

In the past, the Group has focused its R&D and marketing activities on the promotion of its wireless system solutions. The Directors believe that the Group's earlier investment and the experience accumulated in the R&D and marketing of wireless system solutions served as foundation for development of its wireless terminal business, and more importantly for the development of industry applications in the following ways:—

- (i) telecommunication operators, which are the major customers of the Group's wireless system solutions, are also important clientele for the Group's wireless terminal products;
- (ii) continuous provision of wireless system solutions to telecommunication operators would not only help maintain the Group's relationship with telecommunication operators but also allow the Group to gain insight of technological development and system requirements of telecommunication operators. The Directors believe that such developments will likely shape the behavior of wireless service users and consider them as important considerations in designing wireless terminal products; and
- (iii) under one of the current business models of promoting industry applications, the Group would design an industry application, supply wireless system solution directly to corporate users, and at the same time supply the wireless terminals to telecommunication operators. The telecommunication operators would then resell the wireless terminals together with network usage packages to the corporate users to encourage higher network usage. This model has already been used by customers of the Group and the Group has been and is engaged in promotion of the industry application jointly with one of the major telecommunication operators in the PRC.

In view of the above, the Directors expect that the Group would continue to engage in the provision of wireless system solutions along with the provision of wireless terminals. Given the same core technologies for wireless telecommunication and the commercial considerations cited above, notwithstanding the change in contribution of different products and solutions to the turnover of the Group, the Directors consider that there was no significant change in key functional units of the Group, namely management, R&D, marketing and sales, during the Track Record Period.

Wireless terminals

The Group designs and distributes wireless terminals under its own brand name *Coolpad*. The wireless terminals enable one-way or two-way transmission of wireless data. The Group's wireless terminals are mainly sold to local branches of telecommunication operators and telecommunication equipment distributors in the PRC. The Group also promotes its wireless terminal products as part of its industry application. Typically, the average product cycle of wireless terminal product is estimated to be about 1 to 2 years.

The Group currently supplies wireless terminals in the following categories:—

One-way wireless terminals

Paging information receiver



The one-way wireless handheld terminal is designed to enable subscribers to receive wireless data such as financial market information, stock quote, news and weather forecast. Currently, the one-way wireless terminals are offered in the form of paging information receiver. In view of the shrinking paging market in the PRC, one-way wireless terminals are no longer the Group's main stream products and were included in the Group's product portfolios mainly for the purpose of maintaining a full range of wireless terminal products. The Group intends not to put substantial resources in the R&D or marketing of this product. Instead, the Group will only deliver this type of products based on specific order from earlier customers.

During the Track Record Period, the unit selling price (inclusive of value-added tax) of the Group's one-way wireless terminals was about RMB200 (approximately HK\$189) to RMB600 (approximately HK\$566).

Fixed Wireless terminals



The Group's 2.5G fixed wireless terminals support two-way voice and data communication. The Group's fixed wireless terminals can provide user functions similar to conventional fixed-line phone. However, instead of connecting to a fixed-line network, the fixed wireless terminals make use of a mobile telecommunication network for voice and data transmission. With plug-in SIM cards, the terminals will be able to connect to a mobile network. Some of the Group's fixed wireless terminals can also be used to receive text and/or graphical messages such as financial market information, stock quote, news and email. The Group's fixed wireless terminals are compatible with either CDMA or GSM/GPRS network. In addition, some of the Group's fixed wireless

terminals are designed to allow users to access the Internet. The Directors also believe that the Group's fixed wireless terminal is an effective tool to allow telecommunication operators to provide telephone services to subscribers located in areas which are not covered by conventional fixed-line networks. Some of the Group's fixed wireless terminals have been used as public phones in retail shops. These terminals are capable of retrieving billing information from the telecommunication network, recording call duration, calculating cost for each call and displaying the usage charge on the terminal display. The shop owners can then charge callers based on usage.

The fixed wireless terminals are promoted mainly to operators of mobile telecommunication networks in the PRC, as the fixed wireless terminals encourage usage of mobile networks even in a stationary environment such as office and home. The telecommunication operators will then resell the fixed wireless terminals to their subscribers directly or as part of bundled packages offered by them. In case such terminal is sold as part of a bundled package, the subscribers would typically be required to enter into a fixed-term contract with the telecommunication operator and to undertake to subscribe to the telecommunication operator's services for a fixed period of time. The terminal can also support the Group's fixed wireless network management solution which allows a telecommunication operator to activate, deactivate, configure and manage the fixed wireless terminal remotely. The Directors believe that the fixed wireless terminals would be useful tools for mobile telecommunication operators to attract wider range of users with the product marketed as desktop device. The Group's CDMA fixed wireless terminal passed the field test conducted by the China Unicom Group and was enlisted by the China Unicom Group as one of its approved CDMA fixed wireless terminal providers. As at the Latest Practicable Date, the Directors understand that there were 15 CDMA fixed wireless terminal providers approved by the China Unicom Group in the PRC, including the Group.

During the two years ended 31 December 2003 and the five months ended 31 May 2004, the average selling price of the Group's fixed wireless terminals was approximately RMB1,456 (approximately HK\$1,374), RMB1,708 (approximately HK\$1,611) and RMB743 (approximately HK\$701) respectively. The decrease in average selling price in the five months ended 31 May 2004 was mainly due to the launch of new models with less functions and of lower prices in response to market demand and increasing market competition.

Smartphones



The Group's smartphone product integrates a mobile phone and a PDA with wireless applications such as email, Internet browsing, and SMS. During the Track Record Period, the Group offered smartphones that operate on the CDMA1X network in the PRC. In September 2004, the Smartphone Manufacturing Partner obtained the Network Access Licence for the Group's GSM/GPRS smartphone and the trial licence for the Group's CDMA-GSM dual-mode smartphone. As at the Latest Practicable Date, the Group has delivered more than 15,000 GSM/GPRS smartphones and expects to deliver the CDMA-GSM dual-mode smartphones by the end of 2004.

To enhance user experience with *Coolpad* smartphones, the Group works with ICPs in the PRC and has developed applications that enable *Coolpad* smartphone users to access services and contents provided by these content providers. Through the infrastructure of the telecommunication operators, users of the Group's smartphone can access the various services and contents provided by ICPs. Currently message storage services and other entertainment services such as dating services, lucky draw, fortune telling, quiz, games and jokes are provided by ICPs.

Under the prevailing PRC regulatory restrictions on foreign investments in ICP related business, the Group as a WFOE is not allowed to act as an ICP. As such, the Directors consider it necessary for the Group to collaborate with ICPs to enrich contents for the *Coolpad* smartphone users. As at the Latest Practicable Date, the Group has not paid or received any consideration to/from ICPs. The Directors believe that the Group's cooperation with the ICP is mutually beneficial. The Group can provide value-added services and applications for its smartphone users whilst ICPs can attract more market awareness by teaming up with smartphone manufacturers. Therefore, ICPs provide content services to *Coolpad* smartphone users for free.

