this has been possible because of the system and software expertise buildup by the company over the last year.

**3. Future plan of action**

The company continues to invest in R&D for future products. Some newer bus standards such as PCI Express create opportunities for new products. The company plans to leverage the SOC products with software for various applications. This opens up opportunities for new market segments and helps our customer differentiate by software value addition.

**4. Expenditure on R&D**

The expenditure on R&D is not separately classified, as there is no separate R&D division.

Technology absorption, adaptation and innovation

The requisite information under the head is not applicable to company as there were no imports of any technology.

**3. Foreign Exchange Earnings and Outgo**

**a) Activities relating to exports; initiative taken to increase exports; development of new export markets for products and services; and export plans;**

The Company's products are meant for the international markets. Our products are being designed in by various customers and have started generating revenues for the Company. We expect revenues from licensing of software for these products to gain momentum during the current year.

The Company has also commenced development of custom products where the customer shares part of the development costs. The company has also signed contracts for development and licensing of Intellectual Property. Apart from these, the Company is also planning to tap opportunities in offshore ASIC Development and Software Services for semiconductor companies. The revenues from these initiatives are expected to gain momentum in the coming years.

**b) Foreign exchange earnings and outgo**

(Value in Rs.)

|                           | <b>Year ended<br/>31 March 2006</b> | Year ended<br>31 March 2005 |
|---------------------------|-------------------------------------|-----------------------------|
| Foreign Exchange earnings | <b>49,898,022</b>                   | 23,289,723                  |
| Foreign Exchange outgo    | <b>63,217,720</b>                   | 45,852,969                  |

For and behalf of the Board of Directors

Hyderabad  
31 August 2006

**K. Ramachandra Reddy**  
Chairman & CEO

**ANNEXURE 'C'**

| Sl.No.  | Name                 | Designation/<br>nature of Duty | Qualifications             | Exp.<br>(Yrs.) | Date of<br>Joining | Nature of<br>Employ-<br>ment           | Gross<br>Remune-<br>ration | Age<br>(Yrs.) | Previous<br>Employment/<br>position held                               |
|---|----------------------|--------------------------------|----------------------------|----------------|--------------------|--|----------------------------|---------------|--|
| <b>(i) Employed throughout the Financial Year</b>     |                      |                                |                            |                |                    |  |                            |               |  |
| 1   | K. Ramachandra Reddy | CEO/Chairman                   | MSEE<br>Madison,<br>USA    | 29             | 01.06.2000         | Director                               | 26,66,032                  | 57            | Startech<br>Semiconductor,<br>USA/CEO                                  |
| 2   | C. Dayakar Reddy     | Managing<br>Director           | MSEE<br>SJSU<br>California | 21             | 01.06.2000         | Director                               | 26,66,032                  | 44            | National<br>Semiconductor,<br>USA/Director -<br>Systems<br>Engineering |
| <b>(ii) Employed for a part of the Financial Year</b> |                      |                                |                            |                |                    |  |                            |               |  |
| 1   | Dinendra<br>K. Reddy | GM-ASIC<br>Engineering         | B.E.                       | 11             | 01.07.2004         | Engineering<br>Design &<br>Development | 27,46,254                  | 32            | MosChip<br>USA/Design<br>Manager                                       |

Note : Gross remuneration includes salary and perquisites

For and behalf of the Board of Directors

Hyderabad  
31 August 2006

**K. Ramachandra Reddy**  
Chairman & CEO

## ANNEXURE 'D'

**MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

MosChip Semiconductor Technology Limited (MosChip India) is a fabless semiconductor company with its headquarters in Hyderabad, India. The company specializes in development, marketing & sale of Application Specific Integrated Circuits (ASIC's) & SOC (System On a Chip) for PC Peripheral, Data Communication & Consumer Electronic segments. In this report, "MosChip Group", "Group", "we", "us" and "our" each refers to MosChip India and also its wholly owned subsidiary MosChip Semiconductor Technology, USA (MosChip USA), which was formerly known as NetMos Technology Incorporated, USA.

The financial statements have been prepared in compliance with the requirements of the Companies Act 1956 and the Generally Accepted Accounting Principles in India. The management of MosChip accepts responsibility for the integrity and objectivity of these financial statements, as well as, for various estimates and judgments used therein.

In addition to the historical information, this report contains certain forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from the results anticipated in these forward-looking statements as a result of certain factors including those set forth under the sub-heading "Risks and Concerns." Forward looking statements can be identified by the use of forward-looking words, such as "may," "could," "expect," "believe," "plan," "anticipate," "continue," "likely," or other similar words.

**1. Overview**

MosChip is a fabless semiconductor company from India with focus on products, and leveraging its engineering skills to develop custom products and IP development.

As a fabless semiconductor company MosChip designs products and outsources the manufacturing of products. The product design and ASIC software development is done by MosChip. The software is licensed to MosChip USA, which subcontracts the manufacturing to ASIC Service Providers and sells the chip through its distribution network worldwide.

The entire revenue from sale of products is thus in MosChip USA. MosChip USA pays a license fee to

MosChip, which fee is linked to the gross margin on the products designed and developed by MosChip.

MosChip Group's product focus has been on data connectivity between computers and peripherals & other consumer electronic devices. The new product launches have been focused on the opportunity thrown up by the convergence of PC and consumer electronic devices and the growing need for Internet Security and networking. Apart from developing its own products, MosChip also develops custom products and IP for its customers and has plans to tap opportunities in offshore software services for semiconductor companies.

**2. Industry**

According to the Semiconductor Industry Association (SIA), worldwide sales of semiconductors set a new record at \$227.5 billion in 2005 an increase of 6.8 percent from the \$213 billion reported in 2004.

Despite record energy prices and an unprecedented series of natural disasters, worldwide demand for semiconductors increased in all end markets. Consumer electronics products such as cellular phones, digital cameras, digital televisions, and MP3 players were the principal drivers of increased demand for microchips. Personal computer sales, the largest single market for semiconductors, remained strong. The fastest-growing end-market segment is cellular telephones - especially third-generation (3G) phones. It is believed that approximately one billion cell phones will be sold worldwide in 2006. With an average semiconductor content of \$41 per unit, this segment is now second only to the personal computers in terms of total chip consumption.

The semiconductor sales data reflect the continuing shift of electronics manufacturing operations to the Asia-Pacific region in general and to China in particular. This region represented 46.6 percent of the global market for microchips in 2006. The largest share of the market is in China, which has become the world's leading manufacturer of electronics products.

The SIA had released an updated forecast in June 2006, projecting worldwide sales of semiconductors to grow by 9.8 percent to \$249.6 billion in 2006. The revised forecast also includes more optimistic projections for industry sales from 2006 through 2009. According to the SIA, the industry will grow by 11

percent in 2007, 12 percent in 2008 and 4 percent in 2009. If the latest forecast materializes, worldwide semiconductor sales will reach \$323 billion in 2009. The total sales for the first half of the year were at \$118 billion, up 8.3 percent over the first half of 2005.

MosChip Group's current focus is on PCI and USB product categories.

**PCI**

Compared to the progress made every year in other areas of computer technology such as processors and video cards, computer Input/Output (I/O) system technology has not changed much. Since the introduction of the PCI bus in the early 90's, very little has changed the way data is handled inside the computer.

Hard drives, peripherals, LAN cards, sound cards, USB and firewall all pass data through the same I/O system as the first 486 PC; the PCI bus running at 33 Megahertz and shifting 133 Mega Bytes per second of data. With the ever-growing need for higher bandwidth, Intel, in partnership with several other companies, which include the likes of IBM, Dell, Compaq, HP and Microsoft have recently introduced the PCI-Express standard for PC I/O. PCI-Express was approved in July 2002 and was recently released on motherboard products in 2004.

As of 2006, PCI Express appears to be well on its way to becoming the new backplane standard in personal computers. Almost all of the high end graphics cards being released in 2006 from ATI and NVIDIA use PCI Express. Most new gigabit Ethernet chips and some 802.11 wireless chips also use PCI Express. Other hardware such as RAID controllers and network cards are also starting to make the switch. PCI Express is nearing completion of version 2.0, and should be available in version 2.0 by early 2007.

**Universal Serial Bus (USB)**

USB is a new external bus standard that was introduced in 1996 and became popular in 1998 and has been the most successful interface in the history of PCs. Today, USB connections can be found in a range of devices, from PC cameras to scanners, printers, digital camcorders and digital modems.

USB 1.1 standard, which supports data transfer rates up to 12 Megabits per second, has difficulty in handling high-speed peripherals such as external high capacity

storage or high-end PC cameras, which have capability to move large chunks of data at high speed. The second difficulty that USB 1.1 enabled PC might encounter is in handling multiple USB peripherals.

USB 2.0 standard, which supports 480 Megabits per second, is an improvement over USB 1.1 in terms of data transfer rate. The USB 2.0 was introduced in May 2002, when Intel launched three USB 2.0 enabled core logic chipsets. The USB 2.0 market has increased at a good pace, as most PC and peripheral vendors now demand PCs installed with USB 2.0.

With over three billion devices using standard USB connectivity, USB has become the de-facto standard for connecting peripherals. USB can connect peripherals such as mouse, keyboards, gamepads and joysticks, scanners, digital cameras, printers, external storage, networking components, etc.

USB OTG (On-The-Go) has also emerged to meet the challenge for connecting devices together without the PC. USB OTG will enable consumers to print photos directly from a camera, directly email pictures from a still camera using a mobile phone, print directly from a PDA, etc.

Wireless USB is the hottest current news in the USB world. Wireless USB will allow the USB standard to operate wirelessly. It promises to have an effect particularly on those portable USB-enabled devices that make frequent ad-hoc connections such as portable digital audio players, digital still cameras and digital camcorders.

**3. Opportunities**

**PCI**

The emergence of the PCI Express is throwing up new market opportunities as the market migrates to the new standard. MosChip is working on a PCI Express product that is likely to be released in 2007.

**USB**

This is a fast growing market with tremendous opportunity as every PC that is shipped in 2006 had USB connectivity. USB On-the-go is also emerging to meet the challenge for connecting devices together without the PC.

**Outsourcing**

American and European companies, in a bid to cut to costs have been looking to outsource design,

verification and software aspects of the chip design process. A large pool of well-trained, low-cost engineering talent has been driving this trend, which is expected to gain momentum in the semiconductor industry in particular.

#### 4. Threats

Delays in launch of new products, customer acceptance could adversely affect the Group's growth.

Development of semiconductor products and technologies is a highly complex process, and any failure to develop new technologies in a timely manner would adversely affect the Group's business.

Loss of key hardware and software professionals could adversely affect the Group's ability to support existing products and delay new products.

Unforeseen changes in technology / markets could render company's products obsolete.

Any changes in the international markets and government policies may affect the Company's future performance.

#### 5. Outlook

The immediate outlook for the global semiconductor industry is positive. We expect sales from PCI products to remain stable as the need for UARTs is stable and many motherboards have dropped the UART and Printer Port support. PCI products have also been designed in by OEMs into new applications such as point-of-sale machines, game consoles and HDTV tuner modules.

The USB products have also won OEM designs into various applications such as laptop and industrial docking stations. The new products MCS 7840 and MCS 7820 have potential for design wins in USB to Serial products and even Ethernet to Serial applications.

With new OEM design wins for many of the products, consolidated revenues from product sales are expected to grow significantly during the current financial year.

The Company has also demonstrated its engineering capabilities by developing custom products for a customer and successfully developing IP for its customers. The Company expects to increase revenues from the services business during the current

year as additional space is being taken up to increase the seating capacity.

#### 6. Risks and concerns

The following important factors could affect our future results of operations.

***Semiconductor products are difficult to manufacture without defects and the existence of defects in the manufactured products could result in an increase in costs and delays in the availability of products.***

The manufacture of semiconductors is a complex process and it is often difficult for semiconductor foundries to produce semiconductors free of defects. The ability to manufacture products of acceptable quality depends both on product design and manufacturing process technology. Since defective products can be caused by either design or manufacturing difficulties, identifying quality problems can occur only by analysing and testing semiconductors in a system after they have been manufactured. Failure to achieve defect-free products due to their complexity may result in an increase in the costs and delay in the availability of MosChip Group's products.

***Because of the complex nature of semiconductor designs and of the associated manufacturing process and the rapid evolution of the customers' product designs, MosChip Group may not be able to develop new products or product enhancements in a timely manner, which could decrease customer demand for its products and reduce revenues.***

The development of semiconductors is highly complex. These complexities require that the Company employ advanced designs and manufacturing processes that are unproven. The Group has experienced increased development time and delays in introducing new products that resulted in significantly less revenue than originally expected for those products. The Group will not always succeed in developing new products or product enhancements nor will the Group always do so in a timely manner.

Successful development and timely introduction of new enhanced products depends on a number of other factors, including:

- Accurate prediction of customer requirements and evolving industry standards;

- Use of advanced foundry processes and achievement of high manufacturing yields;
- Timely completion and introduction of new product designs; and
- Market acceptance of new products.

If the Group is not able to successfully develop and introduce new products in a timely manner, the Group's results of operations will be adversely affected.

***Dependence on a sole source, third party manufacturers for its products exposes MosChip Group to shortages based on capacity allocation.***

The Company does not own or operate a semiconductor fabrication facility and does not have the resources to manufacture its products internally. The ASIC software is licensed to MosChip USA, which, relies on third party ASIC Service Providers for wafer fabrication, assembly and testing of its products. MosChip USA's requirements represent only a small portion of the total production capacity of its contract manufacturers. MosChip USA does not have long-term supply contracts with its third-party manufacturers so they are not obliged to supply products for any specific period, in any specific quantity or at any specific price, except as may be provided in a particular purchase order. MosChip USA tries not to maintain substantial inventories of products, but needs to order products long before it has firm purchase orders for those products, which could result in excess inventory or shortages. If MosChip USA is unable to obtain its products from manufacturers on schedule, its ability to satisfy customer demand will be harmed, and revenue from the sale may be lost or delayed.

***Manufacturers of semiconductor products periodically discontinue manufacturing processes, which could make MosChip Group's products unavailable from current suppliers.***

Semiconductor manufacturing technologies change rapidly and manufacturers typically discontinue older manufacturing processes in favour of newer ones. Once a manufacturer makes a decision to retire a manufacturing process, notice is generally given to its customers. Customers will then either retire the affected part or develop a new version of the part that can be manufactured on the newer process. In the event a manufacturing process is discontinued, the Group's products could become unavailable from

current suppliers. Additionally, migrating to a new, more advanced process requires significant expenditures for research and development.

***Future success depends upon the continued services of key personnel, many of whom would be difficult to replace and the loss of one or more of these employees could seriously harm the Company's business by delaying product development***

The Company's future success depends upon the continued services of its executive officers, key hardware and software engineers, and sales, marketing and support personnel, many of whom would be difficult to replace. The loss of one or more of these employees could seriously harm the Company's business. In addition, because of the highly technical nature of its business, the loss of key engineering personnel could delay product introductions and significantly impair the Company's ability to successfully create future products. The Company believes that its success depends, in large part, upon its ability to identify, attract and retain qualified hardware and software engineers, and sales, marketing, finance and managerial personnel. Competition for talented personnel is intense and the Company may not be able to retain its key personnel or identify, or attract or retain other qualified personnel in the future. If the Company does not succeed in hiring and retaining employees with appropriate qualifications, its product development efforts, revenues and business could be seriously harmed.

***Failure to meet the export obligation may subject the Company to a penalty***

The Company's STPI unit must achieve a minimum export obligation of five times of the CIF value of its capital equipment imports within a period of five years from commencement of commercial operations. The unit also has an obligation to earn minimum of 20 percent Net Foreign Exchange Earnings (NFEE) both annually and cumulatively over a period of five years from commencement of commercial production.

The Company's STPI unit is in deficit in its NFEE to the tune of Rs. 0.15 crores and export performance to the tune of Rs. 19.94 crores as on 31 March 2006. Failure to meet the NFEE or the export performance could subject the Company to a penalty of one thousand rupees or five times the value of goods in respect of which contravention is made.

The STPI unit of the Company completed its initial term of registration of five years with STPI and renewed the license for another five years effective from 01 July 2005 to 30 June 2010.

***MosChip Group does not have long-term commitments from its customers, and plans purchases based on estimates of customer demand, which may be inaccurate.***

MosChip USA's sales are made on the basis of purchase orders rather than long term-purchase commitments. Customers may cancel or defer purchase orders at any time. This process requires MosChip USA to make multiple demand-forecast assumptions, each of which may introduce error into its estimates. If MosChip USA overestimates demand, it may purchase products that it may not be able to sell. As a result, the Company would have excess inventory, which would negatively affect the operating results. Conversely, if MosChip USA underestimates demand, it would forego revenue opportunities, lose market share and damage customer relationships.

***Because of long product development process and sales cycle, MosChip Group may incur substantial expenses before it earns associated revenues and may not ultimately sell as many units of its products as forecasted.***

MosChip Group develops products based on anticipated market and customer requirements and incurs substantial product development expenditures prior to generating associated revenues. The customers typically perform numerous tests and extensively evaluate MosChip Group's products before incorporating them into their systems. The time required for testing, evaluation and design of MosChip Group's products, into a customer's equipment can take up to six months or more. However, even when the Group achieves design win, the customer may never ship systems incorporating the Group's products. Because of this lengthy development and sales cycle, the Group will experience delays between the time it incurs expenditures for research and development, sales and marketing, inventory levels and the time it generates revenues, if any, from these expenditures. Additionally, if actual sales volumes for a particular product are substantially less than originally forecasted, the Group may experience large write-offs of capitalised license fees, product masks and prepaid royalties that would

adversely affect the operating results.

***MosChip Group may not be able to respond to the rapid technological changes in the market in which it competes, or it may not be able to comply with industry standards in the future making its products less desirable or obsolete.***

The markets in which the Group competes or seeks to compete are subject to rapid technological change, frequent new product introductions, changing customer requirements for new products and features, and evolving industry standards. The introduction of new technologies and the emergence of new industry standards could render the Group's products less desirable or obsolete, which could harm its business.

***MosChip Group's products and software could contain defects, which could reduce sales of those products or result in claims against the Group.***

Despite testing both by the Group's customers and the Group, errors or performance problems may be found in existing or new semiconductors and software. This could result in a delay in the recognition or loss of revenues, loss of market share or failure to achieve market acceptance. These defects may cause the Group to incur significant warranty, support and repair costs. They could also divert the attention of its engineering personnel from product development efforts and harm relationships with its customers. The occurrence of these problems could result in the delay or loss of market acceptance of the Group's semiconductors and would likely harm its business.

***Others may bring infringement actions against MosChip Group that could be time-consuming and expensive to defend.***

The Group may become subject to claims involving patents and other property rights. Intellectual property claims would subject the Group to significant liability claims for damages and invalidate its proprietary rights. In addition, intellectual property claims may be brought against customers that incorporate its products in the design of their own products. These claims, regardless of their success or merit and regardless of whether the Group is named as a defendant in a lawsuit, would likely be time consuming and expensive to resolve and would divert the time and attention of the Management and technical personnel. Any future intellectual property litigation or claims also could force

the Group to do one or more of the following:

- stop selling products using technology that contains the allegedly infringing intellectual property;
- attempt to obtain a license to the relevant intellectual property, which license may not be available on reasonable terms or at all;
- attempt to redesign those products that contain the allegedly infringing intellectual property; and
- pay damages for past infringement claims that are determined to be valid or which are arrived at in settlement of such litigation or threatened litigation.