The Group aims to position its smartphone as a wireless communication device for the high-end market. The Directors intend the target users of the Group's smartphone to be high-end users requiring sophisticated data functions or corporations using the Group's industry applications. The Directors believe that with the enhancement of wireless telecommunication network, more sophisticated wireless services will become available to the market. Smartphone with ability to support various data related functions such as email, database management, and multi-media functions such as video viewing and recording, Internet browsing and camera function will be of demand. On the other hand, the Directors understand that the competition in this area is intense with various local and overseas competitors. Some of them have very strong market position and technical background.

During the Track Record Period, the unit selling price (inclusive of value-added tax) of the Group's smartphone was about RMB4,500 (approximately HK\$4,245.3) to RMB5,000 (approximately HK\$4,717).

Self-developed operating system

The Group's wireless terminals have been developed based on its self-developed operating system. The Directors consider that by using a self-developed operating system, the Group will have complete control on the software development for its wireless terminals and can come up with new features in a timely manner. The Directors believe that if the Group were to rely on a third party operating system, not only additional time is required but also third party's assistance would be necessary for feature updates and troubleshooting. The saving in time and costs for external assistance and licensing fee for using an operating system developed by third party would be an important positive factor for further development of the wireless terminal products developed by the Group.

To enhance features of the smartphone, the Group works with third party software developers which can make use of the Group's application program interfaces to develop smartphone applications. As at the Latest Practicable Date, the Group had entered into agreements with certain third parties for cooperation in developing application software for smartphone functions such as SMS and Internet browsing.

The Directors believe that the Group has more flexibility in building and enhancing the security features of the wireless terminals with its self-developed operating system. The Directors believe that such features would be particularly important if the Group is to develop industry application that normally requires high level of security. For example, it would be preferable for an application that handles transactions for financial institutions to have its own encryption systems for security purpose.

Industry applications developed based on the Group's wireless terminal products

Combining its technological know-how in wireless telecommunication and its portfolio of products and solutions, the Group is well positioned to provide innovative industry applications (comprising customised wireless system solutions and wireless terminal products) for enhancing internal and external communication of its customers, and thereby creating business opportunities. As at the Latest Practicable Date, the Group had provided industry application solutions to customers engaged in stock trading, aviation, land

transportation and public security. The Group has been in discussion with potential customers in relation to industry applications for banking and insurance. The Group will also explore other industry applications in the future.

Stock trading platform

In February 2004, the Group entered into an agreement with China Galaxy Securities Company Limited (中國銀河證券有限責任公司) with an aim of enabling stock trading through wireless telecommunication network. The application comprises a back-end wireless system solution to support stock trading, and supply of smartphones for use of stock account customer. Based in Beijing, China Galaxy Securities is one of the leading securities brokerages in the PRC. The group companies of China Galaxy Securities Limited are engaged in a wide range of financial services including securities brokerage, investment banking, asset management, fund management, and foreign exchange. Pursuant to the agreement, the Group designed and implemented the software system which allows the customers of China Galaxy Securities Company Limited to use their smartphones to receive stock market information, to analysis, and to place trading orders directly to the securities house.

Public security

In June 2004, the Group entered into an agreement with the Shandong provincial branch of a telecommunication operator. Pursuant to the agreement, the Group is responsible for designing and implementing industry application based on its *Coolpad* smartphones, which would allow public security personnel to have remote access to information such as personal identification and drivers licence registrations. The industry application, together with the *Coolpad* smartphones, will be delivered to the Shandong provincial branch of the telecommunication operator. The Directors understand that the smartphones and the public security application will be resold to the public security authority in Shandong province together with the telecommunication operator's network usage package.

Land transportation

Another example of industry applications provided by the Group is a wireless communication network for a transportation company based on the Group's paging information receiver. The Group provides the paging information receivers as well as the embedded software to support a customised telecommunication network for the customers' headquarters and the drivers. The agreement between the Group and the client for the implementation of the system was entered into in November 2003. The system together with the paging information receivers with customised software have been delivered in batches starting from January 2004.

Aviation

In August 2004, the Group entered into an agreement with an Independent Third Party whereby the Group would supply smartphones with customised software which allow pilots to download data on weather, geographical and other information about the areas covered by the flight. The pilots would then be able to retrieve information or perform analysis on the smartphone interactively. The smartphones with customised software have been delivered in 2004.

Insurance

The Group is currently in discussion with two insurance companies in respect of industry applications, under which the Group's smartphone would be used as key communication channel for insurance agents and the insurance companies. Since insurance agents spend substantial time outside office, a real time communication channel for insurance companies for disseminating updated corporate information, new insurance policy and industry information would be useful in promoting efficiency of the agents. Moreover, the smartphone could also be used as PDA for agents to store and organise client information and policy record for customer relationship management purpose. As part of the solution, the insurance agents would also be able to perform analysis on the spot and produce insurance policy proposal at the time of visit. The Directors consider that this would greatly enhance the efficiency and competitiveness of the agents. In order to enable such services, the Group would need to design certain application software for terminals and back-end systems for the insurance companies.

Banking

The Group is currently in discussion with one commercial bank for industry application solution under which the Group's smartphone would be used by account managers who are responsible for servicing banking clients and may be required to regularly visit existing and prospective clients outside the bank's premises. It is envisaged that the smartphones could be used as mobile devices for the account managers to obtain updates about the bank's services and rates such that most updated information and analysis could be provided to client instantly on the spot. As in the case for insurance companies, to implement such solution, the Group would need to design certain application software to be run on the smartphone and the related back-end system for the bank.

In December 2003, the Group entered into a strategic alliance agreement with an independent software developer for a term of two years for promoting industry applications based on the Group's wireless terminal products for banking institution and other applications in Zhejiang province, the PRC. Under the agreement, the Group will supply the smartphones and provide the necessary software development tools and the independent software developer will be responsible for application software development and system integration. There is no profit sharing scheme between the Group and the independent software developer. The Directors understand that the independent software developer will separately charge the bank for application software it develops for operation using the Group's smartphone and owns the copyrights to such software.

Development plan for wireless terminal product

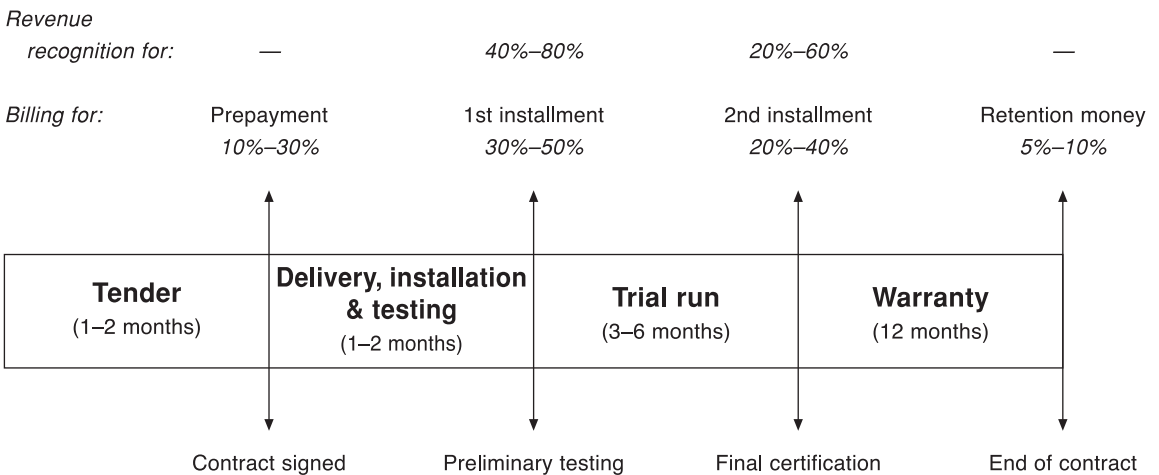
During the Track Record Period, wireless terminal products made less than 10% contribution to the Group's turnover in 2001 and 2002. In 2003 and the five months ended 31 May 2004, revenue from wireless terminal products accounted for approximately 70% and 82% of the Group's turnover, mainly due to the launch of fixed wireless terminals and smartphones. For the five months ended 31 May 2004, the average selling price of one-way wireless terminals and fixed wireless terminals declined compared to those in 2003, mainly as a result of shrinking paging market in the PRC and the pricing pressure on the fixed wireless terminals due to increasing market competition; while the average price of the smartphones maintained at the same level as that in 2003.

The Directors believe that the significant contribution was firstly due to the product quality and marketing activities undertaken by the Group, and secondly the promotion policy of telecommunication operators. During the Track Record Period, telecommunication operator was the Group's major customer of wireless terminals and typically resold the products to subscribers as part of incentive package for using their telecommunication networks. The Directors expect that in future the Group's fixed wireless terminals will be sold mainly to telecommunication operators and telecommunication equipment distributors who usually resell such products to the telecommunication operators, and future sales of fixed wireless terminals will continue to depend on factors including promotion policy of telecommunication operators. On the other hand, it is the policy of the Group to promote its smartphones not only to telecommunication operators and telecommunication equipment distributors but also to potential users of its industry applications. With a much diversified distribution channel, the Directors expect that the sales of its smartphone will principally depend on product quality and effectiveness of marketing activities. Given the huge size and population of the PRC, the increasing use of wireless services and requirement for more sophisticated data handling capability of wireless terminals, the Directors envisage the potential of the Group's wireless terminal products, particularly smartphone, to be substantial.

BUSINESS MODEL

Wireless system solution

Under the current business model, the Group's wireless system solutions are mainly provided directly to telecommunication operators on project basis. The Group provides design, delivery and installation, testing and inspection, maintenance and after-sales services for its wireless system solution customers. Following acceptance, the customer would be responsible for the ongoing operation of the system solution. A wireless system solution project could take about one to two years from the commencement of tender to the end of the warranty period, depending on the complexity and size of the project. The following chart illustrates the typical stages of a wireless system solution project:—



Tender

For wireless system solution project, there would normally be a tender process whereby solution providers are required to submit detailed bidding proposal. The Group may partner with third party sub-contractor in pitching for projects of telecommunication

operator. The telecommunication operator sets out technical requirements and specifications of the projects on their tender offers, based on which the Group designs the relevant software and hardware and develops the installation and operational procedures for telecommunication operators' evaluation. On preparing for the pitch, the Group will conduct technical survey of the site and physical environment where the system is to be installed. Based on the data collected from the technical survey and the specifications of the solution, a detailed plan would be prepared in accordance with the requirements of the telecommunication operator, setting out, among other things, system specifications, installation procedures, an analysis of the design plan, and costs estimate. The design plan would be submitted to the telecommunication operator for selection, approval and amendment if necessary. The tender process normally takes about one to two months, depending on the size and complexity of the wireless system solution.

Delivery, installation and testing

After the Group is awarded the project, the Group signs the contract with the customer and will normally receive prepayment of about 10% to 30% of the contract amount. The percentage of prepayment decreased substantially during the Track Record Period from about 30% to 10% as a result of the increasing bargaining power of the telecommunication operators. Upon receipt of the prepayment, the Group delivers the products and solutions in accordance with customers' specifications. The Group then either installs the system solutions by itself or engages sub-contractors according to the design plan and specifications agreed with the customer. Typically, the sub-contractors would be remunerated for no more than 5% of contract amount related to the hardware components. The sub-contractors would be responsible for all the installation works and be subject to the supervision of the Group. During this stage, the Group provides testing and inspection to fine tune and modify the solution to achieve satisfactory and smooth running. Technical manual would be prepared by engineers of the Group setting out, among other things, the specifications of the solutions installed, any change in design and technical plans. The installation and testing works are typically completed within one to two months.

If the results of installation and testing prove to be satisfactory, the customer issues a preliminary certification to the Group. Upon receiving such preliminary certification, the Group will normally receive the first installment of about 30% to 50% of the contract amount. At the same time, the Group recognises the amount of prepayment and first installment as revenue.

Trial run

After the installation and testing, trial run will be conducted by the customer with assistance provided by the Group. Trial runs normally last three months to six months, depending on the size and complexity of the project. If the trial run proves to be satisfactory, the customer will give the Group final certification. Upon obtaining the final certification, the Group will normally receive the second installment of the contract amount, which normally represents 20% to 40% of the contract amount. The Group then recognises the remaining portion of the contract amount as revenue.

In case where the solution provided by the Group fails to satisfy the agreed requirements during the trial run, the Group will need to devote further resources to rectify the situation. If the Group's in-house resources are unable to do so, the Group might have to cooperate with other company in order to deliver the solutions. This would have negative impact on the financial position and reputation of the Group. The Directors confirm that up to the Latest Practicable Date, none of the Group's wireless system solution was rejected by customers due to failure in trial run.

Warranty

The Group normally provides one-year warranty for its wireless system solutions, during which complimentary after-sales maintenance and repair services are typically provided by the Group to customers. These include technical support, system inspection, equipment repair, replacement and maintenance. The Group's engineers also provide continuous customer support and technical training programs to the customers. During the one-year period, customers are provided with free after-sales services and access to 24-hour telephone hotline for technical enquiry, while half-yearly, quarterly or monthly on-site inspections may be carried out by the Group in accordance with the terms of the contracts. Inspections may also be provided to customers on request. At the end of the warranty period, retention money equivalent to 5% to 10% of the contract amount would be paid by the customers. Such retention money would have been already recognised by the Group upon final certification for acceptance by the customers.

After the warranty period, the Group usually charges for maintenance and after-sales services provided to its customers. The charges are determined by taking into consideration the cost of software and hardware components as well as that of the maintenance staff.