If the Group is forced to take any of the foregoing actions, it may be unable to manufacture and sell its products, which could seriously harm its business. In addition, the Group may not be able to develop, license or acquire non-infringing technology under reasonable terms. These developments could result in an inability to compete for customers or could adversely affect the Group's ability to increase its earnings.

***Failure to manage growth and expansion effectively could adversely affect MosChip Group's ability to increase its business and the results of operation.***

The Group's ability to successfully market and sell its products in a rapidly evolving market requires effective planning and management processes. The Group continues to increase the scope of its operations domestically and internationally and has increased its headcount substantially. The Group's past growth, and its expected future growth, places a significant strain on its management systems and its resources including the financial and managerial controls, reporting systems and procedures. The Company must also manage multiple relationships with customers, contract manufacturers and other third parties. Moreover, there may be unexpected costs. The Group's systems, procedures or controls may not be adequate to support its operations and it may not be able to expand quickly enough to exploit potential market opportunities.

***The cyclical nature of the semiconductor industry may lead to significant variances in the demand for MosChip Group's products and could harm its operations.***

In the past, the semiconductor industry has been

characterized by significant downturns and wide fluctuations in supply and demand. Also, during this time, the industry has experienced significant fluctuations in anticipation of changes in general economic conditions, including economic conditions in Asia, Europe and North America. The cyclical nature of the semiconductor industry has led to significant variances in product demand and production capacity. It has also accelerated the reduction of average selling prices per unit. The Group may experience periodic fluctuations in its future financial results because of changes in industry-wide conditions.

#### 7. Internal control systems

The Company has formulated effective internal control systems and implemented the same strictly to ensure that the assets and interests of the Company are safeguarded and to determine the accuracy and reliability of accounting data. The Company has an internal audit system and its functions are to ensure that systems are designed and implemented with adequate internal controls. The Company's control methodology is commensurate with the size of operations, the transactions that are executed, and the assets that must be safeguarded and deployed in accordance with the Company's policies. An Audit Committee, headed by a non-executive independent Director, periodically reviews the audit information/ observation and all significant issues are brought to the attention of the committee.

#### 8. Human resources

The Company currently employs a total of 111 employees. All the employees are located at Hyderabad, India. Of these 89 are technical employees and the rest are marketing and support staff.

MosChip believes that the key to its success is in its ability to hire and retain employees with appropriate qualifications and competencies. The Company's human resource management works towards this end goal and strives to provide the right work atmosphere, opportunities for learning and personal development to all employees, and appraisal and reward mechanisms to encourage excellence in performance.

The Company regularly ensures that the compensation packages are in line with industry levels and grants stock options to retain talent.

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## COMMENTARY ON THE FINANCIAL STATEMENTS OF MOSCHIP INDIA

### Balance Sheet

#### 1. Share Capital

The Company has only one class of shares. During the year under review, the Company has allotted 9,326,955 equity shares of Rs. 10 each. The details of the allotment of shares during the year are provided elsewhere in the Directors' Report.

As a result, the total paid-up equity share capital of the company has increased from 34,043,062 shares during the previous year to 43,370,017 shares in the year under review.

There are no calls-in-arrears.

#### 2. Share Application Money

Share application money primarily consists of the excess amount received from and repayable to non-resident/foreign investors against the shares allotted to them. It also includes an amount of Rs. 40,125 received upon exercise of stock options, pending allotment of 1,500 equity shares of Rs. 10 each at a premium of Rs.16.75 each.

#### 3. Reserves and Surplus

##### *Capital Reserve*

The capital reserve of Rs. 1,250,000 is on account of investment subsidy received from Government of Andhra Pradesh, of which Rs. 250,000 was received during the year.

##### *Securities Premium*

The securities premium account increased by Rs. 231,897,563 during the financial year upon allotment of 9,326,955 equity shares of Rs. 10 each as per details provided elsewhere in the Directors' Report.

#### 4. Fixed Assets

During the year the Company's Gross Block of fixed assets increased by 25.8% from Rs. 116,997,027 to Rs. 147,211,119.

#### 5. Investments

The long-term investments of the Company include 19,192,404 shares of MosChip Semiconductor

Technology USA (a company incorporated in USA). Of these, 16,131,180 shares were acquired in consideration of 8,325,770 equity shares of Rs.10 each of the Company at a premium of Rs.27.14 per share. The company has made an additional investment of Rs. 66,359,989 during the year to acquire additional 3,061,224 shares. The Company owns the entire equity capital of MosChip Semiconductor Technology USA.

#### 6. Interest Accrued on Deposits

Interest accrued on deposits represents the interest accrued but not due on fixed deposits with banks.

#### 7. Cash and Bank Balances

The bank balances in India include both Rupee accounts and Foreign Currency Accounts. Fixed Deposits of Rs. 618,040 are given as security for issue of bank guarantees.

#### 8. Sundry Debtors

Sundry Debtors of Rs. 8,068,634 includes Rs. 4,577,119 due from its wholly owned subsidiary MosChip Semiconductor Technology, USA and Rs. 3,491,515 due from ESS Technology Inc., USA and the Company has received the same after 31 March 2006.

#### 9. Loans and Advances

##### **Deposits**

Deposits represent deposits towards electricity, telephone, rent, etc.

##### **Loans to subsidiary**

Loans to subsidiary represents outstanding amount of US\$ 400,000 given to the wholly owned subsidiary, MosChip Semiconductor Technology, USA. The loan is repayable at the end of 3 years from the date of disbursement of loan. Interest at the rate of LIBOR plus 200 basis points on the outstanding loan amount is payable quarterly.

##### **Advance to MosChip Employees' Trust**

Advance to MosChip Employees' Trust of Rs. 3,903,000 is the balance amount of interest free loan given to the Trust as a part of the ESOP scheme of the Company.

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**Other advances**

Other advances recoverable in cash, kind or value to be received are primarily towards prepayments for value to be received.

**Prepaid Income Tax**

Prepaid Income Tax represents the refund due from Income Tax Department for the taxes deducted at source by others from the amounts payable to the Company.

**10. Current Liabilities**

Sundry Creditors (Others) of Rs. 2,301,759 include liabilities for GDR Issue expenses amounting to Rs. 1,488,410 and Rs. 260,272 to the wholly owned subsidiary. These amounts have been paid subsequently.

**11. Provisions**

Provision of Rs. 3,941,477 includes provision for Leave Encashment amounting to Rs. 1,768,281 and Rs. 2,173,196 towards Gratuity.

No provision has been made for Income Tax as the book profit as well as the Taxable Income as per the Income Tax Act is resulting in a loss.

**12. Miscellaneous Expenditure**

The Miscellaneous Expenditure, which consists of GDR issue expenses, is being amortized over a period of 5 years in accordance with the Accounting Policy adopted by the Company.

**13. Guarantees**

The Company has outstanding guarantees for various purposes amounting to Rs. 3,143,040 (previous year Rs. 3,126,250) for the year ended 31 March 2006.

These guarantees are in the nature of performance guarantees relating to export obligations.

**PROFIT AND LOSS ACCOUNT****14. Sales Revenue**

The sales revenue for the year under review amounted to Rs. 49,898,022 as against Rs. 23,289,723 during the previous year. Of this Rs. 26,520,751 was on account of software development charges billed to the wholly owned subsidiary.

**15. Non Operating Income**

Non-operating income consists of interest on deposits with banks & others and profit on sale of current investments.

**16. Expenditure**

The expenditure for the year under review amounted to Rs. 105,752,578 as against Rs. 99,435,931 during the previous year.

**17. Depreciation**

During the year, the company charged depreciation at 100% in respect of assets costing less than Rs. 5,000 each amounting to Rs. 116,948.

**18. Loss for the year**

The loss for the year is Rs. 65,615,961 compared to the previous year loss of Rs. 97,024,496 before providing for the tax liability.

**19. Earnings Per Share**

The Basic and Diluted Earnings per Share computed in accordance with the Accounting Standard 20 issued by the Institute of Chartered Accountants of India is Rs. -1.54. More details on computation of EPS are given in Note 5 of Notes on Accounts.

**20. Foreign Exchange Difference**

An amount of Rs. 1,479,658 has been considered as unrealized loss and an amount of Rs. 914,732 as realized loss on foreign exchange fluctuation during the current year on account of foreign exchange rate differences arising due to timing differences between accrual of income/expense and receipt/payment of the same.

**21. Related Party Transactions**

The transactions with the related parties other than employees are given in Note 7 of Notes on Accounts.

All the transactions are on commercial basis and are not detrimental to the interests of the Company.

None of the employees are related to any of the directors.

**22. Leases**

The Company has operating leases for Office Buildings. The rental expenses for operating leases for the year

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ended 31 March 2006 amounted to Rs. 2,399,557. The Company has the right to terminate the lease agreement for Hyderabad office building after completion of 3 years from the date of commencement of lease.

### **23. Employees Stock Options**

The company has set up a Trust called "MosChip Employee Trust" to manage Stock Option plans introduced by the company to its employees. Towards this the company has funded the trust with Rs. 6,005,000 by way of an interest free loan. Since the establishment of trust is prior to the IPO, the Guidelines of SEBI on ESOPs and ESPS are not applicable to this scheme.

The Company has Five more Employee Stock Option Schemes namely MosChip Stock Option Plan 2001, MosChip Stock Option Plan 2002, MosChip Stock

Option Plan 2004, MosChip Stock Option Plan 2005 (MI) and MosChip Stock Option Plan 2005 (WOS) with 300,000 equity shares, 700,000 equity shares, 1,000,000 equity shares, 500,000 equity shares and 500,000 equity shares respectively, in accordance with the Employee Stock Option Scheme and Employee Stock Purchase Guidelines 1999 issued by SEBI.

Details such as options granted, exercised and outstanding under each of the plans are given in Note 4 of Notes on Accounts and Annexure - A to Directors Report.

For and on behalf of the Board of Directors

Hyderabad  
31 August 2006

**K. Ramachandra Reddy**  
Chairman & CEO

## CORPORATE GOVERNANCE REPORT

**1. Company's Philosophy**

MosChip is committed to pursue the principles of good corporate governance in order to be a good corporate citizen of India and also to keep abreast the shareholders of the company with day-to-day affairs of the Company in the best possible manner.

Executive directors. Non-Executive directors comprise 66.66% of the Board.

**a) Composition and category of directors as on 31 March 2006****Table - 1**

| Category                                     | No. of Directors |
|--|------------------|
| Executive Directors<br>(Promoter Directors ) | 2                |
| Non-Executive<br>Independent Directors       | 4                |
| Total  | 6                |

**2. Board of Directors**

The Company has an Executive Chairman. The Chairman along with Managing Director manages the day-to-day affairs of the Company. The Board of the Company has a combination of Executive and Non-

**b) Attendance of each director at the Board meetings held during the year 2005- 06 and at the last Annual General Meeting****Table - 2**

| Name of the Director     | Meetings held during the tenure | Meetings Attended | Last AGM |
|--------------------------|---------------------------------|-------------------|----------|
| Mr. K. Ramachandra Reddy | 9                               | 6                 | Yes      |
| Mr. C. Dayakar Reddy     | 9                               | 7                 | Yes      |
| Mr. Alur Ramesh          | 9                               | 8                 | No       |
| Prof. Vijaya Chandru     | 9                               | Nil               | No       |
| Mr. G. Prasad            | 9                               | 6                 | Yes      |
| Dr. M. Rammohan Rao      | 9                               | 6                 | No       |
| Mr.K.E.C.Raja Kumar*     | 9                               | 1                 | No       |

\* Resigned on 23/02/2006.

**c) No. of other Boards/Board Committees in which the Directors were either Member or Chairman during the year 2005-06****Table - 3**

| Name of the Director     | Boards   |        | Committees |        |
|--------------------------|----------|--------|------------|--------|
|                          | Chairman | Member | Chairman   | Member |
| Mr. K. Ramachandra Reddy | Nil      | Nil    | Nil        | Nil    |
| Mr. C. Dayakar Reddy     | Nil      | Nil    | Nil        | Nil    |
| Mr. Alur Ramesh          | Nil      | 10     | Nil        | Nil    |
| Prof. Vijaya Chandru     | 1        | 3      | Nil        | Nil    |
| Dr. M. Rammohan Rao      | Nil      | 3      | Nil        | 2      |
| Mr. G. Prasad            | Nil      | 2      | Nil        | Nil    |
| Mr. K.E.C. Raja Kumar*   | Nil      | 5      | Nil        | Nil    |

\* Resigned on 23/02/2006.

d) **No. of Board Meetings held and dates on which they were held during 2005-06**

Table - 4

| Quarter      | No. of Meetings | Dates on which held          |
|--------------|-----------------|------------------------------|
| Apr - June   | 3               | 13/04/05, 26/04/05, 30/06/05 |
| Jul - Sep    | 3               | 14/07/05, 31/08/05, 30/09/05 |
| Oct - Dec    | 2               | 09/10/05, 20/12/05           |
| Jan - Mar    | 1               | 24/01/06                     |
| <b>Total</b> | <b>9</b>        |                              |

None of the directors on the Board are members in more than ten Committees and they do not act as Chairman of more than five Committees across all companies in which they are directors.

None of the Non-Executive directors have any pecuniary relationship or transactions with the Company.

**3. Audit Committee**

The Audit Committee was formed on 19 January 2001 with qualified and independent members of the Board of Directors of the Company. The Company Secretary acts as Secretary of the Committee. This Committee was last re-constituted on 26 August 2004.

**a) Brief description of terms of reference**

The terms of reference of the Audit Committee is in conformity with the provisions of paragraphs C & D in Sub-clause II of Clause 49 of the Listing Agreements entered with The Stock Exchange, Mumbai, which inter alia, includes the following:

- Overseeing the Company's financial reporting process and ensuring correct, adequate and credible disclosure of financial information.
- Recommending appointment and removal of external auditors and fixing of their fees.
- Reviewing with management the annual financial statements with special emphasis on accounting policies and practices, compliances with accounting standards and other legal requirements concerning financial statements.
- Reviewing the adequacy of the Audit and compliance functioning including their policies, procedures, techniques and other regulatory requirements.

- Reviewing the adequacy of internal control systems and significant audit findings.

**b) Composition, name of members and Chairperson**

The Audit Committee comprises of the following directors

1. Mr.G.Prasad                    -- Chairman
2. Mr.A.Ramesh                -- Member
3. Prof Vijaya Chandru      -- Member
4. Dr.M.Rammohan Rao      -- Member

**c) Meetings and attendance during the year 2005-06**

Four meetings of the Audit Committee were held during the year 2005-06. Mr. A. Ramesh and Dr. M. Rammohan Rao attended all four meetings, Mr. G. Prasad attended two meetings and Prof. Vijaya Chandru has not attended any meeting.

**4. Remuneration Committee**

**a) Brief description of terms of reference**

To determine on behalf of Board and Shareholders, the Company's policy on specific remuneration packages for Executive directors and Non-Executive directors, including pension rights and any compensation payment. The Committee was last re-constituted on 26 August 2004.

**b) Composition, name of members and Chairperson**

The Remuneration Committee comprises of the following directors

- Mr. G.Prasad                    -- Chairman
- Mr. A. Ramesh                -- Member
- Prof. Vijaya Chandru      -- Member
- Dr.M.Rammohan Rao      -- Member

**c) Attendance during the year 2005-06**

One meeting of the Remuneration Committee was held during the year 2005-06 to revise the remuneration package of CEO and Managing Director. Mr. A. Ramesh and Dr. M. Rammohan Rao attended the meeting while Mr. G. Prasad and Prof. Vijaya Chandru were granted leave of absence. Besides, sitting fee for attending Board and Committee meetings, no special compensation to Non-Executive directors was paid during the year 2005-06.

**d) Details of remuneration to all the directors****Table - 5**

| Sl. No. | Name                 | Designation | Salary in Rs. | Performance incentives Rs. | Commission | Total in Rs. | Notice period | Severance Fee in Rs. | Sitting Fee in Rs. | Stock Options |
|---------|----------------------|-------------|---------------|----------------------------|------------|--------------|---------------|----------------------|--------------------|---------------|
| 01      | K.Ramachandra Reddy  | Chairman    | 2,666,032     | Nil                        | Nil        | 2,666,032    | NA            | NA                   | Nil                | Nil           |
| 02      | C.Dayakar Reddy      | M.D.        | 2,666,032     | Nil                        | Nil        | 2,666,032    | NA            | NA                   | Nil                | Nil           |
| 03      | A. Ramesh            | Director    | NA            | NA                         | NA         | NA           | NA            | NA                   | 13,500             | Nil           |
| 04      | G.Prasad             | Director    | NA            | NA                         | NA         | NA           | NA            | NA                   | 9,000              | Nil           |
| 05      | Prof. Vijaya Chandru | Director    | NA            | NA                         | NA         | NA           | NA            | NA                   | Nil                | Nil           |
| 06      | Dr. M. Rammohan Rao  | Director    | NA            | NA                         | NA         | NA           | NA            | NA                   | 11,500             | Nil           |
| 07      | K.E.C.Raja Kumar     | Director    | N.A           | N.A                        | N.A        | N.A          | N.A           | N.A                  | 1,000              | Nil           |

**5. Shareholders / Investors Grievance Committee**

This Committee was last re-constituted on on 26 August 2004.

**a) Terms of reference**

The Committee shall specifically look into the redressing of shareholder and investor complaints like transfer of shares, non-receipt of balance-sheet, non-receipt of declared dividend etc.

**b) Composition, name of members and Chairperson**

The Committee comprises of the following Non-Executive directors

|                      |    |          |
|----------------------|----|----------|
| Mr. Alur Ramesh      | -- | Chairman |
| Mr. G.Prasad         | -- | Member   |
| Prof. Vijaya Chandru | -- | Member   |
| Dr. M. Rammohan Rao  | -- | Member   |

**c) Name and Designation of Compliance Officer**

Mr. Raj Kumar Singh — Company Secretary

**d) No. of Shareholders Complaints received during the year 2005-06**

During the year 2005-06, in total 11 Nos. of complaints / letters were received from the investors and all were disposed of during the year. Please see the Table-6 given below

**e) No. of complaints not solved to the satisfaction of shareholders**

There was no complaint that was not solved to the satisfaction of shareholders.

**f) No. of shares pending transfer:**

All shares which were received for transfer during the year were transferred and no transfer was pending.