Some of the Group's *Realink PHS Intelligent Coverage Systems* are sold to telecommunication equipment or solution distributors, which then resell to telecommunication operators. The distributors are responsible for installation, testing and maintenance, with the Group providing technical and marketing support. The distributors are typically required to settle the purchase price upon delivery, while in some cases, the Group may offer credit terms of up to three months to distributors with good payment record. Revenue is recognised by the Group upon delivery the products.

Wireless terminals

The Group takes initiative to design and develop various models of terminal products, and designs value-added features and industry applications to cater for specific requirements of its customers in different industries. The Group also provides after-sales services for about 12 months from the date of purchase of ultimate users. The wireless terminal distributors selling the products would act as the front-line after sales services providers within such period. To ensure quality service to user, the Group provides technical training and marketing support to the distributors. Wireless terminal distributors may also courier the wireless terminals to the Group's headquarters for repair or part replacement.

Typically, sales are made on cash on delivery basis or on credit term of up to three months in general, and revenue is typically recognised upon delivery of products. However, in some cases, wireless equipment distributors would make prepayment to the Group before delivery of products.

MANUFACTURING

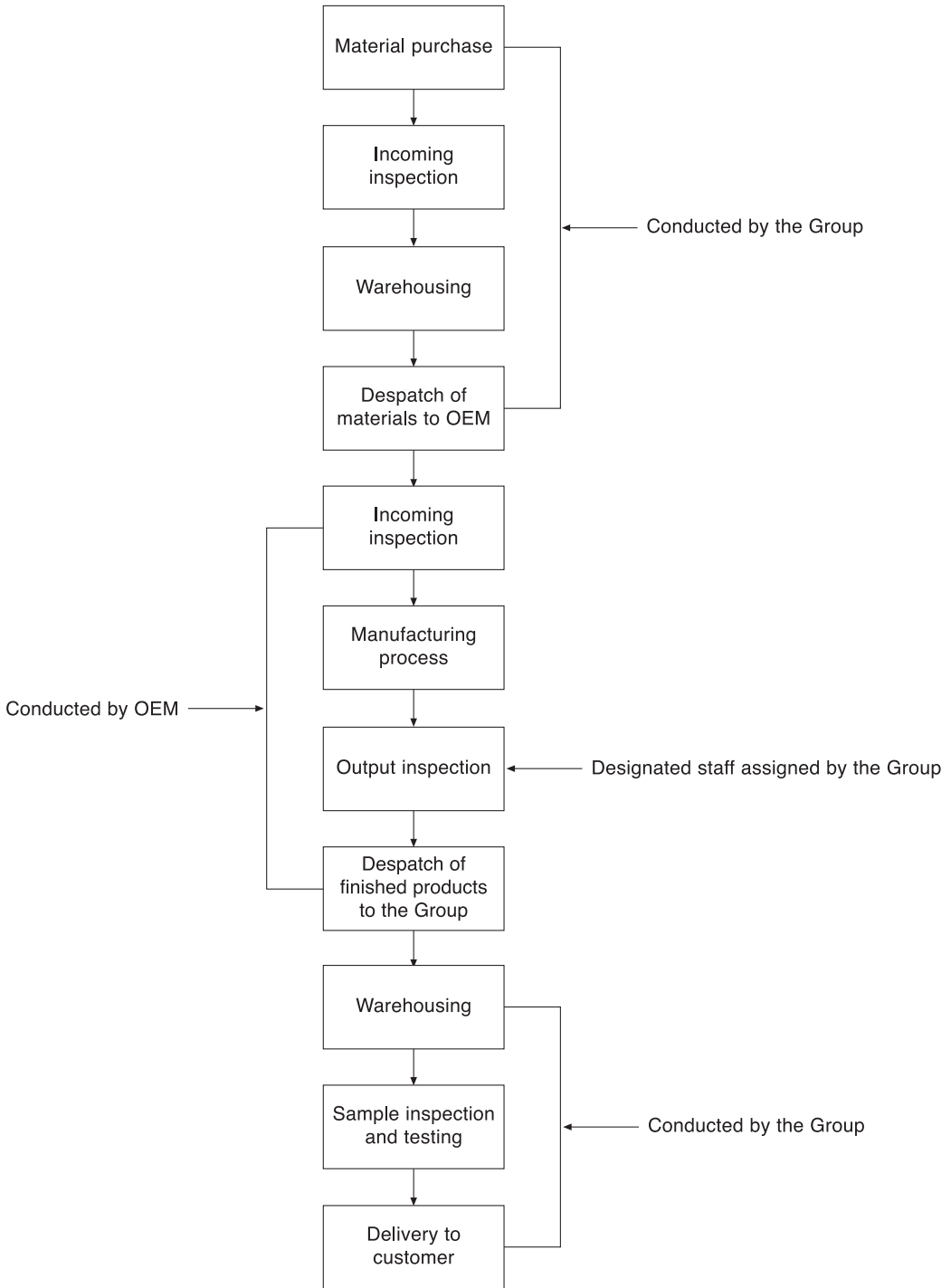
Since its establishment, the Group has adopted the strategy of focusing on its core competency in R&D of wireless technologies and applications. The Group conserves resources by contracting out most of the manufacturing process for its hardware products and only retains certain testing and simple assembly works in its own premises.

OEM management

As at the Latest Practicable Date, the Group engaged three OEMs for the manufacturing of the Group's wireless terminals. All of these OEMs are located in Shenzhen, the PRC and two of these OEMs started to cooperate with the Group since 2003 and the remaining OEM started in 2004 respectively.

Manufacturing process

The following chart illustrates the key steps of the manufacturing process for the Group's hardware products:—



The incoming inspection, warehousing, outgoing sample inspection, testing and other simple assembly works are conducted in the Group's premises located in Shenzhen, the PRC.

Terms of cooperation with OEM

Based on the terms of agreements between the Group and the OEMs, the Group is responsible for the design and technology aspects of the manufacturing process as well as the procurement of materials and components. For each piece of product manufactured, the OEM receives a fixed amount, which is settled on a monthly basis with the Group based on the quantity of products manufactured and accepted by the Group. The Group is responsible for the products and services while the OEMs are liable to compensate the Group for loss due to any defect of products not caused by the Group's design and technologies.

Supply management

The Group has a supply management system whereby suppliers are graded every year in accordance with a set of criteria including pricing, timeliness of delivery and quality of materials supplied. Those who obtained a satisfactory grade will be put on the qualified supplier list. Materials for the Group's production will only be purchased from suppliers on this list. The higher the grade of a supplier, normally the larger the proportion of materials the Group purchases from such supplier.

Materials and components sourced from suppliers are subject to sample testing and quality inspection by the Group before being used in the production process to ensure that such materials comply with the Group's quality standards. In the event that the materials and components do not meet the Group's quality standards, depending on the nature of the defects, materials and components may be returned to the relevant suppliers.