**Details of Shareholders complaints during the year 2005-06****Table - 6**

| Sl.No | Nature of Complaint              | Received  | Disposed  | Pending    |
|-------|----------------------------------|-----------|-----------|------------|
| 01    | Change / Correction of address   | 1         | 1         | Nil        |
| 02    | Share Certificates for splitting | 8         | 8         | Nil        |
| 03    | Non-receipt of Dividend warrants | 1         | 1         | Nil        |
| 04    | Others                           | 1         | 1         | Nil        |
|       | <b>TOTAL</b>                     | <b>11</b> | <b>11</b> | <b>Nil</b> |

**6. General Body Meetings****a) Details of last three AGMs**

The information about the last three general body meetings is given in Table-7 as shown below:

**Table - 7**

| Annual General Meeting | Venue  | Time & Date                     |
|------------------------|--|---------------------------------|
| Fourth                 | 8-2-685/1/1, Road No.12,<br>Banjara Hills, Hyderabad - 500 034 | 30 September 2003 at 10.30 hrs. |
| Fifth                  | 8-2-685/1/1, Road No.12,<br>Banjara Hills, Hyderabad - 500 034 | 30 September 2004 at 10.30 hrs. |
| Sixth                  | 8-2-685/1/1, Road No.12,<br>Banjara Hills, Hyderabad - 500 034 | 30 September 2005 at 10.30 hrs. |

**b) Special Resolutions passed through postal ballot system during the last year.**

Special resolutions for raising of limits of FIs and NRIs upto 100% of the paid-up capital and fixing up the remuneration to Chairman & CEO and Managing Director were conducted through postal ballot during July 2005.

**7. Disclosures**

- a) During the year 2005-06 the Company has entered into related party transactions worth Rs.121,446,000/- (both receivables and payables) with MosChip Semiconductor Technology, USA the Wholly Owned Subsidiary of the Company. All these transactions were at arm's length and do not have potential conflict with the interest of the Company.

**9. General Shareholder Information**

- AGM - Date, Time and Venue : 29 September 2006, 10.30 am at Registered Office of the Company at 8-2-685/1/1, Road No.12, Banjara Hills, Hyderabad - 500 034

- Financial Calendar :  
The following is the tentative financial calendar of the Company, which is subject to change:

## Un-Audited Financial Results for the FY 2006-07

|  |                                |
|--|--------------------------------|
| First Quarter Results  | : 14 July 2006                 |
| Second Quarter & Half-yearly Results                                       | : Between 20 & 31 October 2006 |
| Third Quarter Results  | : Between 20 & 31 January 2007 |
| Fourth Quarter & Annual Results<br>(Audited in lieu of un-audited results) | : Between 20 & 30 June 2007    |

- Date of Book Closure : 22 to 29 September 2006 (both days inclusive)
- Dividend Payment Date : Not Applicable
- Listing on Stock Exchange : The Stock Exchange, Mumbai  
P J Towers, Dalal Street, Fort, Mumbai - 400 001.
- Stock Code  
The Stock Exchange, Mumbai (BSE) : 532407 / MOSCHIP SEMI
- Market Price data : High / Low during each month in the Financial Year 2005-06 and Performance in comparison to broad-based indices such as BSE Sensex, Crisil Index etc.

The information on market price of MosChip stock and its comparison with BSE Sensex is shown in Table-8 MosChip Share price on BSE and in comparison with BSE Sensex

Table-8

| Month & Year | MosChip |       | Sensex   |          |
|--------------|---------|-------|----------|----------|
|              | High    | Low   | High     | Low      |
| Apr-05       | 44.90   | 37.60 | 6649.42  | 6118.42  |
| May-05       | 45.20   | 32.95 | 6772.74  | 6140.97  |
| Jun-05       | 42.80   | 35.35 | 7228.21  | 6647.36  |
| Jul-05       | 50.50   | 36.00 | 7708.59  | 7123.11  |
| Aug-05       | 68.90   | 41.25 | 7921.39  | 7537.50  |
| Sep-05       | 70.85   | 44.10 | 8722.17  | 7818.90  |
| Oct-05       | 55.30   | 34.75 | 8821.84  | 7656.15  |
| Nov-05       | 46.80   | 36.50 | 9033.99  | 7891.23  |
| Dec-05       | 46.85   | 37.35 | 9442.98  | 8769.56  |
| Jan-06       | 44.40   | 37.05 | 9945.19  | 9158.44  |
| Feb-06       | 58.50   | 33.90 | 10422.65 | 9713.51  |
| Mar-06       | 45.40   | 34.50 | 11356.95 | 10344.26 |

- Registrar and Transfer Agents : Sathguru Management Consultants Private Limited.  
Plot No.15, Hindi Nagar, Behind Saibaba Temple,  
Punjagutta, Hyderabad - 500 034.  
Tel: +91-40-2335-0586 / 2335-6507 / 2335-6975  
Fax: +91-40-2335-4042  
Email: sta@sathguru.com  
Web: www.sathguru.com

- **Share Transfer System**

The applications for transfers, transmission etc., are received by the Company at Registered Office address at Hyderabad or at Sathguru Management Consultants Private Limited, Registrar and Transfer Agents, Hyderabad. As the Company's shares are currently traded in dematerialized form the transfers are processed and approved in the electronic form by NSDL / CDSL through their depository participants.

Shares sent for physical transfer are generally registered and returned within a week from the date of receipt; provided the documents are clear in all respects. The authorised persons for share transfers meet at regular interval to clear the transfer cases as early as possible.

Sathguru Management Consultants Private Limited is the Common Share Transfer Agent for both Physical and demat mode.

- **Distribution of Shareholding**

The Distribution of shareholding of the Company as on 31 March 2006 is shown in Table-9

Table-9

| Sl. No.            | Category |        | No. of members |            | No. of shares   |            | % of equity   |            |
|--------------------|----------|--------|----------------|------------|-----------------|------------|---------------|------------|
|                    | From     | To     | Physical       | Electronic | Physical        | Electronic | Physical      | Electronic |
| 1                  | 1        | 5000   | 88             | 23992      | 16238           | 5365931    | 0.04          | 12.37      |
| 2                  | 5001     | 10000  | 1              | 3950       | 1000            | 3431992    | 0.00          | 7.91       |
| 3                  | 10001    | 20000  | 0              | 1773       | 0               | 2846901    | 0.00          | 6.56       |
| 4                  | 20001    | 30000  | 4              | 638        | 10500           | 1688734    | 0.02          | 3.89       |
| 5                  | 30001    | 40000  | 0              | 226        | 0               | 827033     | 0.00          | 1.91       |
| 6                  | 40001    | 50000  | 4              | 286        | 20000           | 1374544    | 0.05          | 3.17       |
| 7                  | 50001    | 100000 | 1              | 296        | 7590            | 2244437    | 0.02          | 5.18       |
| 8                  | 100001   | Above  | 22             | 255        | 35986110        | 21936506   | 8.30          | 50.58      |
|                    | Total    |        | 120            | 31416      | 3653939         | 39716078   | 8.43          | 91.57      |
| <b>Grand Total</b> |          |        | <b>31536</b>   |            | <b>43370017</b> |            | <b>100.00</b> |            |

- **Dematerialisation of shares and liquidity**

As per SEBI guidelines on investors' protection, the Company's shares are to be traded only in dematerialized mode. Accordingly, the Company has entered into agreements with National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) to establish electronic connectivity and facilitate scrip-less trading. As on 31 March 2006, 91.57% of the outstanding equity shares of the company are in electronic form.

The Company's shares are being traded in the Stock Exchange, Mumbai (BSE) under ISIN-INE935B01017

- **Outstanding GDRs/ADRs/Warrants or any other convertible instruments conversion date and likely impact on equity**

During April 2005, the Company had issued 4,553,727 GDRs with 9,107,454 equity shares as underlying shares to the GDRs. Each GDR is convertible into 2 equity shares. All these underlying equity shares were listed with BSE on 13 May 2005.

- **Plant locations**

The Company does not have manufacturing facilities. However, the Company's Registered Office and Design

Centre are located at Hyderabad and a Branch office at USA, the particulars of which are given in Table -10:

Table-10

| Design Centre / Branch Office                 | Location   |
|---|--|
| Hyderabad (Registered Office & Design Centre) | 8-2-685/1/1, Road No.12, Banjara Hills, Hyderabad - 500 034, AP, India |
| USA (Branch Office)                           | 3335, Kifer Road, Santa Clara, California 95051, USA                   |

- **Address for Correspondence and contact persons for investors queries**

Investors' correspondence may be addressed to the Company Secretary and Compliance Officer and any queries relating to the financial statements of the Company may be addressed to the Chief Financial Officer, at the registered office of the Company at 8-2-685/1/1, Road No.12, Banjara Hills, Hyderabad - 500 034, Tel: +91-40-2337-9440 Fax: +91-2334-9439, Email : [financials@moschip.com](mailto:financials@moschip.com)

Besides, investors are also requested to make any correspondence with the Share Transfer Agents, whose particulars are furnished as under:

**Sathguru Management Consultants Private Limited**

Plot No.15, Hindi Nagar, Punjagutta,  
Hyderabad - 500 034  
Contact Person: Mr. K. Raghunathan - Director /  
Mr. R. Chandrasekher - Divisional Manager  
(Capital Markets)  
Tel: +91-40-2335-0586 / 2335-6507 / 2335-6975  
Fax: +91-40-2335-4042,  
Email: [sta@sathguru.com](mailto:sta@sathguru.com)  
Web: [www.sathguru.com](http://www.sathguru.com)

**10. Non-Mandatory requirements:**

Pursuant to the provisions of Notes 2 under Clause 49 of Listing Agreement it is informed that the Company had complied with all the mandatory provision of the Clause and had adopted the following non-mandatory requirements during the year under report.

- Compliance with the provision of Clause 49 pertinent to Remuneration Committee.

For and on behalf of the Board of Directors

Hyderabad,  
04 September 2006

**K. Ramachandra Reddy**  
Chairman & CEO

**ANNEXURE 'E'**

**CERTIFICATE ON CORPORATE GOVERNANCE**

The Members  
MosChip Semiconductor Technology Limited

1. We have examined the registers, records, books of and the implementation of Corporate Governance procedures by MosChip Semiconductor Technology Limited for the year ended 31 March 2006, with the relevant records and documents maintained by the company, furnished to us for our examination and the report on corporate governance as approved by the Board of Directors.
2. The compliance of conditions of Corporate Governance is the responsibility of the management. Our examination was limited to the procedures and implementation thereof, adopted by the company for ensuring the compliance of the conditions of Corporate Governance. It is neither an audit nor an expression of opinion on the financial statements of the company. We further state that, such compliance is neither an assurance as to the future viability of the company

nor the efficiency or effectiveness with which the management has conducted the affairs of the company.

3. We state that in respect of investor grievances received during the year ended on 31 March 2006, no investor grievances are pending against the company for a period exceeding one month as per the records maintained by the company and presented to the shareholders/investors grievance committee.
4. In our opinion and to the best of our information and according to the explanations given to us, the conditions of Corporate Governance as stipulated in Clause 49 of the listing agreement(s) with the Bombay Stock Exchange Limited, have been complied with in all material respects by the company.

**For LVV Associates,**  
Company Secretaries,

Hyderabad  
31 August 2006

**(L.Dhanamjaya Reddy)**  
(Partner)  
C.P. No. 3752

**ANNEXURE 'F'**

**CEO'S DECLARATION**

I, K. Ramachandra Reddy, CEO and Chairman of the Company do hereby declare that pursuant to the provisions of Clause 49(I) (D) (ii) of the Listing Agreement, all the members of the Board and the Senior Management Personnel have furnished their affirmation of compliance with the Code of Conduct of the Company.

Hyderabad,  
31 August 2006

**K. Ramachandra Reddy**  
Chairman & CEO

**AUDITOR'S REPORT ON THE  
CONSOLIDATED FINANCIAL STATEMENTS**

The Members  
MOSCHIP SEMICONDUCTOR TECHNOLOGY LIMITED  
Hyderabad

We have examined the attached Consolidated Balance Sheet of MosChip Semiconductor Technology Limited and its wholly owned subsidiary MosChip Semiconductor Technology, USA as at 31 March 2006 and the Profit and Loss Account as well as the Cash Flow statement for the year ended on that date.

These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We have conducted our audit in accordance with auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

1. The company has made a total investment of Rs. 375,579,087/- in its wholly owned unlisted subsidiary company MosChip Semiconductor Technology, USA (formerly NetMos Technology Inc, USA). The investment is being carried at cost. The difference between the investment amount of Rs. 375,579,087/- and the Networth amount of Rs 98,504,982/- of MosChip Semiconductor Technology, USA, at book value, as on 31 March 2006 has not been charged to the Profit & Loss Account.

2. We report that the consolidated financial statements have been prepared by the Company in accordance with the requirements of Accounting Standard (AS) 21 on Consolidated Financial Statements, issued by the Institute of Chartered Accountants of India.

And on the basis of the separate audited financial statements of MosChip Semiconductor Technology Limited and the wholly owned subsidiary MosChip Semiconductor Technology, USA

On the basis of the information and explanations given to us and on the consideration of the audited financial statements of MosChip Semiconductor Technology Limited and its wholly owned subsidiary, we are of the opinion that:

- a) the Consolidated Balance Sheet gives a true and fair view of the consolidated state of affairs of MosChip semiconductor Technology Limited and its wholly owned subsidiary MosChip Semiconductor Technology, USA as at 31 March 2006;
- b) the Consolidated Profit & Loss Account for the year ended 31 March 2006 gives a true and fair view of the consolidated results of operations of the company and
- c) the consolidated cash flow statement shows a true and fair view of the consolidated cash flows for the year ended on 31 March 2006.

For **Gokhale & Co**  
Chartered Accountants

**Chandrashekhar Gokhale**

Place : Hyderabad  
Date : 28 June 2006

Partner  
Membership No 23839

**CONSOLIDATED BALANCE SHEET  
AS AT 31 MARCH 2006**

|  | Schedule<br>No. | As at              |                      | As at             |                    |
|--|-----------------|--------------------|----------------------|-------------------|--------------------|
|  |                 | Rs.                | Rs.                  | Rs.               | Rs.                |
| <b>SOURCES OF FUNDS:</b>   |                 |                    |                      |                   |                    |
| <b>SHAREHOLDERS' FUNDS:</b>  |                 |                    |                      |                   |                    |
| Share Capital  | 1               |                    | 433,700,170          |                   | 340,430,620        |
| Share Application Money  |                 |                    | 165,110              |                   | 175,542            |
| Reserves and Surplus   | 2               |                    | 665,086,583          |                   | 428,803,732        |
| Total  |                 |                    | <u>1,098,951,863</u> |                   | <u>769,409,894</u> |
| <b>APPLICATION OF FUNDS:</b>   |                 |                    |                      |                   |                    |
| <b>FIXED ASSETS:</b>   |                 |                    |                      |                   |                    |
| Gross Block  | 3               | 194,602,631        |                      | 153,052,977       |                    |
| Less: Depreciation   |                 | <u>132,950,667</u> |                      | <u>96,744,128</u> |                    |
| Net Block  |                 | 61,651,964         |                      | 56,308,849        |                    |
| Capital work in progress   |                 | <u>8,448,459</u>   | 70,100,423           | <u>7,596,063</u>  | 63,904,912         |
| Goodwill   |                 |                    | 239,725,378          |                   | 235,817,338        |
| <b>INVESTMENTS</b>   | 4               |                    | 67,466,337           |                   | 896,110            |
| <b>NET CURRENT ASSETS:</b>   |                 |                    |                      |                   |                    |
| <b>CURRENT ASSETS,<br/>LOANS AND ADVANCES:</b>                       |                 |                    |                      |                   |                    |
| Interest accrued on Deposits   |                 | 7,778,326          |                      | 282,234           |                    |
| Inventories  | 5               | 16,539,286         |                      | 14,406,105        |                    |
| Sundry Debtors   | 6               | 28,295,768         |                      | 19,263,705        |                    |
| Cash and Bank Balances   | 7               | 197,060,086        |                      | 27,982,917        |                    |
| Loans and Advances   | 8               | 13,193,183         |                      | 8,819,897         |                    |
| GROSS CURRENT ASSETS   |                 | <u>262,866,649</u> |                      | <u>70,754,858</u> |                    |
| Less: Current Liabilities<br>and provisions                          | 9               | <u>20,813,715</u>  |                      | <u>9,927,123</u>  |                    |
| <b>NET CURRENT ASSETS</b>  |                 |                    | 242,052,934          |                   | 60,827,735         |
| <b>MISCELLANEOUS EXPENDITURE</b>                                     | 10              |                    | 11,272,299           |                   | 3,376,408          |
| <b>PROFIT AND LOSS ACCOUNT</b>                                       |                 |                    | 468,334,492          |                   | 404,587,391        |
| <b>NOTES TO ACCOUNTS AND<br/>SIGNIFICANT ACCOUNTING<br/>POLICIES</b> | 15              |                    |                      |                   |                    |
| Total  |                 |                    | <u>1,098,951,863</u> |                   | <u>769,409,894</u> |

Per and subject to our report of even date  
For **Gokhale & Co.**,  
Chartered Accountants

For and on behalf of the Board of Directors

**Chandrashekhar Gokhale**  
Partner

**K. Ramachandra Reddy**  
Chairman & CEO

**C. Dayakar Reddy**  
Managing Director

Place : Hyderabad  
Date : 28 June 2006

**Raj Kumar Singh**  
Company Secretary

**Vivek Bhargava**  
Chief Financial Officer

**CONSOLIDATED PROFIT AND LOSS ACCOUNT  
FOR THE YEAR ENDED 31 MARCH 2006**

|   | Schedule No. | For the year ended<br>31 March 2006<br>Rs. | For the year ended<br>31 March 2005<br>Rs. |
|---|--------------|--|--|
| <b>I INCOME:</b>  |              |  |  |
| Sales Revenue   | 11           | 228,693,514                                | 179,056,155                                |
| Other Income  | 12           | 17,284,272                                 | 2,949,851                                  |
|   |              | <u>245,977,786</u>                         | <u>182,006,006</u>                         |
| <b>II EXPENDITURE:</b>                                    |              |  |  |
| Material Cost, Software and product development Expenses  | 13           | 195,331,676                                | 159,620,228                                |
| Sales, General and Administration Expenses                | 14           | 76,839,375                                 | 62,291,795                                 |
| Depreciation  |              | 37,239,440                                 | 36,361,208                                 |
|   |              | <u>309,410,491</u>                         | <u>258,273,231</u>                         |
| <b>III Profit(+)/Loss(-) Before Tax</b>                   |              | <b>-63,432,705</b>                         | <b>-76,267,225</b>                         |
| Less: Income Tax Expense                                  |              |  |  |
| Fringe Benefit tax  |              | 314,396                                    | -  |
| <b>Profit(+)/Loss After Tax</b>                           |              | <b>-63,747,101</b>                         | <b>-76,267,225</b>                         |
| Add: Balance brought forward from previous year           |              | -404,587,391                               | -328,320,166                               |
| <b>Balance carried to Balance Sheet</b>                   |              | <b><u>-468,334,492</u></b>                 | <b><u>-404,587,391</u></b>                 |
| <b>IV Earnings Per Share</b>                              |              |  |  |
| Basic   |              | -1.50                                      | -2.32                                      |
| Diluted   |              | -1.50                                      | -2.32                                      |
| <b>No. of shares used in computing Earnings per share</b> |              |  |  |
| Basic   |              | 42,569,215                                 | 32,916,612                                 |
| Diluted   |              | 42,569,705                                 | 32,916,748                                 |

Per and subject to our report of even date  
For **Gokhale & Co.**,  
Chartered Accountants

**Chandrashekhhar Gokhale**  
Partner

Place : Hyderabad  
Date : 28 June 2006

For and on behalf of the Board of Directors

**K. Ramachandra Reddy**  
Chairman & CEO

**Raj Kumar Singh**  
Company Secretary

**C. Dayakar Reddy**  
Managing Director

**Vivek Bhargava**  
Chief Financial Officer

**SCHEDULES FORMING PART OF  
CONSOLIDATED BALANCE SHEET**

|  | As At<br>31 March 2006<br>Rs. | As At<br>31 March 2005<br>Rs. |
|--|-------------------------------|-------------------------------|
| <b>SCHEDULE 1</b>  |                               |                               |
| SHARE CAPITAL  |                               |                               |
| <u>Authorised:</u>   |                               |                               |
| 55,000,000 (Previous Year 55,000,000)<br>equity shares of Rs.10/- each   | <u>550,000,000</u>            | <u>550,000,000</u>            |
| <u>Issued:</u>   |                               |                               |
| 45,100,589 (Previous Year 34,993,135)<br>equity shares of Rs.10/- each   | <u>451,005,890</u>            | <u>349,931,350</u>            |
| <u>Subscribed and Paid-up:</u>   |                               |                               |
| 43,370,017 (Previous Year 34,043,062)<br>equity shares of Rs.10/- each   | <u>433,700,170</u>            | <u>340,430,620</u>            |
| (Of the above 8,325,770 shares of Rs.10 each have been allotted for consideration other than cash pursuant to the acquisition of 100% equity in MosChip Semiconductor Technology, USA)   |                               |                               |
| (Of the above 6,177,778 shares of Rs.10 each have been allotted for consideration other than cash pursuant to the Scheme of Amalgamation of Verasity Technologies, Inc with the Company) |                               |                               |
| <b>SCHEDULE 2</b>  |                               |                               |
| RESERVES AND SURPLUS:  |                               |                               |
| Foreign Currency Translation Reserve   | 4,135,288                     | -                             |
| Capital Reserve  | 1,250,000                     | 1,000,000                     |
| Securities Premium   |                               |                               |
| Opening Balance  | 427,803,732                   | 343,255,963                   |
| Additions  | 231,897,563                   | 84,547,769                    |
| Closing balance  | <u>659,701,295</u>            | <u>427,803,732</u>            |
|  | <u>665,086,583</u>            | <u>428,803,732</u>            |

**SCHEDULES FORMING PART OF  
CONSOLIDATED BALANCE SHEET**

**SCHEDULE - 3  
CONSOLIDATED FIXED ASSETS**

(Amounts in Rupees)

| Sl. No. | DESCRIPTION             | GROSS BLOCK         |                           |                                       | DEPRECIATION        |                   |                   |                                       | NET BLOCK           |                   |                   |
|---------|-------------------------|---------------------|---------------------------|---------------------------------------|---------------------|-------------------|-------------------|---------------------------------------|---------------------|-------------------|-------------------|
|         |                         | Cost as at 01.04.05 | Additions during the year | Deletions/ Adjustments <sup>(1)</sup> | Total Upto 31.03.06 | Upto 31.03.05     | For the year      | Deletions/ Adjustments <sup>(2)</sup> | Total Upto 31.03.06 | As at 31.03.06    | As at 31.03.05    |
| 1       | Computers               | 28,789,699          | 5,664,186                 | 334,702                               | 34,119,183          | 14,755,783        | 5,046,351         | 199,586                               | 19,602,548          | 14,516,635        | 14,033,916        |
| 2       | Electrical Installation | 3,007,900           | 85,387                    | -                                     | 3,093,287           | 544,838           | 140,871           | -                                     | 685,709             | 2,407,578         | 2,463,062         |
| 3       | Plant and Machinery     | 26,403,559          | 1,416,900                 | -                                     | 27,820,459          | 9,824,322         | 10,425,625        | -                                     | 20,249,947          | 7,570,512         | 16,579,237        |
| 4       | Software                | 56,730,606          | 20,959,799                | 497,120                               | 77,193,285          | 47,371,506        | 11,592,558        | 495,837                               | 58,468,227          | 18,725,058        | 9,359,100         |
| 5       | Furniture and Fittings  | 7,619,834           | 179,738                   | 20,370                                | 7,779,202           | 1,969,849         | 499,039           | 10,304                                | 2,458,584           | 5,320,618         | 5,649,985         |
| 6       | Office Equipment        | 5,212,604           | 205,499                   | 148,831                               | 5,269,272           | 2,786,341         | 391,608           | 98,660                                | 3,079,289           | 2,189,983         | 2,426,263         |
| 7       | Vehicles                | 52,435              | 31,822                    | -                                     | 84,257              | 24,097            | 6,274             | -                                     | 30,371              | 53,886            | 28,338            |
| 8       | Lab Equipment           | 348,528             | 2,008,463                 | -                                     | 2,356,991           | 30,457            | 30,711            | -                                     | 61,168              | 2,295,823         | 318,071           |
| 9       | Mask Tools              | 24,887,812          | 13,088,473                | 1,089,590                             | 36,886,695          | 19,436,935        | 9,106,403         | 228,514                               | 28,314,824          | 8,571,871         | 5,450,877         |
|         | <b>TOTAL</b>            | <b>153,052,977</b>  | <b>43,640,267</b>         | <b>2,090,613</b>                      | <b>194,602,631</b>  | <b>96,744,128</b> | <b>37,239,440</b> | <b>1,032,901</b>                      | <b>132,950,667</b>  | <b>61,651,964</b> | <b>56,308,849</b> |
|         | Previous Year           | 128,970,920         | 25,210,074                | 1,128,017                             | 153,052,977         | 60,564,242        | 36,361,208        | 181,322                               | 96,744,128          | 56,308,849        | -                 |

**Note :**

- 1) Adjustments for the year includes Rs.1,752,911/- considered in Foreign Currency Translation Reserve due to Translation of non-integral foreign subsidiaries.
- 2) Adjustments for the year includes Rs.830,315/- considered in Foreign Currency Translation Reserve due to Translation of non-integral foreign subsidiaries.

**SCHEDULES FORMING PART OF  
CONSOLIDATED BALANCE SHEET**

|  | As At<br>31 March 2006<br>Rs. | As At<br>31 March 2005<br>Rs. |
|--|-------------------------------|-------------------------------|
| <b>SCHEDULE 4</b>  |                               |                               |
| INVESTMENTS:   |                               |                               |
| <b>Current</b>   |                               |                               |
| <b>Non-Trade, Unquoted, At Cost</b>  |                               |                               |
| Nil (previous year 70,504.8146) Units of Rs.10/- each in                             | -                             | 896,110                       |
| Kotak Mahindra Mutual Fund   |                               |                               |
| SVB Securities Liquid Fund   | <u>67,466,337</u>             | -                             |
|  | <u>67,466,337</u>             | <u>896,110</u>                |
| <b>SCHEDULE 5</b>  |                               |                               |
| INVENTORIES :  |                               |                               |
| Finished Goods   | <u>16,539,286</u>             | 14,406,105                    |
|  | <u>16,539,286</u>             | <u>14,406,105</u>             |
| <b>SCHEDULE 6</b>  |                               |                               |
| SUNDRY DEBTORS:  |                               |                               |
| (Unsecured, Considered Good)   |                               |                               |
| Out standing for a period exceeding six months                                       | -                             | -                             |
| Accounts Receivable  | <u>28,295,768</u>             | 19,263,705                    |
|  | <u>28,295,768</u>             | <u>19,263,705</u>             |
| <b>SCHEDULE 7</b>  |                               |                               |
| CASH AND BANK BALANCES:  |                               |                               |
| Cash on hand   | 18,395                        | 26,257                        |
| Balance with Scheduled Banks   |                               |                               |
| - In Current accounts  | 13,068,273                    | 11,607,274                    |
| - In fixed deposit accounts  | 170,624,988                   | 608,198                       |
| (Rs. 618,040 (Previous Year Rs.601,250)<br>pledged towards margin on Bank Guarantee) |                               |                               |
| Balances with Non-Scheduled Bank in Current Account                                  | <u>13,348,430</u>             | 15,741,188                    |
|  | <u>197,060,086</u>            | <u>27,982,917</u>             |

**SCHEDULES FORMING PART OF  
CONSOLIDATED BALANCE SHEET**

|  | As At<br>31 March 2006<br>Rs. | As At<br>31 March 2005<br>Rs. |
|--|-------------------------------|-------------------------------|
| <b>SCHEDULE 8</b>  |                               |                               |
| LOANS AND ADVANCES:<br>(Unsecured, considered good, recoverable in cash or<br>in kind or for value to be received) |                               |                               |
| Deposits   | 1,225,853                     | 2,385,987                     |
| MosChip Employees Trust  | 3,903,000                     | 4,503,000                     |
| Other Advances and Receivables   | 3,374,762                     | 502,961                       |
| Prepaid Expenses   | 4,154,987                     | 955,540                       |
| Prepaid Income Tax   | 534,581                       | 472,409                       |
|  | <u>13,193,183</u>             | <u>8,819,897</u>              |
| <b>SCHEDULE 9</b>  |                               |                               |
| CURRENT LIABILITIES AND PROVISIONS:  |                               |                               |
| CURRENT LIABILITIES:   |                               |                               |
| Sundry Creditors:  |                               |                               |
| Dues to Small Scale Industrial Undertakings  | -                             | -                             |
| Others   | 16,683,201                    | 6,992,959                     |
|  | <u>16,683,201</u>             | <u>6,992,959</u>              |
| PROVISIONS:  |                               |                               |
| Provision for Leave Encashment   | 1,957,318                     | 2,821,602                     |
| Provision for Gratuity   | 2,173,196                     | 112,562                       |
|  | <u>4,130,514</u>              | <u>2,934,164</u>              |
|  | <u>20,813,715</u>             | <u>9,927,123</u>              |
| <b>SCHEDULE 10</b>   |                               |                               |
| MISCELLANEOUS EXPENDITURE:<br>(To the extent not written off or adjusted)  |                               |                               |
| GDR/Share Issue Expenses   | 11,272,299                    | 3,376,408                     |
|  | <u>11,272,299</u>             | <u>3,376,408</u>              |

**SCHEDULES FORMING PART OF  
CONSOLIDATED PROFIT AND LOSS ACCOUNT**

|  | For the year ended<br>31 March 2006<br>Rs. | For the year ended<br>31 March 2005<br>Rs. |
|--|--|--|
| <b>SCHEDULE 11</b>   |  |  |
| SALES :  |  |  |
| Software Sales   | 25,041,369                                 | 14,160,757                                 |
| Semiconductor Sales  | 203,652,145                                | 164,877,163                                |
| Misc. Sales  | -  | 18,235                                     |
|  | <u>228,693,514</u>                         | <u>179,056,155</u>                         |
| <b>SCHEDULE 12</b>   |  |  |
| OTHER INCOME:  |  |  |
| Interest Earned (Gross)                                      | 8,896,733                                  | 89,119                                     |
| (Tax Deducted at Source Rs.534,581/- (previous year Nil ))   |  |  |
| Miscellaneous Income   | 3,254,134                                  | -  |
| Profit on Sale of Fixed Assets                               | 20,056                                     | 1,432,851                                  |
| Realised Gain on Forex Fluctuations                          | -  | 65,592                                     |
| Profit on Sale of Investments                                | 5,113,349                                  | 1,362,289                                  |
|  | <u>17,284,272</u>                          | <u>2,949,851</u>                           |
| <b>SCHEDULE 13</b>   |  |  |
| MATERIAL COST, SOFTWARE AND PRODUCT<br>DEVELOPMENT EXPENSES: |  |  |
| Materials, Finished and Processed Stocks                     | 104,909,530                                | 85,126,159                                 |
| Freight Expenses   | 1,639,783                                  | 1,201,914                                  |
| Salaries and Other Allowances to Employees                   | 52,349,010                                 | 43,562,854                                 |
| Contribution to PF   | 178,360                                    | 191,018                                    |
| Staff Welfare Expenses                                       | 3,173,786                                  | 2,276,478                                  |
| Directors' Remuneration                                      | 2,666,032                                  | 1,929,000                                  |
| Professional Charges - Technical                             | 4,296,608                                  | 14,175,359                                 |
| Rent   | 4,875,318                                  | 2,243,381                                  |
| Electricity Charges  | 1,667,613                                  | 1,481,123                                  |
| Consumables  | 3,522,550                                  | 2,875,363                                  |
| Repairs & Maintenance  | 186,950                                    | 134,260                                    |
| Software Charges   | 4,109,495                                  | 1,195,262                                  |
| Research & Development Expenses                              | 10,665,945                                 | 2,395,813                                  |
| Communication Expenses                                       | 627,739                                    | 509,696                                    |
| Computer Maintenance   | 462,957                                    | 322,548                                    |
|  | <u>195,331,676</u>                         | <u>159,620,228</u>                         |

**SCHEDULES FORMING PART OF  
CONSOLIDATED PROFIT AND LOSS ACCOUNT**

|   | For the year ended<br>31 March 2006<br>Rs. | For the year ended<br>31 March 2005<br>Rs. |
|---|--|--|
| <b>SCHEDULE 14</b>                          |  |  |
| SALES, GENERAL AND ADMINISTRATIVE EXPENSES: |  |  |
| Salaries and Other Allowances to Employees  | 36,470,842                                 | 31,375,968                                 |
| Contribution to PF                          | 84,495                                     | 79,358                                     |
| Directors' Remuneration                     | 2,666,032                                  | 1,929,000                                  |
| Directors' Sitting Fee                      | 35,000                                     | 39,000                                     |
| Printing and Stationery                     | 224,860                                    | 141,290                                    |
| Postage, Telegrams and Telephones           | 1,924,184                                  | 1,232,904                                  |
| Rent  | 998,559                                    | 2,391,479                                  |
| Fees, Rates and Taxes                       | 780,450                                    | 1,477,338                                  |
| Vehicle Maintenance                         | 40,826                                     | 36,908                                     |
| Repairs and Maintenance                     | 155,946                                    | 172,824                                    |
| Traveling and conveyance                    | 8,443,915                                  | 5,621,096                                  |
| Marketing Expenses                          | 2,801,504                                  | -  |
| Advertisement Expenses                      | 2,666,420                                  | 794,026                                    |
| Payments to Auditors                        | 847,664                                    | 1,108,081                                  |
| Insurance                                   | 2,763,225                                  | 3,067,446                                  |
| Professional charges                        | 4,040,192                                  | 1,603,348                                  |
| Electricity Charges                         | 341,559                                    | 749,439                                    |
| Recruitment Expenses                        | 425,420                                    | 829,425                                    |
| General Expenses                            | 4,481,998                                  | 2,946,693                                  |
| Loss on Fixed Assets Sold/Discarded         | 21,573                                     | 944,695                                    |
| Rights Issue Expenses                       | -  | 1,268,214                                  |
| Interest and Finance Charges                | 10   | 903,388                                    |
| Realised Loss on Forex Fluctuation          | 914,732                                    | -  |
| Unrealised Loss on Forex Fluctuation        | 1,479,657                                  | 1,916,835                                  |
| With Holding Tax                            | 329,250                                    | -  |
| Share Issue Expenses written off            | -  | 1,367,180                                  |
| Preliminary expenses written off            | -  | 8,896                                      |
| Improvements to leased premises             | 14,174                                     | 8,849                                      |
| Prior Period Adjustments                    | 1,068,819                                  | 278,115                                    |
| GDR Issue Expenses Written Off              | 2,818,069                                  | -  |
|   | <u>76,839,375</u>                          | <u>62,291,795</u>                          |

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

**SCHEDULE 15**

**SIGNIFICANT ACCOUNTING POLICIES**

**A. Principles of consolidation**

The consolidated financial statements present the accounts of the Company and its wholly owned subsidiary MosChip Semiconductor Technology, USA. The consolidation is based on the audited financial statements of MosChip Semiconductor Technology Limited and MosChip Semiconductor Technology, USA (Wholly Owned Subsidiary) for the year ended 31 March 2006. Consistency in adoption of accounting policies among group companies is ensured to the extent practicable.

**B. Use of Estimates**

The preparation of the financial statements in conformity with the Generally Accepted Accounting Principles in India require that the management makes estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent liabilities as at the date of the financial statements, and the reported amounts of revenue and expenses during the reported year. Actual results could differ from those estimates.

**C. Revenue Recognition**

Sales are recognized on dispatch of material. Revenue from Software development is recognized based on software developed and billed as per the terms of specific contracts.

**D. Expenditure**

Expenses are accounted on the accrual basis and provision is made for all known losses and liabilities. Computer spares, accessories and stationery are charged to revenue in the year in which such expenditure is incurred.

**E. Fixed Assets**

Fixed Assets are stated at cost of acquisition inclusive of inland freight, duties and taxes and incidental expenditure incurred during installation where applicable.

**F. Depreciation**

Depreciation on fixed assets of the holding company is provided under Straight Line method at the rates specified in Schedule XIV of the Companies Act,

1956 except Computer Software which are depreciated over a period of five years based on the technical evaluation about their useful economic life and at one hundred percent for assets costing less than Rs.5,000/-.

Depreciation on fixed assets of the subsidiary company is computed using the straight-line method and is charged to income over the estimated useful lives of two, three, five and seven years.

**G. Foreign Exchange Transactions**

Transactions in foreign currency are recorded at exchange rate prevailing on the date of transaction.

Monetary assets and liabilities denominated in foreign currency are translated at the rate of exchange at the balance sheet date and resultant gain or loss is recognized in the profit and loss account.

Non-monetary assets and liabilities are translated at the rate prevailing on the date of transaction.

The operations of foreign branches of the company are of integral in nature and the financial statements of these branches are translated using the same principles and procedure of head office.

Realized gains and losses on foreign exchange transactions other than those relating to fixed assets are recognized in the Profit and Loss account.

Gain or Loss on translation and realized gain or loss in respect of Liabilities incurred to acquire fixed assets is adjusted to the carrying cost of fixed assets.

Foreign subsidiaries are non-integral in nature. Assets and Liabilities of subsidiary are translated at the year end exchange rate, income and expenditure are translated at the average rate during the period. The resultant translation adjustment is reflected as a separate component of shareholders funds as "Foreign Currency Translation Reserve".

**H. Investments**

Investments are classified into current investments and long-term investments. Current Investments are carried at the lower of cost and fair value, and provision is made to recognize any decline in the carrying value. Long-term investments are carried at cost, and provision is made to recognize any decline, other than temporary, in the value of such investment.

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

**I. Inventories**

Inventories are valued on the following basis:

- i. Stock-in-process: at cost.
- ii. Finished goods: at cost or net realizable value, whichever is lower.

**J. Retirement benefits**

- (i) Provident Fund: The Company contributes to the employees' provident fund (a defined contribution benefit) maintained under the Employees Provident Fund scheme by the Central Government.
- (ii) Gratuity: The Company Contributes to LIC Group Gratuity Fund. Provision for accrued Gratuity liability is made as per the latest actuarial certificate provided by LIC updated with material changes between the date of valuation and balance sheet date.
- (iii) Leave Encashment: The liability in respect of leave encashment is provided on accrual basis as estimated by the management

**K. Miscellaneous Expenditure**

Preliminary expenses and expenditure in connection with issue of shares are written off over a period of five years.

**NOTES TO ACCOUNTS**

**1. Contingent Liabilities:**

- (i) Estimated amount of Contracts remaining to be executed on Capital Account and not provided for Rs. 21,571,500/- (Previous Year Rs.3,924,858/-).
- (ii) On account of Bank Guarantee given by bankers Rs. 618,040/- (Previous Year Rs. 601,250/-)
- (iii) On account of Bond executed by the Company to Government of India towards exemption of customs Duty on Imported Equipment and Excise Duty on Indigenous Equipment Rs.2,525,000/- (Previous Year Rs. 2,525,000/-)

**2.. Earnings Per Share**

The basic earnings per share has been computed using the weighted average number of equity shares outstanding during the applicable periods.