Quality assurance

To ensure high quality of the hardware components of its products and solution, the Group exercises stringent control on the manufacturing process. The production department of the Group appoints designated staff to inspect and ensure that all prescribed production procedures are properly complied with by the OEMs or during the assembly procedures conducted in the Group's premises. Visual inspection and performance tests are carried out at each checkpoint. Upon completion of the production process, function tests and inspections are carried out by the Group. Sample function testing is then carried out again to further ensure the quality of the Group's products. It is the policy of the Group to consider to disqualify an OEM if it commits material mistake in the production process. The Group also deals directly with suppliers of parts and components. Designated staff would normally be assigned to control and monitor the logistics of components and products between the Group and the OEMs' manufacturing sites.

Collaboration with the Smartphone Manufacturing Partner for manufacturing of smartphones

Background

In the PRC, approval must be obtained for a wireless terminal to be sold to mass consumer market from MII which is responsible for evaluating the prototype of the wireless terminal and examining the product's suitability for mass consumer market in the PRC. MII enlisted 19 and 29 manufacturers respectively acceptable for being responsible for manufacturing CDMA and GSM/GPRS handsets (including smartphones designed by the Group) in the PRC, 12 of which are acceptable for being responsible for manufacturing both

GSM/GPRS and CDMA handsets. For processing approval application for wireless terminal, MII accepts application from one of the designated manufacturers named as “manufacturer”. As the Group is not listed as one of the manufacturers designated by MII as handset manufacturers, the Group collaborates with the Smartphone Manufacturing Partner in submitting application for Network Access Licence of its *Coolpad* CDMA1X, GSM/GPRS and CDMA-GSM dual-mode smartphone. As such, the Smartphone Manufacturing Partner is primarily responsible to the authority for any defects in the *Coolpad* smartphone. The Smartphone Manufacturing Partner is principally engaged in design, manufacture and sale of telecommunication products including CDMA and GSM/GPRS mobile phones.

Details of the collaboration

For production of the Group’s *Coolpad* CDMA1X smartphone, the Group and the Smartphone Manufacturing Partner entered into agreements on 9 June 2003 and 24 February 2004 for a term of two years. For the production of the Group’s *Coolpad* GSM/GPRS and CDMA-GSM dual-mode smartphones, the Group and the Smartphone Manufacturing Partner entered into another agreement on 28 June 2004 and a supplemental agreement on 30 September 2004 for a term valid until 30 September 2005. According to these agreements, the Group is responsible for (1) design and technical aspects of the manufacturing of the smartphone; (2) parts and components purchasing; (3) planning and regulating all OEMs engaged in the manufacturing process; (4) testing, assembly, quality control functions for the manufacturing process; (5) selling and distribution of the smartphone; and (6) after-sales services. Based on market demand, the Group should determine the selling price and manufacturing quantity of the smartphone. Under the agreements, for each smartphone manufactured, the Smartphone Manufacturing Partner receives fixed amount for each unit manufactured. According to the agreements for the manufacturing of CDMA1X smartphone, in case of any force majeure events (including earth quake, fire, flooding, war, government action, accident or other events that the parties could not reasonably avoid and overcome) leading to inability of a party to the agreements to fulfil its obligations thereunder, that party shall advise the other party in writing within three days of occurrence of the event and the agreements shall be terminated accordingly. In case where force majeure events leading to temporary suspension of the development of the products for more than 30 days, the agreements shall be terminated automatically. In case of termination, prepayment shall be returned and actual cost incurred shall be shared by the parties. According to the agreement for the manufacturing of GSM/GPRS and CDMA-GSM dual-mode smartphones, in the event of force majeure, the party claiming force majeure must provide proof of force majeure to the other party within 14 days after the happening of the incident. In such case, either party can terminate the agreement by giving 30 days written notice before the expiration of the agreement. Under any circumstances, the fees paid by the Group will not be returned.

As the Group is responsible for the manufacturing and selling activities of the smartphone, there has not been and will not be any physical delivery of the *Coolpad* smartphones to the Smartphone Manufacturing Partner. The Group owns all the intellectual properties rights in relation to the smartphone products and the Smartphone Manufacturing Partner has undertaken not to make use of any information about the Group’s smartphone on other products. There are also non-disclosure clauses in all the agreements in relation to the technologies, sales and marketing, documents and materials of the *Coolpad* smartphones with which the Group and the Smartphone Manufacturing Partner must comply. The Directors confirm that they are not aware of any breach of terms of the agreements by the Smartphone Manufacturing Partner. As the applicant for the type approval and the Network Access Licence of *Coolpad* smartphone, the Smartphone Manufacturing Partner has acknowledged its

responsibilities to the ultimate users of the *Coolpad* smartphone. The Group has not received any material claims for defective products from its customers as at the Latest Practicable Date.

COMPLIANCE

The Directors confirmed that the Group has obtained all licences, permits or certificates necessary to conduct its operations from the relevant governmental bodies in the jurisdiction where the Group operates, and that the Group complies with all applicable laws and regulations of the jurisdiction where it operates since its establishment, and all outstanding tax liabilities that have become due have been duly settled.

For the Group’s products and solutions, the PRC Lawyers have confirmed that except for 無線電發射設備型號核准證 (Radio Transmission Equipment Type Approval Certificates) (“Type Approval”) and Network Access Licences, the Group does not need to obtain any other approvals from PRC authorities for the operation of its current business in the PRC. Type Approval certificates are issued by the MII to show that such equipment conforms with the required technical specifications. Network Access Licences are issued by the MII to certify that it has approved the use of such equipment in the national telecommunication network of the PRC.

As at the Latest Practicable Date, the Group and the Smartphone Manufacturing Partner had eight Type Approvals, all of which are valid for five years, with the earliest certificate issued on August 2000 and the latest on August 2004. As at the Latest Practicable Date, the Group and the Smartphone Manufacturing Partner had the following seven Network Access Licences:

Product name	Expiry date
<u><i>Wireless Terminals</i></u>	
高速無線電尋呼接收機 VLCDP-400 (High speed radio paging receiver VLCDP-400)	16 January 2005
PDA 無線電尋呼接收機 333 (Radio paging receiver 333)	16 February 2005
PDA 高速漫遊無線電尋呼接收機 PDA336 (High speed roam radio paging receiver PDA336)	26 September 2005
CDMA1X 數字移動電話機 CECT CoolPAD688 (CDMA1X digital mobile phone CECT CoolPAD688) (<i>Note 1</i>)	31 August 2007
GSM 雙頻 GPRS 功能數字移動電話機 (GSM dual-band GPRS capable digital mobile phone) (<i>Note 1</i>)	27 September 2007
GSM/CDMA1X 雙模數字移動電話機 (GSM/CDMA1X dual-mode digital mobile phone) (<i>Note 1 and 2</i>)	28 March 2005
<u><i>Wireless System Solutions</i></u>	
數字排隊機7號信令系統 Uniswitch/SS7 (Signaling System No. 7 number sequencer)	17 August 2005

Notes:—

- (1) As the Group collaborates with the Smartphone Manufacturer Partner to apply for these Network Access Licences, these licences are registered under the name of the Smartphone Manufacturer Partner.
- (2) This is only a trial licence.