Diluted earnings per share is computed using the weighted average number of equity shares and dilutive potential equity shares outstanding during the applicable periods. Potential equity shares include equity shares issuable against the share application money received during the year.

**3. Segment Reporting**

The Company recognises sale of ASIC design and Chips (ASICs) as the primary segments since its operations during the year consists of ASIC design and sale of related intellectual property/products developed by it. Accordingly revenues from sale of software (designs/intellectual property) and ASICs comprise the primary basis of segmental information set out in these Financial Statements. Secondary segmental reporting is performed on the basis of the geographical location of customers

**Performance of business segment is as follows:**

|  | Year ended 31 March 2006 |             |
|--|--------------------------|-------------|
|  | Software                 | ASICs       |
| <b>Revenue</b>                                       |                          |             |
| Sales to external customers                          | 25,041,369               | 203,652,145 |
| Segment result Profit/(loss)                         | (108,444,287)            | 27,727,310  |
| Interest expense                                     | -                        | -           |
| Other Income   | 16,762,185               | 522,087     |
| Income Taxes   | 314,396                  | -           |
| Net profit/(loss)                                    | (91,996,498)             | 28,249,397  |
| <b>Other Segment Information</b>                     |                          |             |
| Depreciation   | 27,873,292               | 9,366,148   |
| Non-cash expenses other than depreciation            | 2,839,642                | -           |
| <b>Particulars of Segment Assets and Liabilities</b> |                          |             |
| Segment Assets                                       | 69,071,988               | 59,056,672  |
| Investments  | -                        | 67,466,337  |
| Bank Deposits  | 183,947,228              | 13,112,858  |
| Other Assets   | 7,778,326                | -           |
| Total Assets   | 260,797,542              | 139,635,867 |
| Segment Liabilities                                  | 5,982,965                | 14,830,750  |
| Total Liabilities                                    | 5,982,965                | 14,830,750  |

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

|   | Year ended<br>31 March 2006 |
|---|-----------------------------|
| <b>Geographic Segment Revenue</b>                         |                             |
| Hong Kong   | 108,822,630                 |
| Taiwan  | 68,026,679                  |
| Rest of the World   | 51,844,205                  |
| <b>Segment Gross Fixed Assets based on their location</b> |                             |
| Segment Gross Fixed Assets as at 31 March 2006            |                             |
| North America   | 76,959,567                  |
| India   | 126,091,523                 |
| Additions to gross fixed assets                           |                             |
| North America   | 14,265,673                  |
| India   | 29,374,594                  |

4. The Company owns a 100% subsidiary, MosChip Semiconductor Technology USA incorporated in the USA.
5. The consolidated financial statements are prepared in Indian Rupees. The Indian Rupee is the functional currency of MosChip Semiconductor Technology Limited and US Dollar is the functional currency of MosChip Semiconductor Technology, USA.
6. The figures for previous year have been regrouped / reclassified wherever necessary

Per and subject to our report of even date  
For **Gokhale & Co.**,  
Chartered Accountants

**Chandrashekhar Gokhale**  
Partner

Place : Hyderabad  
Date : 28 June 2006

For and on behalf of the Board of Directors

**K. Ramachandra Reddy**  
Chairman & CEO

**Raj Kumar Singh**  
Company Secretary

**C. Dayakar Reddy**  
Managing Director

**Vivek Bhargava**  
Chief Financial Officer

**CONSOLIDATED CASH FLOW STATEMENT  
FOR THE YEAR ENDED 31 MARCH 2006**

|  | 31 March 2006<br>Rs. | 31 March 2005<br>Rs. |
|--|----------------------|----------------------|
| <b>A) Cash Flow from Operating Activities</b>                                      |                      |                      |
| Net Profit before tax  | (63,432,705)         | (76,267,225)         |
| Adjustments for:   |                      |                      |
| 1) Depreciation  | 37,239,440           | 36,361,208           |
| 2) GDR/Share issue expenses written off  | 2,818,069            | 1,367,180            |
| 3) Miscellaneous Expenses written off  | -                    | 8,896                |
| 4) Interest received   | (8,896,733)          | (89,119)             |
| 5) Profit on sale of fixed assets  | (20,056)             | -                    |
| 6) Profit on sale of investments   | (5,113,349)          | (1,362,289)          |
| 7) Loss on sale of fixed assets  | 21,573               | 944,695              |
| 8) Exchange differences on translation of foreign currency cash & Cash equivalents | 92,506               | 94,020               |
| Operating Profit before changes in working capital                                 | (37,291,255)         | (38,942,634)         |
| <b>Adjustments for:</b>  |                      |                      |
| 1) (Increase)/Decrease in Sundry Debtors   | (9,032,063)          | 2,605,589            |
| 2) (Increase)/Decrease in Inventories  | (2,133,181)          | (8,603,642)          |
| 3) (Increase)/Decrease in Loans and Advances                                       | (4,311,114)          | 4,602,222            |
| 4) Increase/(Decrease) in current liabilities                                      | 10,886,592           | (20,073,537)         |
| 5) Increase/(Decrease) in Bank Guarantee Deposits with Bankers                     | (16,790)             | (21,250)             |
|  | (41,897,811)         | (60,433,252)         |
| <b>Adjustments for:</b>  |                      |                      |
| Income-tax paid  | (376,568)            | 306,022              |
| <b>Net cash flow from operating activities [A]</b>                                 | <u>(42,274,379)</u>  | <u>(60,127,230)</u>  |
| <b>B) Cash flow from Investing Activities:</b>                                     |                      |                      |
| 1) Purchase of Fixed Assets  | (47,478,107)         | (16,679,109)         |
| 2) Sale proceeds of Fixed Assets   | 133,600              | 2,000                |
| 3) Purchase of Investments   | (508,166,337)        | (78,500,000)         |
| 4) Interest received   | 1,400,641            | (34,450)             |
| 5) Sale of Investments   | 446,709,458          | 100,895,662          |
| 6) Foreign currency translation adjustment for non-integral operation              | 4,135,288            | -                    |
| <b>Net cash used for Investing activities [B]</b>                                  | <u>(103,265,457)</u> | <u>5,684,103</u>     |

**CONSOLIDATED CASH FLOW STATEMENT  
FOR THE YEAR ENDED 31 MARCH 2006**

|   | 31 March 2006<br>Rs. | 31 March 2005<br>Rs. |
|---|----------------------|----------------------|
| <b>C) Cash flow from Financing Activities:</b>                      |                      |                      |
| 1) Net proceeds from Issue of Share Capital                         | 93,259,118           | 33,986,205           |
| 2) Securities Premium   | 231,897,563          | 84,547,769           |
| 3) Secured Loan   | -                    | (40,000,000)         |
| 4) Subsidy From State Govt  | 250,000              | -                    |
| 5) GDR/Share issue Expenses   | (10,713,960)         | (3,376,408)          |
| <b>Net Cash from Financing Activities [C]</b>                       | <b>314,692,721</b>   | <b>75,157,566</b>    |
| Net Increase/(Decrease) in cash & cash equivalents [A+B+C]          | 169,152,885          | 20,714,439           |
| Cash and Cash equivalents at the beginning of the Period            | 27,381,667           | 6,761,248            |
| Cash and Cash equivalents at the end of the period                  | <u>196,534,552</u>   | <u>27,475,687</u>    |
| Note: <u>Cash and Cash equivalents at the beginning of the year</u> |                      |                      |
| Cash and Bank balances  | 27,982,917           | 7,341,248            |
| Less: Deposits with Bankers towards Bank Guarantee                  | 601,250              | 580,000              |
|   | <u>27,381,667</u>    | <u>6,761,248</u>     |
| <u>Cash and Cash equivalents at the end of the year</u>             |                      |                      |
| Cash and Bank balances  | 197,060,086          | 27,982,917           |
| Add: Unrealised gain on foreign exchange fluctuation                | 92,506               | 94,020               |
| Less: Deposits with Bankers towards Bank Guarantee                  | 618,040              | 601,250              |
|   | <u>196,534,552</u>   | <u>27,475,687</u>    |

For and on behalf of the Board of Directors

**K. Ramachandra Reddy**  
Chairman & CEO

**C. Dayakar Reddy**  
Managing Director

Place : Hyderabad  
Date : 28 June 2006

**Raj Kumar Singh**  
Company Secretary

**Vivek Bhargava**  
Chief Financial Officer

**AUDITOR'S CERTIFICATE**

We have examined the above Cash Flow Statement compiled from the audited financial statements of MosChip Semiconductor Technology Limited for the Year ended 31 March 2006 reported by us on 28 June 2006. According to the information and explanations given to us, the above Cash Flow Statement has been prepared in consonance with the requirements of Accounting Standard – 3 on Cash Flow Statements issued by the Institute of Chartered Accountants of India and found the same to be in accordance with the requirements of the amended Clause 32 of the Listing Agreement with Stock Exchanges.

For **Gokhale & Co.**,  
Chartered Accountants

Place : Hyderabad  
Date : 28 June 2006

**Chandrasekhar Gokhale**  
Partner

## AUDITOR'S REPORT

The Members  
MOSCHIP SEMICONDUCTOR TECHNOLOGY LIMITED  
Hyderabad

We have audited the attached Balance Sheet of MosChip Semiconductor Technology Limited, Hyderabad as at 31 March 2006 and the Profit and Loss Account and the Cash Flow Statement for the year ended on that date annexed thereto. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in India. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

1. As required by the Companies (Auditors' Report) Order, 2003 issued by the Central Government of India in terms of sub-section (4A) of Section 227 of the Companies Act, 1956, we enclose in the annexure a statement on the matters specified in paragraphs 4 and 5 of the said order.
2. The company has made a total investment of Rs. 375,579,087/- in its wholly owned unlisted subsidiary company MosChip Semiconductor Technology, USA (formerly NetMos Technology Inc, USA). The investment is being carried at cost. The difference between the investment amount of Rs. 375,579,087/- and the Networth amount of Rs 98,504,982/- of MosChip Semiconductor Technology, USA, at book value, as on 31 March 2006 has not been charged to the Profit & Loss Account.
3. Further to our comments in the annexure referred to in paragraph 1, and subject to what is stated in paragraph 2 above, we report that:

- a) We have obtained all the information and explanations, which to the best of our

knowledge and belief were necessary for the purposes of our audit.

- b) In our opinion, proper books of account as required by law have been kept by the company so far as appears from our examination of those books.
- c) The Balance Sheet, Profit and Loss Account and Cash Flow Statement dealt with by this report are in agreement with books of account.
- d) In our opinion, the Balance Sheet, Profit & Loss Account and Cash Flow Statement dealt with by this report comply with the accounting standards referred to in sub-section (3C) of Section 211 of the Companies Act, 1956.
- e) On the basis of written representation received from the Directors, as on 31 March 2006 and taken on record by the Board of Directors, we report that, none of the directors is disqualified as on 31 March 2006 from being appointed as director in terms of clause (g) of sub-section (1) of Section 274 of the Companies Act, 1956.
- f) In our opinion and to the best of our information and according to the explanations given to us, the said accounts give the information required by the Companies Act, 1956, in the manner so required, and give a true and fair view in conformity with the accounting principles generally accepted in India:
  - i) In the case of the Balance Sheet, of the state of affairs of the Company as at 31 March 2006;
  - ii) In the case of the Profit & Loss Account, of the Loss of the company for the year ended on 31 March 2006; and
  - iii) In the case of the Cash Flow Statement of the Cash Flows for the year ended on 31 March 2006.

For **Gokhale & Co**  
Chartered Accountants

**Chandrashekhar Gokhale**

Partner

Place : Hyderabad  
Date : 28 June 2006

Membership No 23839

## AUDITOR'S REPORT

### ANNEXURE

As required by the Companies ( Auditor's Report ) Order, 2003 issued by the Central Government of India in terms of sub-section (4A) of Section 227 of the Companies Act, 1956 ( 1 of 1956 ) and on the basis of such checks, as we considered appropriate, we further report that:

- (i) The company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets. The fixed assets have been physically verified by the management according to the phased programme designed to cover all assets on rotation basis. In respect of assets verified according to this programme, which is reasonable, no material discrepancies were noticed. The company has not disposed off substantial part of its fixed assets during the year.
- (ii) The company had no inventory during the year.
- (iii) The company has not taken any loans, secured or unsecured from companies, firms or other parties covered in the register maintained under Section 301 of the Act. The company has granted a loan to its fully owned subsidiary MosChip Semiconductor Technology, USA and the balance outstanding as at the year end was of Rs 17,848,000/-. The loan is repayable after three years from the date it was given and as at the Balance Sheet date it is not overdue. Keeping in view the strategic business relationship between the two companies, in our opinion, the rate of interest and other terms and conditions of the loan are not, prima facie, prejudicial to the interests of the company.
- (iv) In our opinion, and according to the information and explanations given to us, there are adequate internal control procedures commensurate with the size of the company and the nature of its business, for the purchase of fixed assets and for the sale of its products.
- (v) Transactions that need to be entered into a register in pursuance of Section 301 of the Act have been entered. In our opinion and based on information and explanations given to us transactions of the value of Rs. 5 lakhs or more have been made at prices which are reasonable having regard to the prevailing market prices at the relevant time.
- (vi) The company has not accepted deposits from the public covered by the provisions of Section 58 A of the Companies Act.
- (vii) The company has an internal audit system commensurate with its size and nature of its business.
- (viii) The company is not required to maintain any cost records under clause (d) of sub-section (1) of Section 209 of the Act.
- (ix) As explained to us the provisions of ESI Act are not applicable to the company for the year under audit. The company is regular in depositing the Provident Fund dues with the appropriate authorities. According to the explanations and information given to us there were no undisputed statutory dues including Investor Education and Protection Fund, Income-tax, Sales-tax, Wealth Tax, Custom Duty, Excise Duty etc outstanding for a period of more than six months from the date they became payable.
- (x) The company's accumulated losses at the end of the financial year were less than fifty percent of its net worth. The company has incurred cash losses in the financial year under audit as well as in the immediately preceding financial year.
- (xi) There were no dues payable to any Bank or financial institution/s during the year.
- (xii) The company has not granted any loans and advances on the basis of security by way of pledge of shares, debentures and other securities.
- (xiii) The company has not given any guarantee for loans taken by others from bank or financial institutions.
- (xiv) No part of the funds raised on short-term basis have been used for long-term investments and vice-versa.
- (xv) The company has not made any preferential allotment of shares to parties and companies covered in the Register maintained under Section 301 of the Act.
- (xvi) The company had made a GDR ( Global Depository Receipts ) issue during the financial year and the end use of money raised has been disclosed by the management and the same has been verified by us.
- (xvii) On the basis of information and explanations given to us no fraud on or by the company has been noticed or reported during the year.

The other clauses of the order are not applicable to the company for the year under audit.

For **Gokhale & Co**  
Chartered Accountants

**Chandrashekhhar Gokhale**

Partner

Membership No 23839

Place : Hyderabad  
Date : 28 June 2006

## BALANCE SHEET AS AT 31 MARCH 2006

|  | Schedule No. | As at<br>31 March 2006<br>Rs. | As at<br>31 March 2005<br>Rs. |
|--|--------------|-------------------------------|-------------------------------|
| <b>SOURCES OF FUNDS:</b>   |              |                               |                               |
| <b>SHAREHOLDERS' FUNDS:</b>  |              |                               |                               |
| Share Capital  | 1            | 433,700,170                   | 340,430,620                   |
| Share Application Money  |              | 165,110                       | 175,542                       |
| Reserves and Surplus   | 2            | 660,951,295                   | 428,803,732                   |
| Total  |              | <u>1,094,816,575</u>          | <u>769,409,894</u>            |
| <b>APPLICATION OF FUNDS:</b>   |              |                               |                               |
| <b>FIXED ASSETS:</b>   |              |                               |                               |
| Gross Block  | 3            | 147,211,119                   | 116,997,027                   |
| Less: Depreciation   |              | 94,647,897                    | 66,977,191                    |
| Net Block  |              | 52,563,222                    | 50,019,836                    |
| <b>INVESTMENTS</b>   | 4            | 375,579,087                   | 310,115,208                   |
| <b>NET CURRENT ASSETS:</b>   |              |                               |                               |
| <b>CURRENT ASSETS,<br/>LOANS AND ADVANCES:</b>                       |              |                               |                               |
| Interest accrued on Deposits   |              | 7,778,326                     | 282,234                       |
| Sundry Debtors   | 5            | 8,068,634                     | 5,295,970                     |
| Cash and Bank Balances   | 6            | 183,947,226                   | 12,507,277                    |
| Loans and Advances   | 7            | 30,865,251                    | 42,220,342                    |
| GROSS CURRENT ASSETS   |              | 230,659,437                   | 60,305,823                    |
| Less: Current Liabilities<br>and provisions                          | 8            | 6,243,236                     | 19,777,186                    |
| <b>NET CURRENT ASSETS</b>  |              | 224,416,201                   | 40,528,637                    |
| <b>MISCELLANEOUS EXPENDITURE</b>                                     | 9            | 11,272,299                    | 3,376,408                     |
| <b>PROFIT AND LOSS ACCOUNT</b>                                       |              | 430,985,766                   | 365,369,805                   |
| <b>NOTES TO ACCOUNTS AND<br/>SIGNIFICANT ACCOUNTING<br/>POLICIES</b> |              |                               |                               |
| Total  | 13           | <u>1,094,816,575</u>          | <u>769,409,894</u>            |

Per and subject to our report of even date  
For **Gokhale & Co.**,  
Chartered Accountants

For and on behalf of the Board of Directors

**Chandrashekhar Gokhale**  
Partner

**K. Ramachandra Reddy**  
Chairman & CEO

**C. Dayakar Reddy**  
Managing Director

Place : Hyderabad  
Date : 28 June 2006

**Raj Kumar Singh**  
Company Secretary

**Vivek Bhargava**  
Chief Financial Officer

**PROFIT AND LOSS ACCOUNT  
FOR THE YEAR ENDED 31 MARCH 2006**

|   | Schedule<br>No. | For the year ended<br>31 March 2006<br>Rs. | For the year ended<br>31 March 2005<br>Rs. |
|---|-----------------|--|--|
| <b>I INCOME:</b>                                      |                 |  |  |
| Sales Revenue   |                 | 49,898,022                                 | 23,289,723                                 |
| Other Income  | 10              | 18,426,283                                 | 3,127,277                                  |
|   |                 | <u>68,324,305</u>                          | <u>26,417,000</u>                          |
| <b>II EXPENDITURE:</b>                                |                 |  |  |
| Software and product<br>development Expenses          | 11              | 74,791,543                                 | 69,889,871                                 |
| Sales, General and<br>Administration Expenses         | 12              | 30,961,035                                 | 29,546,060                                 |
| Depreciation  |                 | 27,873,292                                 | 24,005,565                                 |
|   |                 | <u>133,625,870</u>                         | <u>123,441,496</u>                         |
| <b>III Profit(+)/Loss(-) Before Tax</b>               |                 | -65,301,565                                | -97,024,496                                |
| Less: Income Tax Expense                              |                 |  |  |
| Fringe Benefit tax                                    |                 | 314,396                                    | -  |
| Profit(+)/Loss After Tax                              |                 | -65,615,961                                | -97,024,496                                |
| Add: Balance brought forward<br>from previous year    |                 | -365,369,805                               | -268,345,309                               |
| Balance carried to Balance Sheet                      |                 | <u>-430,985,766</u>                        | <u>-365,369,805</u>                        |
| <b>IV Earnings Per Share</b>                          |                 |  |  |
| Basic   |                 | -1.54                                      | -2.95                                      |
| Diluted   |                 | -1.54                                      | -2.95                                      |
| No. of shares used in computing<br>Earnings per share |                 |  |  |
| Basic   |                 | 42,569,215                                 | 32,916,612                                 |
| Diluted   |                 | 42,569,705                                 | 32,916,748                                 |