The Directors confirm that the Group and the Smartphone Manufacturing Partner will duly renew all the Network Access Licences for products and solutions that the Group is currently selling and intends to continue to sell. The Directors confirmed that the Group has regularly renewed the applicable approvals and licences and has not experienced any material difficulties in obtaining such approvals and licences. Based on the Directors' experience, it normally takes six to twelve months from application to grant of approval. The Directors do not foresee any material difficulties in obtaining or renewing such approvals and licences in the future.

The PRC Lawyers confirmed that (i) the Group has obtained all necessary permissions and approvals from the relevant PRC authorities for the products currently sold by the Group; (ii) that the agreements and the Group's cooperation with the Smartphone Manufacturing Partner are in line with the prevailing PRC laws and are within the Group's permitted scope of business and do not need additional approval from the government; and (iii) the Smartphone Manufacturing Partner would be responsible for any claim and responsibilities in relation to the *Coolpad* smartphones.

SALES AND MARKETING

The Group fosters its relationship with existing and potential customers by joining industry seminars and trade fairs and directing marketing efforts such as site visit to customers' premises. These activities are all undertaken by the Group's sales department with the support of the Group's product marketing and after-sales services department. The Directors believe that the latter would be able to gain insight for developing products and solutions better suit customers' requirements through the provision of after-sales services. The product marketing and after-sales services department would then provide the insight to the R&D department and devise relevant product marketing scheme for the sales department.

As at the Latest Practice Date, the Group employed a sales team comprising 105 people, who stationed in the Group's headquarters in Shenzhen, representative office in Beijing and sales liaison points in Shanghai, Chongqing, Tianjin and 20 provinces of the PRC.

The Group also has a product marketing team, the members of which are grouped according to the Group's products and solutions. In particular, a sub-team of about 20 persons was set up to focus on the smartphone market. They undertake survey and study the latest development of smartphone market; and the promoting of industry applications developed based on the Group's smartphone. The team would normally initiate certain business solution to potential corporate customers. The solutions aim to improve operational working efficiency by way of better wireless telecommunication and information processing. To date, the Group has developed solutions for a few industries including stock trading, land transportation, aviation, public security, banking, and insurance. At the time of formulating a business solution with corporate customer, the Group may liaise with telecommunication operator to try to come up with discounted usage package for the corporate user.

Each of the Group's sales liaison point is staffed by trained engineers and other professional staff, and is responsible for the initiation, negotiation and coordination of sales and the conduct of promotional activities in respect of the Group's solutions and product. Through the Group's sales and services network in the PRC, the Group's sales engineers liaise locally with customers and assist customers in identifying their needs and requirements. Preliminary project ideas are then evaluated by the Group's engineers with customers. Project specifications would then be passed on to the Group's project survey and design department. According to the PRC Lawyers, the Group's sales liaison points are not a geographical or legal term but a commercial term refers to the Group's relatively stable and continuous operation in a certain area without having a representative office. The PRC laws allow a company to conduct business activities in different areas of the PRC without having a representative office. The Group's sales liaison points do not have independent legal status and are not required to obtain any approval and permission from the relevant authorities or to undertake any registration procedures.

In order to promote its corporate image and products and solutions, the Group has adopted a series of marketing strategies, including placing advertisements in press and television, holding technical discussions with its telecommunication operators and corporate customers, giving presentations and free trials of new products, and conducting satisfaction surveys with them through its sales and services offices. The data and feedback collected are then being considered in the R&D process to improve the Group's products and services. The Group also attends and participates in related technology seminars and industry trade fairs to promote its products and solutions. Moreover, the Group promotes its corporate image through its websites "www.chinawireless.cn", "www.chinawireless.com.cn", "www.chinawireless.net.cn", "www.yulong.com", "www.coolpad.cn" and "www.coolpad.com.cn".

CUSTOMERS

During the Track Record Period, the customers for the Group's wireless system solutions include (i) local branches of telecommunication operators; (ii) telecommunication equipment or solution distributors which resell the Group's solutions to telecommunication operators; and (iii) corporations in the PRC that requires in-house wireless systems solutions, such as TCL; the customers for the Group's wireless terminals are mainly local branches of telecommunication operators and wireless terminal distributors in the PRC. The following is the breakdown of the Group's turnover during the Track Record Period by types of customer:—

	2001		Year ended 31 December 2002				2003			Five months ended 31 May 2004					
	RMB'000	% of turnover	Number of customers	RMB'000	% of turnover	Number of customers	RMB'000	% of turnover	Number of customers	2003 (unaudited) RMB'000	% of turnover	Number of customers	RMB'000	% of turnover	Number of customers
Wireless system solutions															
Wireless transceivers for paging network															
Telecommunication operators	60,936	72	3	27,659	27	3	16,118	10	2	12,917	27	2	—	—	—
Corporates	22,427	26	21	45,772	45	39	4,490	3	5	5,112	11	3	—	—	—
Realink PHS Intelligent Coverage System															
Distributors	—	—	—	—	—	—	10,034	6	3	—	—	—	11,424	13	19
Callnet															
Telecommunication operators	—	—	—	13,343	13	1	11,967	7	1	8,121	17	1	—	—	—
Corporates	—	—	—	—	—	—	—	—	—	—	—	—	2,448	3	1
Wireless Value-added Service Platform															
Telecommunication operators	836	1	1	8,176	8	1	5,951	4	1	5,482	12	1	1,488	2	1
Corporates	—	—	—	—	—	—	239	—	1	239	1	1	—	—	—
Wireless terminal															
One-way wireless terminal															
Telecommunication operators	—	—	—	4,029	4	1	3,883	2	1	2,598	6	1	—	—	—
Distributors	568	1	7	858	1	7	337	1	2	328	1	1	39	—	2
Fixed wireless terminal															
Telecommunication operators	—	—	—	1,492	2	2	59,817	37	2	10,362	22	2	2,143	3	1
Distributors	—	—	—	—	—	—	29,431	18	38	1,869	3	9	20,395	23	24
Smartphone															
Telecommunication operators	—	—	—	—	—	—	—	—	—	—	—	—	6,515	7	1
Distributors	—	—	—	—	—	—	19,241	12	3	—	—	—	39,737	47	40
Total	84,767	100		101,329	100		161,508	100		47,028	100		84,189	100	

For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, sales to the five largest customers of the Group accounted for approximately 94%, 90%, 90% and 71% of the Group's total turnover, respectively; while sales to the Group's largest customer accounted for approximately 62%, 51%, 60% and 25% of the Group's turnover, respectively.