Per and subject to our report of even date  
For **Gokhale & Co.**,  
Chartered Accountants

For and on behalf of the Board of Directors

**Chandrashekhar Gokhale**  
Partner

**K. Ramachandra Reddy**  
Chairman & CEO

**C. Dayakar Reddy**  
Managing Director

Place : Hyderabad  
Date : 28 June 2006

**Raj Kumar Singh**  
Company Secretary

**Vivek Bhargava**  
Chief Financial Officer

**SCHEDULES FORMING PART OF  
BALANCE SHEET**

|   | As At<br>31 March 2006<br>Rs. | As At<br>31 March 2005<br>Rs. |
|---|-------------------------------|-------------------------------|
| <b>SCHEDULE 1</b>   |                               |                               |
| SHARE CAPITAL:  |                               |                               |
| <u>Authorised:</u>  |                               |                               |
| 55,000,000 (Previous Year 55,000,000) equity shares of Rs.10/- each   | <u>550,000,000</u>            | <u>550,000,000</u>            |
| <u>Issued:</u>  |                               |                               |
| 45,100,589 (Previous Year 34,993,135) equity shares of Rs.10/- each   | <u>451,005,890</u>            | <u>349,931,350</u>            |
| <u>Subscribed and Paid-up:</u>  |                               |                               |
| 43,370,017 (Previous Year 34,043,062) equity shares of Rs.10/- each<br>(Of the above 8,325,770 shares of Rs.10 each have been allotted for consideration other than cash pursuant to the acquisition of 100% equity in MosChip Semiconductor Technology, USA)<br><br>(Of the above 6,177,778 shares of Rs.10 each have been allotted for consideration other than cash pursuant to the Scheme of Amalgamation of Verasity Technologies, Inc with the Company) | <u>433,700,170</u>            | <u>340,430,620</u>            |
| <b>SCHEDULE 2</b>   |                               |                               |
| RESERVES AND SURPLUS:   |                               |                               |
| Capital Reserve   | 1,250,000                     | 1,000,000                     |
| Securities Premium  |                               |                               |
| Opening Balance   | 427,803,732                   | 343,255,963                   |
| Additions   | 231,897,563                   | 84,547,769                    |
| Closing balance   | <u>659,701,295</u>            | <u>427,803,732</u>            |
|   | <u>660,951,295</u>            | <u>428,803,732</u>            |

**SCHEDULES FORMING PART OF  
BALANCE SHEET**

**SCHEDULE - 3  
FIXED ASSETS**

(Amounts in Rupees)

| Sl. No. | DESCRIPTION             | GROSS BLOCK         |                           |                              | DEPRECIATION        |                   |                   |                | NET BLOCK           |                   |                   |
|---------|-------------------------|---------------------|---------------------------|------------------------------|---------------------|-------------------|-------------------|----------------|---------------------|-------------------|-------------------|
|         |                         | Cost as at 01.04.05 | Additions during the year | Fixed Assets Sold/ Discarded | Total Upto 31.03.06 | Upto 31.03.05     | For the year      | On Deletions   | Total Upto 31.03.06 | As at 31.03.06    | As at 31.03.05    |
| 1       | Computers               | 28,789,699          | 5,664,186                 | 334,702                      | 34,119,183          | 14,755,783        | 5,046,351         | 199,586        | 19,602,548          | 14,516,635        | 14,033,916        |
| 2       | Electrical Installation | 3,007,900           | 85,387                    | -                            | 3,093,287           | 544,838           | 140,871           | -              | 685,709             | 2,407,578         | 2,463,062         |
| 3       | Plant and Machinery     | 26,403,559          | 1,416,900                 | -                            | 27,820,459          | 9,824,322         | 10,425,625        | -              | 20,249,947          | 7,570,512         | 16,579,237        |
| 4       | Software                | 48,609,290          | 20,959,799                | -                            | 69,569,089          | 39,251,473        | 11,592,558        | -              | 50,844,031          | 18,725,058        | 9,357,817         |
| 5       | Furniture and Fittings  | 7,287,054           | 179,738                   | -                            | 7,466,792           | 1,740,397         | 476,335           | -              | 2,216,732           | 5,250,060         | 5,546,657         |
| 6       | Office Equipment        | 2,498,562           | 205,499                   | 3,000                        | 2,701,061           | 805,824           | 154,567           | 3,000          | 957,391             | 1,743,670         | 1,692,738         |
| 7       | Vehicles                | 52,435              | 31,822                    | -                            | 84,257              | 24,097            | 6,274             | -              | 30,371              | 53,886            | 28,338            |
| 8       | Lab Equipment           | 348,528             | 2,008,463                 | -                            | 2,356,991           | 30,457            | 30,711            | -              | 61,168              | 2,295,823         | 318,071           |
|         | <b>TOTAL</b>            | <b>116,997,027</b>  | <b>30,551,794</b>         | <b>337,702</b>               | <b>147,211,119</b>  | <b>66,977,191</b> | <b>27,873,292</b> | <b>202,586</b> | <b>94,647,897</b>   | <b>52,563,222</b> | <b>50,019,836</b> |
|         | Previous Year           | 94,073,255          | 24,051,789                | 1,128,017                    | 116,997,027         | 43,152,948        | 24,005,565        | 181,322        | 66,977,191          | 50,019,836        | -                 |

**SCHEDULES FORMING PART OF  
BALANCE SHEET**

|   | As At<br>31 March 2006<br>Rs. | As At<br>31 March 2005<br>Rs. |
|---|-------------------------------|-------------------------------|
| <b>SCHEDULE 4</b>   |                               |                               |
| INVESTMENTS:  |                               |                               |
| Long-Term   |                               |                               |
| Unquoted, At cost   |                               |                               |
| Wholly-owned Subsidiary:  |                               |                               |
| 19,192,404 (Previous Year 16,131,180) shares of<br>MosChip Semiconductor Technology, USA<br>(a company incorporated in USA) | <b>375,579,087</b>            | 309,219,098                   |
|   | <u>375,579,087</u>            | <u>309,219,098</u>            |
| Current   |                               |                               |
| Non-Trade, Unquoted, At Cost  |                               |                               |
| Nil (Previous Year 70,504.8146) Units of Rs.10/- each in<br>Kotak Mahindra Mutual Fund                                      | -                             | 896,110                       |
|   | <u>-</u>                      | <u>896,110</u>                |
| Aggregate market value of the non-trade investments as on<br>31 March 2006 is Rs.Nil (Previous Year Rs.935,102)             | <u><b>375,579,087</b></u>     | <u>310,115,208</u>            |
| <b>SCHEDULE 5</b>   |                               |                               |
| SUNDRY DEBTORS:   |                               |                               |
| (Unsecured, Considered Good)  |                               |                               |
| Outstanding for a period exceeding six months   | -                             | -                             |
| Others  | <b>8,068,634</b>              | 5,295,970                     |
|   | <u><b>8,068,634</b></u>       | <u>5,295,970</u>              |

**SCHEDULES FORMING PART OF  
BALANCE SHEET**

|   | As At<br>31 March 2006<br>Rs. | As At<br>31 March 2005<br>Rs. |
|---|-------------------------------|-------------------------------|
| <b>SCHEDULE 6</b>   |                               |                               |
| CASH AND BANK BALANCES:   |                               |                               |
| Cash on hand  | 18,395                        | 26,257                        |
| Balance with Scheduled Banks  |                               |                               |
| - In Current accounts   | 13,068,272                    | 11,607,274                    |
| - In fixed deposit accounts<br>(Rs. 618,040 (Previous Year Rs.601,250)<br>pledged towards margin on Bank Guarantee)<br>Bank of America, USA | 170,624,987                   | 608,198                       |
| (Maximum amount outstanding during the period<br>Rs.10,114,884 (previous year Rs.4,331,019)   | 235,572                       | 265,548                       |
|   | <u>183,947,226</u>            | <u>12,507,277</u>             |
| <b>SCHEDULE 7</b>   |                               |                               |
| LOANS AND ADVANCES:   |                               |                               |
| (Unsecured, considered good, recoverable in cash<br>Or in kind or for value to be received)   |                               |                               |
| Deposits  | 1,049,921                     | 2,363,582                     |
| Loan to Subsidiary  | 17,848,000                    | 33,422,850                    |
| MosChip Employees Trust   | 3,903,000                     | 4,503,000                     |
| Other Advances and Receivables  | 3,374,762                     | 502,961                       |
| Prepaid Expenses  | 4,154,987                     | 955,540                       |
| Prepaid Income Tax  | 534,581                       | 472,409                       |
|   | <u>30,865,251</u>             | <u>42,220,342</u>             |
| <b>SCHEDULE 8</b>   |                               |                               |
| CURRENT LIABILITIES AND PROVISIONS:   |                               |                               |
| CURRENT LIABILITIES:  |                               |                               |
| Sundry Creditors:   |                               |                               |
| Dues to Small Scale Industrial Undertakings   | -                             | -                             |
| Others  | 2,301,759                     | 18,194,530                    |
|   | <u>2,301,759</u>              | <u>18,194,530</u>             |
| PROVISIONS:   |                               |                               |
| Provision for Leave Encashment  | 1,768,281                     | 1,470,094                     |
| Provision for Gratuity  | 2,173,196                     | 112,562                       |
|   | <u>3,941,477</u>              | <u>1,582,656</u>              |
|   | <u>6,243,236</u>              | <u>19,777,186</u>             |
| <b>SCHEDULE 9</b>   |                               |                               |
| MISCELLANEOUS EXPENDITURE:  |                               |                               |
| (To the extent not written off or adjusted)   |                               |                               |
| GDR/Share Issue Expenses  | 11,272,299                    | 3,376,408                     |
|   | <u>11,272,299</u>             | <u>3,376,408</u>              |

**SCHEDULES FORMING PART OF  
PROFIT AND LOSS ACCOUNT**

|   | For the year ended<br>31 March 2006<br>Rs. | For the year ended<br>31 March 2005<br>Rs. |
|---|--|--|
| <b>SCHEDULE 10</b>  |  |  |
| OTHER INCOME:   |  |  |
| Interest Earned (Gross)<br>(Tax Deducted at Source Rs. 534,581/-<br>(previous year Nil )) | 10,560,831                                 | 1,699,396                                  |
| Miscellaneous Income  | 2,732,047                                  | -  |
| Profit on Sale of Fixed Assets  | 20,056                                     | -  |
| Realised Gain on Forex Fluctuations   | -  | 65,592                                     |
| Profit on Sale of Investments   | 5,113,349                                  | 1,362,289                                  |
|   | <u>18,426,283</u>                          | <u>3,127,277</u>                           |
| <b>SCHEDULE 11</b>  |  |  |
| SOFTWARE AND PRODUCT<br>DEVELOPMENT EXPENSES:   |  |  |
| Salaries and Other Allowances to Employees  | 52,349,010                                 | 43,562,854                                 |
| Contribution to PF  | 178,360                                    | 191,018                                    |
| Staff Welfare Expenses  | 2,963,565                                  | 2,122,333                                  |
| Directors' Remuneration   | 2,666,032                                  | 1,929,000                                  |
| Professional Charges - Technical  | 4,296,608                                  | 14,175,359                                 |
| Rent  | 1,991,632                                  | 2,243,381                                  |
| Electricity Charges   | 1,340,376                                  | 1,481,123                                  |
| Consumables   | 3,662,764                                  | 2,976,427                                  |
| Repairs & Maintenance   | 143,005                                    | 134,260                                    |
| Software Charges  | 4,109,495                                  | 241,872                                    |
| Communication Expenses  | 627,739                                    | 509,696                                    |
| Computer Maintenance  | 462,957                                    | 322,548                                    |
|   | <u>74,791,543</u>                          | <u>69,889,871</u>                          |

**SCHEDULES FORMING PART OF  
PROFIT AND LOSS ACCOUNT**

|   | For the year ended<br>31 March 2006<br>Rs. | For the year ended<br>31 March 2005<br>Rs. |
|---|--|--|
| <b>SCHEDULE 12</b>                          |  |  |
| SALES, GENERAL AND ADMINISTRATIVE EXPENSES: |  |  |
| Salaries and Other Allowances to Employees  | 9,182,329                                  | 9,358,552                                  |
| Contribution to PF                          | 84,495                                     | 79,358                                     |
| Directors' Remuneration                     | 2,666,032                                  | 1,929,000                                  |
| Directors' Sitting Fee                      | 35,000                                     | 39,000                                     |
| Printing and Stationery                     | 129,037                                    | 130,883                                    |
| Postage, Telegrams and Telephones           | 1,376,466                                  | 997,735                                    |
| Rent  | 407,925                                    | 445,503                                    |
| Fees, Rates and Taxes                       | 189,174                                    | 1,189,095                                  |
| Vehicle Maintenance                         | 40,826                                     | 36,908                                     |
| Repairs and Maintenance                     | 146,945                                    | 163,594                                    |
| Traveling and conveyance                    | 5,489,389                                  | 4,364,975                                  |
| Advertisement Expenses                      | 144,013                                    | 150,476                                    |
| Payments to Auditors                        | 207,200                                    | 162,000                                    |
| Insurance                                   | 442,392                                    | 615,679                                    |
| Professional charges                        | 1,366,918                                  | 1,412,874                                  |
| Electricity Charges                         | 274,535                                    | 407,846                                    |
| Recruitment Expenses                        | 412,292                                    | 829,425                                    |
| General Expenses                            | 2,770,982                                  | 1,616,256                                  |
| Loss on Fixed Assets Sold/Discarded         | 21,573                                     | 944,695                                    |
| Rights Issue Expenses                       | -  | 1,268,214                                  |
| Interest and Finance Charges                | 10   | 903,388                                    |
| Realised Loss on Forex Fluctuation          | 914,732                                    | -  |
| Unrealised Loss on Forex Fluctuation        | 1,479,658                                  | 837,564                                    |
| With Holding Tax                            | 329,250                                    | -  |
| Share Issue Expenses written off            | -  | 1,367,180                                  |
| Preliminary expenses written off            | -  | 8,896                                      |
| Improvements to leased premises             | 14,174                                     | 8,849                                      |
| Prior Period Adjustments                    | 17,619                                     | 278,115                                    |
| GDR Issue Expenses Written Off              | 2,818,069                                  | -  |
|   | <b>30,961,035</b>                          | <b>29,546,060</b>                          |

## SIGNIFICANT ACCOUNTING POLICIES AND NOTES TO ACCOUNTS

### SCHEDULE 13

#### SIGNIFICANT ACCOUNTING POLICIES

##### A. Basis of Accounting

The financial statements are prepared under the historical cost convention in accordance with the Generally Accepted Accounting Principles (GAAP) applicable in India and the provisions of the Indian Companies Act, 1956.

##### B. Use of Estimates

The preparation of the financial statements in conformity with the GAAP requires that the management makes estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent liabilities as at the date of the financial statements, and the reported amounts of revenue and expenses during the reported year. Actual results could differ from those estimates

##### C. Revenue Recognition

Revenue from Software sales is recognized based on software developed and billed as per the terms of specific contracts.

##### D. Fixed Assets

Fixed Assets are stated at cost of acquisition inclusive of inland freight, duties and taxes and incidental expenditure incurred during installation where applicable. Assets under installation, as at the Balance Sheet date are shown as Capital work-in-progress.

##### E. Depreciation

- (i) Depreciation on fixed assets is provided under Straight Line method at the rates specified in Schedule XIV of the Companies Act, 1956 except Computer Software which is depreciated over a period of five years based on the technical evaluation about their useful economic life.
- (ii) Depreciation is provided at one hundred percent for assets costing less than Rs.5,000/-.

##### F. Foreign Exchange Transactions

Transactions in foreign currency are recorded at exchange rate prevailing on the date of transaction. Monetary assets and liabilities denominated in foreign

currency are translated at the rate of exchange at the balance sheet date and resultant gain or loss is recognized in the profit and loss account.

Non-monetary assets and liabilities are translated at the rate prevailing on the date of transaction.

The operations of foreign branches of the company are of integral in nature and the financial statements of these branches are translated using the same principles and procedure of head office.

Realized gains and losses on foreign exchange transactions other than those relating to fixed assets are recognized in the Profit and Loss account.

Gain or Loss on translation and realized gain or loss in respect of Liabilities incurred to acquire fixed assets is adjusted to the carrying cost of fixed assets.

##### G. Investments

Investments are classified into current investments and long-term investments. Current Investments are carried at the lower of cost and fair value, and provision is made to recognize any decline in the carrying value. Long-term investments are carried at cost, and provision is made to recognize any decline, other than temporary, in the value of such investment.

##### H. Retirement benefits

- (i) Provident Fund: The Company contributes to the employees' provident fund (a defined contribution benefit) maintained under the Employees Provident Fund scheme by the Central Government.
- (ii) Gratuity: The Company Contributes to LIC Group Gratuity Fund. Provision for accrued Gratuity liability is made as per the latest actuarial certificate provided by LIC updated with material changes between the date of valuation and balance sheet date.
- (iii) Leave Encashment: The liability in respect of leave encashment is provided on accrual basis as estimated by the management.

##### I. Miscellaneous Expenditure

Preliminary expenses and expenditure in connection with issue of shares are written off over a period of five years.

## SIGNIFICANT ACCOUNTING POLICIES AND NOTES TO ACCOUNTS

### NOTES TO ACCOUNTS

#### 1. Contingent Liabilities:

- (i) Estimated amount of Contracts remaining to be executed on Capital Account and not provided for : Rs. 11,250/- (as at 31 March 2005 Rs. 156,338/-).
- (ii) On account of Bank Guarantee given by bankers : Rs. 618,040/- (as at 31 March 2005 Rs.601,250/-)
- (iii) On account of Bond executed by the Company to Government of India towards exemption of customs Duty on Imported Equipment and Excise Duty on Indigenous Equipment : Rs. 2,525,000/- (as at 31 March 2005 Rs. 2,525,000/-)

#### 2. Share Capital

Increase in Share Capital for the Year is on account of the following allotments:

| Particulars                           | No. of Shares    | Price Per Share |
|---------------------------------------|------------------|-----------------|
| On exercise of Employee Stock Options | 38,326           | 26.75           |
| On exercise of Employee Stock Options | 3,000            | 30.50           |
| On exercise of Employee Stock Options | 76,125           | 31.00           |
| On exercise of Employee Stock Options | 100,050          | 33.00           |
| In lieu of shares underlying GDRs     | 9,107,454        | 34.95           |
| On exercise of Employee Stock Options | 1,000            | 40.50           |
| On exercise of Employee Stock Options | 1,000            | 42.85           |
| <b>Total</b>                          | <b>9,326,955</b> |                 |

#### 3. Accounting for taxes on income

During the period under review, the Company carried its operations in India through its 100% Export Oriented Unit, registered with the Software Technology Parks of India (STPI), Hyderabad. Pursuant to the scheme of Amalgamation, the Company continues to carry on the business of erstwhile Veracity Technologies and treats it as an overseas branch office. The operations of the STPI Unit and overseas branch have resulted in a net loss for the year ended 31 March 2006. Hence, no provision has been made in the books of account for the tax liability for the year as well as for the deferred taxes as per the Accounting Standard - 22 on Accounting For Taxes on Income, issued by the Institute of Chartered Accountants of India.