All the five largest customers of the Group during the Track Record Period are Independent Third Parties. None of the Directors, their respective associate nor any shareholders of the Company who own more than 5% of the issued share capital of the Company has any interest in any of the Group's five largest customers during the Track Record Period.

During the Track Record Period, all sales of the Group were made in RMB with over 95% being settled by telegraphic transfers.

Pricing

In determining the contract amount for the Group's wireless system solutions, the Group normally takes into account market conditions, the time and efforts required for developing the solution, the size and complexity of the project, cost of the hardware, as well as the relationship with the customers. For the wireless terminal products, sale price is normally determined based on market conditions, and the manufacturing and hardware cost of the wireless terminal products.

Credit terms

Generally, credit terms of three months may be granted to customers of wireless system solutions for each installment and retention money after billing is issued. For *Realink PHS Intelligent Coverage System* sold to telecommunication equipment or solution distributors and wireless terminal products, sales are typically made on cash on delivery basis or on credit term of up to three months in general. Longer credit terms of up to six months may be extended to telecommunication operators with long business relationship and good repayment history for both wireless system solutions and wireless terminal products.

The Group adopts a general policy of making provision equivalent to 50% of gross amount of receivable of over one year and 100% of gross amount of receivable of over two years. It is the Group's policy to assess the recoverability of trade receivable from each customer individually on a monthly basis and to make specific provision accordingly, by checking sufficiency against the provision made under the general provision policy. If the specific provision is less than that under the general provision policy, additional provision will be made. The increase or decrease of the provision made for the trade receivables will be charged or credited to the Group's profit and loss accounts. The net amount of the receivables (i.e. after such provision) would be presented in the balance sheet of the Group. During the year ended 31 December 2001 and 2002, approximately RMB788,000 (approximately HK\$743,000) and RMB1.7 million (approximately HK\$1.6 million) was charged to the Group's combined profit and loss accounts respectively. During the year ended 31 December 2003 and the five months ended 31 May 2004, approximately RMB315,000 (approximately HK\$297,000) and RMB7,000 (approximately HK\$6,600) was credited to the Group's combined profit and loss accounts respectively.

Relationship with telecommunication operators

During the Track Record Period, the Group derived significant amount of turnover from provision of wireless system solution and wireless terminal products to telecommunication operators. For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, such turnover accounted for approximately 73%, 54%, 60% and 13% of the Group's total turnover respectively. The decrease of sales to telecommunication operators during the Track Record Period was mainly due to the increase in sales of the Group's products and solutions to telecommunication equipment or solution distributors in the PRC. Nevertheless, the Directors understand that *Realink PHS Intelligent Coverage System* sold to telecommunication equipment or solution distributors, as well as certain wireless terminal products sold to wireless terminal distributors were resold to telecommunication operators. As such, the telecommunication operators represented a substantial segment of customers for the Group during the Track Record Period. During the Track Record Period, the Group provided products and solutions to fixed-line and mobile telecommunication operators in the PRC, including the China Unicom Group, China Mobile and China Telecom.

The China Unicom Group is one of the major telecommunication operators in the PRC. It currently operates GSM and CDMA networks in the PRC. As of 31 December 2003, the China Unicom Group had approximately 80.8 million subscribers, with approximately 63.9 million subscribers on its GSM network and 16.9 million subscribers on its CDMA network. The Directors understand that each provincial or municipal branch of the China Unicom Group acts generally as an individual entity under supervision of headquarter. Typically, provincial or municipal local branches of the China Unicom Group would invite tenders from product and solution providers such as the Group for required services and/or solutions. If the Group's bid is successful, the Group and the relevant provincial or municipal branch of the China Unicom Group will enter into specific contract setting out various details including project price and equipment installed. Inspections and payments are made in accordance with the terms of the contract.

The Group has established long-term relationship with the China Unicom Group for more than seven years. The Group is one of a limited number of designated providers of certain equipment to the China Unicom Group in the PRC. During the Track Record Period, the Group has supplied products and solutions to China Unicom Group's headquarters in Beijing and 23 provincial branches in the PRC. During each of the three years ended 31 December 2003 and the five months ended 31 May 2004, sales to the China Unicom Group accounted for approximately 62%, 51%, 60% and 12% of the Group's turnover, respectively, being the largest customer of the Group for each of the three years ended 31 December 2003 and the third largest customer for the five months ended 31 May 2004. The Directors believe that the decrease in sales to the China Unicom Group was mainly due to the increase in sales by the Group to telecommunication equipment or solution distributors in the PRC in light of the relatively long settlement cycle from the China Unicom Group. Nevertheless, it is to the Directors' belief that most of such distributors usually resell the Group's products and solutions to telecommunication operators and therefore consider product acceptance by them to be an important factor for the success of the Group.

Sales to the China Unicom Group

	Year ended 31 December						Five months ended 31 May			
	2001		2002		2003		2003 (unaudited)		2004	
	Number of projects/ RMB'000		Number of projects/ RMB'000		Number of projects/ RMB'000		Number of projects/ RMB'000		Number of projects/ RMB'000	
Wireless system solution										
Wireless transceivers for paging network	51,526	94	24,612	45	16,112	5	12,911	2	—	—
Realink PHS										
Intelligent Coverage System	—	—	—	—	—	—	—	—	—	—
Callnet	—	—	13,343	3	11,967	3	8,121	2	—	—
Wireless Value-added Service Platform	836	2	8,176	11	5,951	9	5,482	6	1,488	5
Sub-total	52,362	96	46,131	59	34,030	17	26,514	10	1,488	5
Wireless terminals										
One-way wireless terminals	—	—	4,029	7,487	3,883	8,903	2,641	7,137	—	—
Fixed wireless terminals	—	—	1,485	1,022	58,281	40,007	9,219	8,238	2,143	2,820
Smartphone	—	—	—	—	—	—	—	—	6,515	1,795
Sub-total	—	—	5,514	8,509	62,164	48,910	11,860	15,375	8,658	4,615
Total	52,362		51,645		96,194		38,374		10,146	

During the Track Record Period, wireless system solution projects provided to the China Unicom Group valued from thousands of RMB to approximately RMB21 million (approximately HK\$19.8 million). As at the Latest Practicable Date, the Group's *Callnet* system solution has been adopted by the China Unicom Group's headquarters in Beijing and five provincial branches, including Guangdong, Guangxi, Jiangsu, Xinjiang and Zhejiang; while the Group's *Wireless Value-added Services Platform* has been adopted by the China Unicom Group's headquarters in Beijing and 14 provincial branches, including Anhui, Gansu, Guangdong, Guangxi, Guizhou, Heilongjiang, Hubei, Hunan, Ningxia, Qinghai, Shandong, Shaanxi, Yunnan and Xinjiang.

The China Unicom Group is an Independent Third Party, the Group has not entered into any long term contract or cooperation agreement with any of the group companies of the China Unicom Group which would give the Group advantage in securing new business with them.