#### 4. Employee Stock Option Plans

As per the Employee Stock Option Scheme and Employee Stock Purchase Guidelines, 1999 issued by the Securities and Exchange Board of India, the excess of the market price of the underlying equity shares as of the date of the grant of the options over the exercise price of the options is to be recognized and amortized on a straight-line basis over the vesting period.

The Company has established six schemes Employee Stock Option Plan, MosChip Stock Option Plan 2001, MosChip Stock Option Plan 2002, MosChip Stock Option Plan 2004, MosChip Stock Option Plan 2005 (MI) and MosChip Stock Option Plan 2005 (WOS) with 600,000 equity shares, 300,000 equity shares, 700,000 equity shares, 1,000,000 equity shares, 500,000 equity shares and 500,000 equity shares respectively. Of these the Employee Stock Options Plan was established when the Company was unlisted and consequently, the Employee Stock Option Scheme and Employee Stock Purchase Guidelines, 1999 are not applicable to the options granted under this Plan.

## SIGNIFICANT ACCOUNTING POLICIES AND NOTES TO ACCOUNTS

### Stock Options Outstanding under the Employee Stock Option Plan

| Particulars                                      | Year ended<br>31 March 2006 | Year ended<br>31 March 2005 |
|--|-----------------------------|-----------------------------|
| Options outstanding at the beginning of the year | 310,840                     | 246,620                     |
| Granted during the year                          | 4,000                       | 208,000                     |
| Forfeited during the year                        | 77,500                      | 77,970                      |
| Exercised during the year                        | 74,840                      | 65,810                      |
| Outstanding at the end of the year               | 162,500                     | 310,840                     |

### Stock Options Outstanding under the MosChip Stock Option Plan 2001

| Particulars                                      | Year ended<br>31 March 2006 | Year ended<br>31 March 2005 |
|--|-----------------------------|-----------------------------|
| Options outstanding at the beginning of the year | 287,000                     | 273,000                     |
| Granted during the year                          | 40,000                      | 66,000                      |
| Forfeited during the year                        | 53,000                      | 41,000                      |
| Exercised during the year                        | 108,375                     | 11,000                      |
| Outstanding at the end of the year               | 165,625                     | 287,000                     |

### Stock Options Outstanding under the MosChip Stock Option Plan 2002

| Particulars                                      | Year ended<br>31 March 2006 | Year ended<br>31 March 2005 |
|--|-----------------------------|-----------------------------|
| Options outstanding at the beginning of the year | 556,029                     | 688,300                     |
| Granted during the year                          | 14,000                      | 148,000                     |
| Forfeited during the year                        | 62,074                      | 239,587                     |
| Exercised during the year                        | 108,376                     | 40,684                      |
| Outstanding at the end of the year               | 399,579                     | 556,029                     |

### Stock Options Outstanding under the MosChip Stock Option Plan 2004

| Particulars                                      | Year ended<br>31 March 2006 | Year ended<br>31 March 2005 |
|--|-----------------------------|-----------------------------|
| Options outstanding at the beginning of the year | 75,000                      | Nil                         |
| Granted during the year                          | 723,000                     | 75,000                      |
| Forfeited during the year                        | 72,000                      | Nil                         |
| Exercised during the year                        | 1,000                       | Nil                         |
| Outstanding at the end of the year               | 725,000                     | 75,000                      |

As on the balance sheet date no options have been granted to any of the employees of the Company or its wholly owned subsidiary under MosChip Stock Option Plan 2005 (MI) and MosChip Stock Option Plan 2005 (WOS).

## SIGNIFICANT ACCOUNTING POLICIES AND NOTES TO ACCOUNTS

### 5. Earnings Per Share

The basic earnings per share has been computed using the weighted average number of equity shares outstanding during the applicable periods.

Diluted earnings per share are computed using the weighted average number of equity shares and dilutive potential equity shares outstanding during the applicable periods. Potential equity shares include equity shares that can be issued against the share application money received during the year.

(Amounts in Rupees)

| Particulars  | Year ended<br>31 March 2006 | Year ended<br>31 March 2005 |
|--|-----------------------------|-----------------------------|
| <b>BASIC EARNINGS/(LOSS) PER SHARE</b>   |                             |                             |
| Net Profit/(Loss) for the period   | (65,615,961)                | (97,024,496)                |
| Weighted average number of equity shares   | 42,569,215                  | 32,916,612                  |
| Basic Earnings/(Loss) per equity share   | (1.54)                      | (2.95)                      |
| <b>DILUTED EARNINGS/(LOSS) PER SHARE</b>   |                             |                             |
| Net Profit/(Loss) for the year   | (65,615,961)                | (97,024,496)                |
| Adjustments  | Nil                         | Nil                         |
| Diluted Net Profit/(Loss) for the period   | (65,615,961)                | (97,024,496)                |
| Weighted average number of equity shares   | 42,569,215                  | 32,916,612                  |
| Potential weighted average number of equity shares applicable to share application money | 490                         | 136                         |
| Weighted average number of diluted equity shares   | 42,569,705                  | 32,916,748                  |
| Diluted earnings/(loss) per share  | (1.54)                      | (2.95)                      |

### 6. Directors' Remuneration:

(Amounts in Rupees)

| Particulars   | Year ended<br>31 March 2006 | Year ended<br>31 March 2005 |
|---|-----------------------------|-----------------------------|
| 1. Salary and allowances  | 5,332,064                   | 3,858,000                   |
| 2. No Provision for Commission to Whole Time Directors has been made in the books, as there is no profit in accordance with Section 198 of the Companies Act, 1956. |                             |                             |

### 7. Related Party Transactions

The Company entered into related party transactions during the period with its wholly owned subsidiary, MosChip Semiconductor Technology, USA. The transactions with subsidiary include investment in equity shares, purchase of capital equipments, consumables, reimbursement of expenses, loans given to meet the working capital requirements and interest receivable on such loans. The key management personnel are:

| Name of Personnel               | Designation             |
|---------------------------------|-------------------------|
| <b>Whole-time Directors</b>     |                         |
| K. Ramachandra Reddy            | Chairman & CEO          |
| C. Dayakar Reddy                | Managing Director       |
| <b>Key Management Personnel</b> |                         |
| Vivek Bhargava                  | Chief Financial Officer |

## SIGNIFICANT ACCOUNTING POLICIES AND NOTES TO ACCOUNTS

The transactions with the related parties, are summarized below:

(Amounts in Rupees)

| Nature of Transactions  | Transactions during the year | Balance as on 31 March 2006 |
|---|------------------------------|-----------------------------|
| <b>Transactions with Subsidiary</b>                           |                              |                             |
| Purchases of Fixed Assets / Payable                           | 2,401,655                    | 72,800                      |
| Reimbursement of expenses / Payable                           | 986,615                      | 506,416                     |
| Revenue / Receivable  | 2,6520,751                   | 4,896,063                   |
| Advance License Fee Refunded                                  | 9,091,440                    | Nil                         |
| Equity Investment in MosChip USA (WOS)                        | 66,359,989                   | 375,579,087                 |
| Loan Refunded /Balance loan Receivable                        | 16,085,550                   | 17,848,000                  |
| <b>Transactions with whole time directors</b>                 |                              |                             |
| Remuneration to Chairman & CEO                                | 2,666,032                    | Nil                         |
| Remuneration to Managing Director                             | 2,666,032                    | Nil                         |
| <b>Transactions with Key management personnel</b>             |                              |                             |
| Remuneration to Key Management Personnel                      | 1,744,373                    | Nil                         |
| Stock Options Granted/Outstanding to key management personnel | Nil                          | 37,500                      |

### 8. Additional information as required under Part II of Schedule VI of the Companies Act, 1956:

(Amounts in Rupees)

|   | For the year ended<br>31 March 2006<br>Rs. | For the year ended<br>31 March 2005<br>Rs. |
|---|--|--|
| <b>A. C I F Value of Imports :</b>        |  |  |
| Capital Goods                             | 4,522,422                                  | 1,449,546                                  |
| Computer Software                         | 19,654,654                                 | Nil  |
| <b>B. Expenditure in Foreign currency</b> |  |  |
| Software Charges                          | 3,506,702                                  | Nil  |
| Traveling Expenses                        | 2,810,438                                  | 1,825,715                                  |
| Salaries                                  | 1,506,409                                  | 7,812,599                                  |
| Professional Charges                      | 4,439,250                                  | 13,560,249                                 |
| Consumables                               | 1,556,722                                  | 1,444,728                                  |
| GDR Issue Expenses                        | 10,473,960                                 | 3,376,408                                  |
| Other Expenses                            | 3,388,365                                  | 1,753,289                                  |
| <b>C. Earnings in Foreign Exchange</b>    |  |  |
| Sales Revenue                             | 49,898,022                                 | 23,289,723                                 |

### 9. Segment Reporting

The Company recognizes ASIC design as its only primary segment since its operations during the year consists of ASIC design and sale/license of related intellectual property developed by it. Accordingly revenues from sale/

## SIGNIFICANT ACCOUNTING POLICIES AND NOTES TO ACCOUNTS

license of software (designs/intellectual property) comprise the primary basis of segmental information set out in these Financial Statements. Secondary segmental reporting is performed on the basis of the geographical location of customers

Business Segment: Performance of business segments for the period under review is as follows:

| Particulars   | Year ended<br>31 March 2006<br>Rs. | Year ended<br>31 March 2005<br>Rs. |
|---|------------------------------------|------------------------------------|
| <b>Revenue</b>  |                                    |                                    |
| Sales to external customers   | 49,898,022                         | 23,289,723                         |
| <b>Result</b>   |                                    |                                    |
| Segment result Profit/(loss)  | (84,356,640)                       | (99,248,385)                       |
| Interest expense  | Nil                                | 903,388                            |
| Other Income  | 18,426,283                         | 3,127,277                          |
| Income Taxes  | 314,396                            | Nil                                |
| Net profit/(loss)   | (65,615,961)                       | (97,024,496)                       |
| <b>Other Segment Information</b>                                    |                                    |                                    |
| Depreciation  | 27,873,292                         | 24,005,565                         |
| Non-cash expenses other than depreciation                           | 2,839,641                          | 2,213,640                          |
| <b>Particulars of Segment Assets and Liabilities</b>                |                                    |                                    |
| Segment Assets  | 91,497,107                         | 97,536,148                         |
| Investments   | 375,579,087                        | 310,115,208                        |
| Cash and Bank Deposits  | 183,947,226                        | 12,507,277                         |
| Other Assets  | 7,778,326                          | 282,234                            |
| Total Assets  | 658,801,746                        | 420,440,867                        |
| Segment Liabilities   | 6,243,236                          | 19,777,186                         |
| Secured Loans   | Nil                                | Nil                                |
| Total Liabilities   | 6,243,236                          | 19,777,186                         |
| <b>Geographic Segment</b>   |                                    |                                    |
| <b>Revenue attributable to location of customers is as follows:</b> |                                    |                                    |
| Geographic Location   |                                    |                                    |
| North America   | 46,155,422                         | 17,763,223                         |
| Others  | 3,742,600                          | 5,526,500                          |
| <b>Segment fixed assets based on their location are as follows</b>  |                                    |                                    |
| Carrying amount of segment fixed assets                             |                                    |                                    |
| India   | 126,091,523                        | 97,054,631                         |
| North America   | 21,119,596                         | 19,942,396                         |
| Additions to fixed assets   |                                    |                                    |
| India   | 29,374,594                         | 4,554,683                          |
| North America   | 1,177,200                          | 19,497,106                         |

## SIGNIFICANT ACCOUNTING POLICIES AND NOTES TO ACCOUNTS

### 10. Amounts paid/payable to Auditors:

| Particulars       | Year ended<br>31 March 2006<br>Rs. | Year ended<br>31 March 2005<br>Rs. |
|-------------------|------------------------------------|------------------------------------|
| As Auditors       | 77,140                             | 66,120                             |
| For Tax Audit     | 27,550                             | 27,880                             |
| For Certification | 102,510                            | 68,000                             |
| Total             | 207,200                            | 162,000                            |

### 11. Utilization of Global Depository Receipts (GDR) Proceeds

The following statement shows the total funds raised through issue of Global Depository Receipts, the amounts utilized up to 31 March 2006 and the balance available as on that date:

| Particulars                           | Amounts in Rs. | Amounts in Rs.     |
|---------------------------------------|----------------|--------------------|
| <b>Issue Proceeds</b>                 |                |                    |
| - Share Capital                       | 91,074,540     |                    |
| - Share Premium                       | 227,230,977    |                    |
| <b>Total Issue Proceeds</b>           |                | <b>318,305,517</b> |
| <b>Utilization</b>                    |                |                    |
| GDR Issue Expenses                    | 14,090,368     |                    |
| Equity Investment in MosChip USA      | 69,390,000     |                    |
| Payments for purchase of fixed assets | 30,524,094     |                    |
| Working Capital /Business Operations  | 28,621,870     |                    |
| <b>Total Funds Utilized</b>           |                | <b>142,617,332</b> |
| <b>Funds Available</b>                |                |                    |
| Deposits with Banks                   |                |                    |
| - In Current accounts                 | 5,688,186      |                    |
| - In Fixed Deposit accounts           | 170,000,000    |                    |
| <b>Total Funds Available</b>          |                | <b>175,688,186</b> |

### 12. Regrouping/ Reclassification

The figures for previous year have been regrouped / reclassified wherever necessary.

### 13. Quantitative Details

The Company is engaged in the development of computer software. The production and sale of such software cannot be expressed in any generic unit. Hence, it is not possible to give the quantitative details of sales and the information as required under Paragraphs 3 and 4C of Part II of Schedule VI of the Companies Act, 1956.

Per and subject to our report of even date  
For **Gokhale & Co.**,  
Chartered Accountants

**Chandrashekhar Gokhale**  
Partner

Place : Hyderabad  
Date : 28 June 2006

For and on behalf of the Board of Directors

**K. Ramachandra Reddy**  
Chairman & CEO

**Raj Kumar Singh**  
Company Secretary

**C. Dayakar Reddy**  
Managing Director

**Vivek Bhargava**  
Chief Financial Officer

## CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2006

|  | 31 March 2006<br>Rs. | 31 March 2005<br>Rs. |
|--|----------------------|----------------------|
| <b>A) Cash Flow from Operating Activities</b>  |                      |                      |
| Net Profit before tax  | (65,301,565)         | (97,024,496)         |
| <b>Adjustments for:</b>  |                      |                      |
| 1) Depreciation  | 27,873,292           | 24,005,565           |
| 2) GDR/Share issue expenses written off  | 2,818,069            | 1,367,180            |
| 3) Miscellaneous Expenses written off  | -                    | 8,896                |
| 4) Interest received   | (10,560,831)         | (1,699,396)          |
| 5) Profit on sale of fixed assets  | (20,056)             | -                    |
| 6) Profit on sale of investments   | (5,113,349)          | (1,362,289)          |
| 7) Loss on sale of fixed assets  | 21,573               | 944,695              |
| 8) Exchange differences on translation of<br>foreign currency cash &<br>Cash equivalents | 92,506               | 94,020               |
| Operating Profit before changes in working capital                                       | (50,190,361)         | (73,665,825)         |
| <b>Adjustments for:</b>  |                      |                      |
| 1) (Increase)/Decrease in Sundry Debtors   | (2,772,664)          | (5,295,970)          |
| 2) (Increase)/Decrease in Loans and Advances   | 11,417,263           | (4,466,151)          |
| 3) Increase/(Decrease) in Current liabilities  | (13,533,950)         | 10,420               |
| 4) Increase/(Decrease) in Bank Guarantee<br>Deposits with Bankers                        | (16,790)             | (21,250)             |
|  | (55,096,502)         | (83,438,776)         |
| <b>Adjustments for:</b>  |                      |                      |
| Income-tax paid  | (376,568)            | 306,022              |
| <b>Net cash flow from operating activities [A]</b>                                       | <u>(55,473,070)</u>  | <u>(83,132,754)</u>  |
| <b>B) Cash flow from Investing Activities:</b>   |                      |                      |
| 1) Purchase of Fixed Assets  | (30,551,794)         | (7,924,761)          |
| 2) Sale proceeds of Fixed Assets   | 133,600              | 2,000                |
| 3) Purchase of Investments   | (507,059,989)        | (78,500,000)         |
| 4) Interest received   | 3,064,739            | 1,575,827            |
| 5) Sale of Investments   | 446,709,458          | 100,895,662          |
| <b>Net cash used for Investing activities [B]</b>  | <u>(87,703,986)</u>  | <u>16,048,728</u>    |

## CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2006

|   | 31 March 2006<br>Rs. | 31 March 2005<br>Rs. |
|---|----------------------|----------------------|
| <b>C) Cash flow from Financing Activities:</b>                        |                      |                      |
| 1) Net proceeds from Issue of Share Capital                           | 93,259,118           | 33,986,205           |
| 2) Securities Premium   | 231,897,563          | 84,547,769           |
| 3) Secured Loans  | -                    | (40,000,000)         |
| 4) Subsidy From State Govt  | 250,000              | -                    |
| 5) GDR/Share issue Expenses   | (10,713,960)         | (3,376,408)          |
| <b>Net Cash from Financing Activities [C]</b>                         | <b>314,692,721</b>   | <b>75,157,566</b>    |
| <b>Net Increase/(Decrease) in cash &amp; cash equivalents [A+B+C]</b> | <b>171,515,665</b>   | <b>8,073,540</b>     |
| Cash and Cash equivalents at the beginning of the Period              | 11,906,027           | 3,926,507            |
| Cash and Cash equivalents at the end of the period                    | <b>183,421,692</b>   | <b>12,000,047</b>    |
| Note: Cash and Cash equivalents at the beginning of the year          |                      |                      |
| Cash and Bank balances  | 12,507,277           | 4,506,507            |
| Less: Deposits with Bankers towards Bank Guarantee                    | 601,250              | 580,000              |
|   | <b>11,906,027</b>    | <b>3,926,507</b>     |
| Cash and Cash equivalents at the end of the year                      |                      |                      |
| Cash and Bank balances  | 183,947,226          | 12,507,277           |
| Add: Unrealised gain on foreign exchange fluctuation                  | 92,506               | 94,020               |
| Less: Deposits with Bankers towards Bank Guarantee                    | 618,040              | 601,250              |
|   | <b>183,421,692</b>   | <b>12,000,047</b>    |

For and on behalf of the Board of Directors

|                     |   |  |
|---------------------|---|--|
|                     | <b>K. Ramachandra Reddy</b><br>Chairman & CEO | <b>C. Dayakar Reddy</b><br>Managing Director |
| Place : Hyderabad   | <b>Raj Kumar Singh</b>                        | <b>Vivek Bhargava</b>                        |
| Date : 28 June 2006 | Company Secretary                             | Chief Financial Officer                      |

### AUDITOR'S CERTIFICATE

We have examined the above Cash Flow Statement compiled from the audited financial statements of MosChip Semiconductor Technology Limited for the year ended 31 March 2006 reported by us on 28 June 2006. According to the information and explanations given to us, the above Cash Flow Statement has been prepared in consonance with the requirements of Accounting Standard – 3 on Cash Flow Statements issued by the Institute of Chartered Accountants of India and found the same to be in accordance with the requirements of the amended Clause 32 of the Listing Agreement with Stock Exchanges.

For **Gokhale & Co.**,  
Chartered Accountants

|                     |                              |
|---------------------|------------------------------|
| Place : Hyderabad   | <b>Chandrasekhar Gokhale</b> |
| Date : 28 June 2006 | Partner                      |

## PART - IV BALANCE SHEET ABSTRACT AND COMPANIES GENERAL BUSINESS PROFILE

### 1. Registration Details

|                    |   |               |
|--------------------|---|---------------|
| Registration No.   | : | 32184         |
| State Code         | : | 01            |
| Balance Sheet Date | : | 31 March 2006 |

### 2. Capital raised during the year (Amount in Rs. Thousands) :

|               |   |        |
|---------------|---|--------|
| Public Issue  | : | Nil    |
| Right Issue   | : | Nil    |
| Bonus Issue   | : | Nil    |
| Private Issue | : | 93,270 |

### 3. Position of Mobilisation and Deployment of Funds (Amount in Rs. Thousands) :

|                         |   |           |
|-------------------------|---|-----------|
| Total Liabilities       | : | 1,094,817 |
| Total Assets            | : | 1,094,817 |
| Source of Funds         | : |           |
| Paid up Capital         | : | 433,700   |
| Share Application Money | : | 165       |
| Reserves and Surplus    | : | 660,952   |
| Secured Loans           | : | Nil       |
| Unsecured Loans         | : | Nil       |
| Application of Funds    | : |           |
| Net Fixed Assets        | : | 52,563    |
| Investments             | : | 375,579   |
| Net Current Assets      | : | 224,417   |
| Misc. Expenditure       | : | 11,272    |
| Accumulated Losses      | : | 430,986   |

### 4. Performance of Company (Amount in Rs. Thousands) :

|                                   |   |         |
|-----------------------------------|---|---------|
| Turnover                          | : | 68,324  |
| Total Expenditure                 | : | 133,626 |
| Profit/(Loss) Before Tax          | : | -65,302 |
| Profit After Tax                  | : | -65,616 |
| Earnings Per Share in Rs. (Basic) | : | -1.54   |
| Dividend Rate %                   | : | Nil     |

### 5. Generic Names of Three Principal Products/Services of Company (As per Monetary terms) :

|                      |   |                                    |
|----------------------|---|------------------------------------|
| Item Code (ITC Code) | : | 8491.90                            |
| Product Description  | : | DEVELOPMENT AND EXPORT OF SOFTWARE |

For and on behalf of the Board of Directors

**K. Ramachandra Reddy**  
Chairman & CEO

**C. Dayakar Reddy**  
Managing Director

Place : Hyderabad  
Date : 28 June 2006

**Raj Kumar Singh**  
Company Secretary

**Vivek Bhargava**  
Chief Financial Officer

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**STATEMENT PURSUANT TO SECTION 212 OF  
THE COMPANIES ACT, 1956 RELATING TO SUBSIDIARY COMPANY**

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|   |  |   |                                       |
|---|--|---|---------------------------------------|
| 1 | Name of subsidiary   | : | MosChip Semiconductor Technology, USA |
| 2 | Financial year ended   | : | Year ended 31 March 2006              |
| 3 | Holding Company's Interest   | : | 100%                                  |
| 4 | Shares held by the holding company<br>In the subsidiary's common stock   | : | 19,192,404 shares                     |
| 5 | The net aggregate of profits(losses)<br>For the current financial year of the<br>Subsidiary so far as it concerns the<br>Members of the holding company    |   |                                       |
|   | a. dealt with or provided for in the<br>Accounts of the holding company  | : | Nil                                   |
|   | b. not dealt with or provided for in the<br>Accounts of the holding company  | : | US \$ 43,070                          |
| 6 | The net aggregate of profits or losses<br>For the previous financial year of the<br>Subsidiary so far as it concerns the<br>Members of the holding company |   |                                       |
|   | a. dealt with or provided for in the<br>Accounts of the holding company  | : | NA                                    |
|   | b. not dealt with or provided for in the<br>Accounts of the holding company  | : | US \$ (787,380)                       |

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For and on behalf of the Board of Directors

**K. Ramachandra Reddy**  
Chairman & CEO

**C. Dayakar Reddy**  
Managing Director

Place : Hyderabad  
Date : 28 June 2006

**Raj Kumar Singh**  
Company Secretary

**Vivek Bhargava**  
Chief Financial Officer

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**DIRECTORS' REPORT**


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To  
The Shareholders of MosChip Semiconductor Technology USA,

Your Directors present this report for the Financial Year 2005-2006.

**Financial Results**

(USD in Millions)

| Particulars                                   | 2005-06 | 2004-05 |
|---|---------|---------|
| Semiconductor Sales                           | 4.604   | 3.662   |
| Operating Profit / (Loss) before Depreciation | 0.243   | 0.720   |
| Less: Depreciation                            | 0.212   | 0.275   |
| Operating Profit / (Loss)                     | 0.031   | 0.445   |
| Add: Other Income                             | 0.012   | 0.031   |
| Net Profit / (Loss) Before Tax                | 0.043   | 0.476   |

Your Company achieved total revenues of USD 4.604 million for the financial year ended 31 March 2006 - an increase of 26% over the year ended 31 March 2005.

The gross profit for the financial year ended 31 March 2006 was USD 2.141 million, an increase of 30% over the previous financial year. However due to a substantial increase in Research & Development expenditure the company made a marginal net profit of USD 0.043 million.

**Outlook**

The immediate outlook for the global semiconductor industry is positive. We expect sales from PCI products to remain stable as the need for UARTs is stable and many motherboards have dropped the UART and Printer Port support. PCI products have also been designed in by OEMs into new applications such as point-of-sale machines, game consoles and HDTV tuner modules.

The USB products have also won OEM designs into various applications such as laptop and industrial docking stations. The new products MCS 7840 and MCS 7820 have potential for design wins in USB to Serial products and even Ethernet to Serial applications.

With new OEM design wins for many of the products, revenues from product sales are expected to grow significantly during the current financial year.

**Acknowledgements**

Your Directors appreciate the support extended by the bankers, vendors, clients and employees.

For and on behalf of the Board of Directors

**K.Ramachandra Reddy**  
CEO

7 August 2006

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## INDEPENDENT AUDITOR'S REPORT

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To the Stockholders of MosChip Semiconductor Technology, USA

We have audited the accompanying balance sheet of MosChip Semiconductor Technology, USA (a California corporation) as of 31 March 2006, and the related statements of net income, accumulated deficit, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The Company has excluded the effects of deferred income taxes that, in our opinion, should be included to conform to accounting principles generally accepted in the United States of America. The effects of this exclusion are not reasonably determinable.

In our opinion, except for the exclusion of the effects of deferred income taxes, as discussed in the preceding paragraph, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of MosChip Semiconductor Technology, USA as of 31 March 2006 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

**Forney Accountancy Corporation**

**Pleasant Hill, California**

25 April 2006

## BALANCE SHEET

| Amounts in US \$  |                        |
|---|------------------------|
|   | As At<br>31 March 2006 |
| <b>Assets</b>   |                        |
| <b>Current assets</b>   |                        |
| Cash  | 1,805,494              |
| Accounts receivable   | 555,775                |
| Inventory   | 370,588                |
| Total current assets  | 2,731,857              |
| Deposits  | 3,942                  |
| <b>Property and equipment</b>   |                        |
| Furniture & Fixtures  | 7,000                  |
| Equipment   | 1,073,345              |
| Software  | 170,831                |
|   | 1,251,176              |
| Accumulated depreciation  | (858,230)              |
|   | 392,946                |
| <b>Total assets</b>   | <b>3,128,745</b>       |
| <b>Liabilities</b>  |                        |
| <b>Current liabilities</b>  |                        |
| Accounts payable  | 322,952                |
| Related party payable   | 96,750                 |
| Current portion of related party note payable   | 300,000                |
| Accrued liabilities   | 9,352                  |
| Total current liabilities   | 729,054                |
| Related party note payable  | 100,000                |
| <b>Stockholder's Deficit</b>  |                        |
| Common Stock, no par value,<br>20,212,813 shares authorized<br>19,192,404 shares issued and outstanding | 1,724,000              |
| Additional paid-in capital  | 1,320,000              |
| Accumulated deficit   | 744,309                |
| Total stockholders' deficit   | 2,299,691              |
|   | <b>3,128,745</b>       |

**STATEMENT OF NET INCOME  
AND ACCUMULATED DEFICIT**

Amounts in US \$

|                                      | For the year<br>ended<br>31 March 2006 |
|--------------------------------------|--|
| <b>Revenue</b>                       |  |
| Sales                                | 4,603,738                              |
| Cost of goods sold                   | 2,425,639                              |
| Shipping and handling                | 36,906                                 |
| <b>Gross profit</b>                  | <u>2,141,193</u>                       |
| <b>Expenses</b>                      |  |
| Selling, general, and administrative | 1,193,276                              |
| Research and development             | 656,915                                |
| Depreciation                         | 211,662                                |
| Interest                             | 37,681                                 |
| <b>Total operating expenses</b>      | <u>2,099,534</u>                       |
| Operating income                     | 41,659                                 |
| Other income/(expense)               |  |
| Inventory market value adjustment    | (8,686)                                |
| Interest income                      | 11,732                                 |
| <b>Income before income taxes</b>    | <u>44,705</u>                          |
| Current income tax                   | 1,633                                  |
| <b>Net income</b>                    | <u>43,072</u>                          |
| Accumulated deficit, 31 March 2005   | (787,381)                              |
| Accumulated deficit, 31 March 2006   | <u>(744,309)</u>                       |

## STATEMENT OF CASH FLOWS

|  | Amounts in US \$                       |
|--|--|
|  | For the year<br>ended<br>31 March 2006 |
| <b>Cash flows from operating activities</b>                                      |  |
| Net income   | 43,072                                 |
| Adjustments to reconcile net income to net cash provided by operating activities |  |
| Depreciation   | 211,662                                |
| (Increase) decrease in:  |  |
| Accounts receivable  | (115,562)                              |
| Related party receivable   | 141,881                                |
| Inventory  | (41,381)                               |
| Deposit  | (3,430)                                |
| Increase (decrease) in:  |  |
| Accounts payable   | 315,437                                |
| Accrued liabilities  | (21,533)                               |
| Related party payable  | 96,750                                 |
| <b>Net cash provided by operating activities</b>                                 | <b>626,896</b>                         |
| Cash flows from investing activities   |  |
| Purchases of property and equipment  | (310,050)                              |
| <b>Net cash used by investing activities</b>                                     | <b>(310,050)</b>                       |
| Cash flows from financing activities   |  |
| Debt reduction   | (365,000)                              |
| Common stock issued  | 1,500,000                              |
| <b>Net cash provided by financing activities</b>                                 | <b>1,135,000</b>                       |
| Net increase in cash   | 1,451,846                              |
| Cash, 31 March 2005  | 353,648                                |
| <b>Cash, 31 March 2006</b>   | <b>1,805,494</b>                       |
| Supplemental disclosures of cash flow information                                |  |
| Interest paid  | 37,681                                 |
| Income taxes paid  | 1,633                                  |

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**NOTES TO FINANCIAL STATEMENTS**


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**A. Summary of significant accounting policies:**

- ◆ Nature of operations – MosChip Semiconductor Technology, USA (the Corporation), a California corporation, is a manufacturer of communication chips primarily sold within Hong Kong and Taiwan.
  - ◆ Use of estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.
  - ◆ Concentrations of cash – The Corporation at times during operations has cash deposits in excess of \$100,000. The Federal Deposit Insurance Corporation (FDIC) insures only the first \$100,000 of funds at member banks.
  - ◆ Accounts receivable – The Corporation considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required. If amounts become uncollectible, they will be charged to operations when that determination is made.
  - ◆ Inventories – Inventories are stated at the lower of cost or market value. Cost is determined by the first-in, first-out method and market represents the lower of replacement cost or estimated net realizable value. Inventory consists of finished goods.
  - ◆ Property and equipment/Depreciation – Property and equipment are recorded at cost. Depreciation is calculated using the straight-line method over estimated useful lives of two, three, five, and seven years. When items of property or equipment are sold or retired, the related cost and accumulated depreciation is removed from the accounts and any gain or loss is included in the results of operations.
  - ◆ Income taxes – Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due.
- B. Operating lease – The Corporation leases its facilities under an operating lease agreement with an unrelated party. The base rent is \$4,000 per month, plus a tax and insurance premium of approximately \$1,626 per month, for a total of approximately \$5,626. The Corporation subleases a portion of its facilities to an unrelated party. The Corporation also leases a residential apartment for the temporary residence of visiting vendors. The apartment rent is \$1,425 per month. Rental expense for the year ended 31 March 2006 is \$72,187.
- C. Related party account payable – The Corporation has an account payable from MosChip Semiconductor Technology Limited, India; the sole shareholder of the Corporation. The account payable represents engineering services provided by MosChip Semiconductor Technology Limited, India less reimbursable costs paid on behalf of MosChip Semiconductor Technology Limited, India. The account payable does not bear interest and is payable on demand. The balance of the account payable at 31 March 2006 is \$96,750.
- D. Related party notes payable – The Corporation has notes payable to MosChip Semiconductor Technology Limited, India; the sole shareholder of the Corporation. The notes bear interest at the London Inter Bank Offered Rate plus 2% (7.25% at 31 March 2006) and mature based on the following schedule. The principal due on these notes at 31 March 2006 is \$400,000.
- |                  |                   |
|------------------|-------------------|
| 9 June 2006      | \$ 100,000        |
| 1 September 2006 | 50,000            |
| 5 October 2006   | 50,000            |
| 11 November 2006 | 50,000            |
| 18 November 2006 | 25,000            |
| 18 December 2006 | <u>25,000</u>     |
| Current portion  | \$ 300,000        |
| 30 August 2007   | <u>100,000</u>    |
|                  | <u>\$ 400,000</u> |
- E. Related party transactions – The Corporation conducts business with MosChip Semiconductor Technology Limited, India, the sole shareholder of the Corporation. The Corporation provides products to MosChip Semiconductor Technology Limited, India as a customer on terms equivalent with those of other customers. The Corporation also licenses ASIC software exclusively from MosChip Semiconductor
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**NOTES TO FINANCIAL STATEMENTS**

Technology Limited, India as part of its production process on terms equivalent with those of other vendors.

Transactions are follows:

|  |            |
|--|------------|
| Revenue due to related party transactions  | \$ 3,159   |
| Expenses due to related party transactions | \$ 599,675 |
| Related party account payable              | \$ 96,750  |

- F. Concentration of credit risk – The Corporation had a concentration of credit risk with respect to revenue and accounts receivable from major customers as follows:

|  |     |
|--|-----|
| Number of major customers                              | 2   |
| Percentage of revenue from major customers             | 86% |
| Percentage of accounts receivable from major customers | 94% |

- G. Litigation – In 2005 ZF Micro Devices, Inc. commenced an action against the Corporation and others, alleging that the Corporation misappropriated its trade secrets, engaged in unfair competition, and induced other defendants to breach their duties of confidentiality in connection with certain technology to which ZF Micro Devices, Inc. claims rights. The Corporation has hired an attorney to defend itself and has filed an Answer denying the allegations and asserting various affirmative defenses. Management firmly believes there is no merit to the claim. The ultimate outcome of this litigation is unknown at this time and management is unable to estimate any possible loss resulting from the outcome of this litigation.

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# MOSCHIP SEMICONDUCTOR TECHNOLOGY LIMITED

Regd. Office:H.No: 8-2-685/1/1, ROAD: 12, BANJARA HILLS, HYDERABAD - 500034.

## ATTENDANCE SLIP

(To be handed over at the entrance of the meeting hall)

I hereby record my presence at the **SEVENTH ANNUAL GENERAL MEETING** of the company held at the **Regd. Office of the Company at H.No: 8-2-685/1/1, Road:12, Banjara Hills, Hyderabad - 500 034.** on **Friday the 29 September 2006 at 1030 hrs.**

NAME OF THE SHAREHOLDER (IN BLOCK LETTERS) \_\_\_\_\_

NAME OF THE PROXY (IN BLOCK LETTERS) \_\_\_\_\_

FOLIO NO. \_\_\_\_\_ DP.Id No. \_\_\_\_\_ Client Id.No. \_\_\_\_\_ No. of Shares held \_\_\_\_\_

SIGNATURE OF SHAREHOLDER \_\_\_\_\_

SIGNATURE OF PROXY (1) \_\_\_\_\_ PROXY(2) \_\_\_\_\_

NOTE: Please complete this attendance slip and hand it over at the entrance of the meeting hall. Joint Shareholders desiring to attend the meeting may obtain additional Attendance Slips on request provided the Company receives such request before 23rd September 2006. No duplicate Attendance Slip will be issued at the Meeting Hall. You are requested to bring your copy of the Annual Report to the Meeting. **Kindly note that gifts will not be distributed at Annual General Meeting.**

# MOSCHIP SEMICONDUCTOR TECHNOLOGY LIMITED

Regd. Office:H.No: 8-2-685/1/1, ROAD: 12, BANJARA HILLS, HYDERABAD - 500034.

## PROXY FORM

FOLIO NO. \_\_\_\_\_ DP.Id No. \_\_\_\_\_ Client Id.No. \_\_\_\_\_ No. of Shares held \_\_\_\_\_

I/We \_\_\_\_\_ residing at \_\_\_\_\_ being a member /

members of MOSCHIP SEMICONDUCTOR TECHNOLOGY LIMITED hereby

appoint \_\_\_\_\_ resident of \_\_\_\_\_ signature of proxy) \_\_\_\_\_

failing him/her \_\_\_\_\_ resident of \_\_\_\_\_ (signature of proxy) \_\_\_\_\_

as my / our Proxy to attend and vote for me / us on my / our behalf at the **SEVENTH ANNUAL GENERAL MEETING** of the company to be held at the **Regd. Office of the Company at H.No: 8-2-685/1/1, Road:12, Banjara Hills, Hyderabad - 500 034.** on **Friday the 29 September 2006 at 1030 hrs.**

Dated \_\_\_\_\_ September, 2006

Notes:

- The form should be signed across the stamp as per signatures registered with the company.
- The proxy form duly completed must be deposited at the Registered Office of the Company not less than 48 hrs before the time fixed for holding the aforesaid meeting.
- The proxy need not be a member of the Company.
- Un-filled proxy form is liable to be rejected. Kindly ensure all blanks of the form is filled-in before its submission.

Affix  
Revenue  
Stamp  
of 0.30P  
and sign across