RESEARCH AND DEVELOPMENT

The Group's R&D team is responsible for developing the Group's new products and solutions as well as designing upgrades on products and solutions. During the Track Record Period, the Group's products and solutions are designed and developed by the Group's R&D team. The Group places strong emphasis on the R&D for product and innovations in order to capture opportunities emerged from the rapid development and advancement in the telecommunication industry. The Directors believe that the Group's strong R&D capability is important in maintaining the Group's continued success and its ability to meet challenge due to rapid technological development.

For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, the Group's R&D expenses were approximately RMB8.5 million (approximately HK\$8 million), RMB10.7 million (approximately HK\$10 million), RMB11.3 million (approximately HK\$10.7 million) and RMB6.3 million (approximately HK\$5.9 million) respectively, representing approximately 10%, 11%, 7% and 8% of the Group's turnover respectively.

R&D directions

In addition to continuous enhancement of its products and solutions, the Group intends to devote efforts in the R&D in the following areas:—

— smartphone and related industry applications

In addition to CDMA1X and GSM/GPRS smartphones, the Group intends to launch its CDMA-GSM dual-mode smartphone and develop different models of smartphone with various features and functions to suit the need of different customers. Moreover, the Group would also put emphasis on improving the operating system and functionality and user interface of its smartphone. The Group would develop a wide range of applications for various industries in the PRC based on its experience in the development of its existing portfolio of system solutions for telecommunication operators.

— products and solutions for network coverage and integrated telecom business platform

The Directors expect that the coverage of PHS network would continue to expand and telecommunication operators will continue to enhance their value-added service offered in the PRC. As such, the Group intends to enhance its existing network coverage system solutions for PHS network and also continue to enhance the functionalities of its integrated telecom business platform.

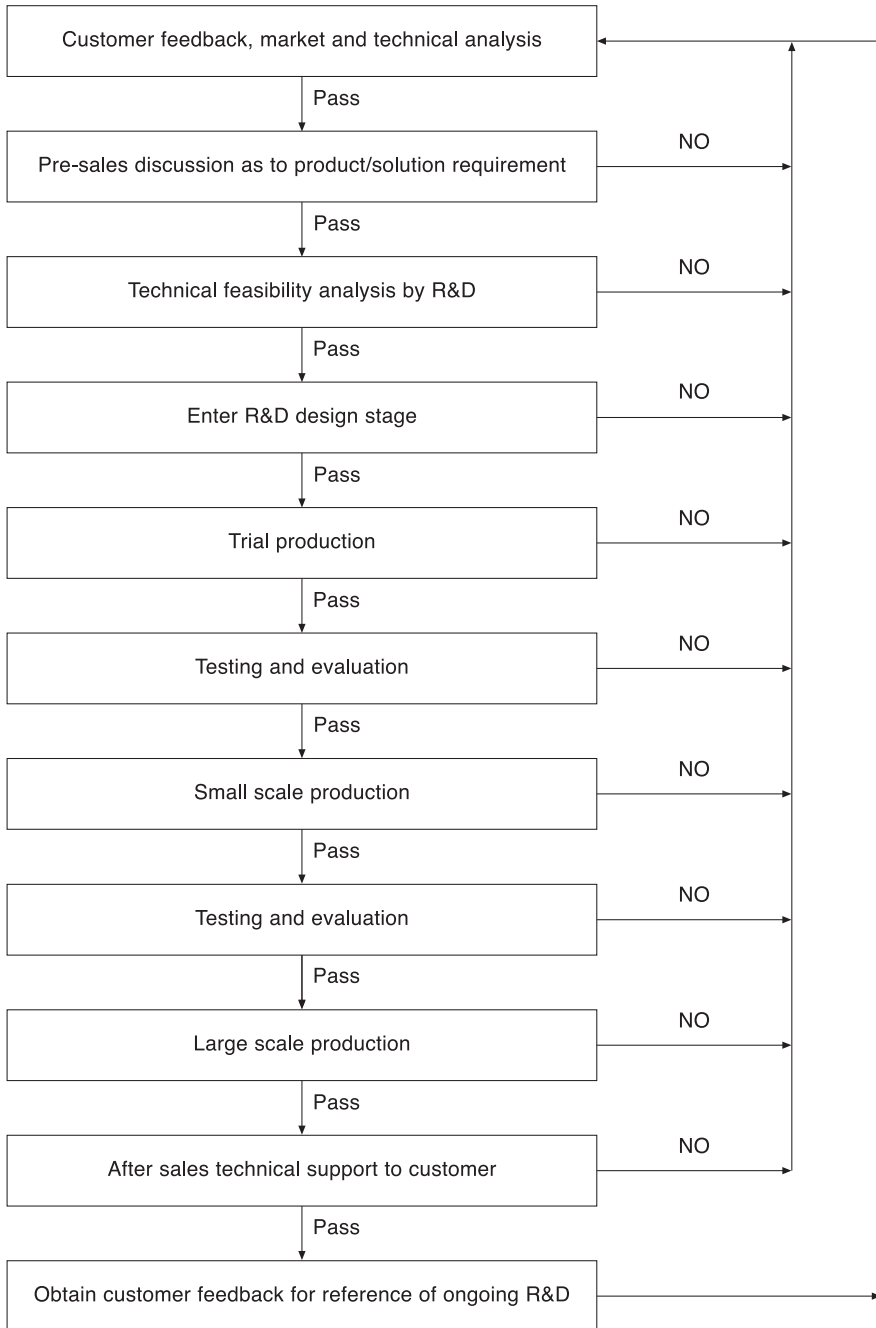
— 3G technologies

The Directors believe that the emergence of 3G standards in the PRC signifies potential new markets for full range of the Group's products and solutions for network coverage solutions, back-end supporting system for telecommunication operators and terminal products. All the designs of the Group's existing products have developed with consideration of future upgrade to 3G standards.

The Directors understand that 3G testing was first carried out in the PRC in 2002; in November 2003, the second stage of 3G testing were conducted by six telecommunication operators and equipment providers on three major 3G standards, being WCDMA, CDMA2000 and TD-SCDMA. 3G inter-vendor equipment operability, network coverage and system capacity tests have been conducted in selected regions in 2004. In light of these developments, the Directors believe that 3G could be launched in the PRC no earlier than 2005, though no concrete timetable, or rules or regulations have been issued by the State as at the Latest Practicable Date. The Directors further believe that, with the deployment of 3G technology in the PRC, mobile operators in the PRC will increase their investment on wireless peripheral equipment so as to extend the functionality of their network coverage and terminal products to achieve 3G compatibility. Accordingly, in order to build up the Group's ability and readiness to provide 3G wireless coverage system solutions and 3G compatible wireless terminals, the Group has set up a 3G and multi-media project team in its R&D department.

Product and solution development approach

The Group takes a customer/market-oriented approach in directing its R&D activities and places emphasis on the joint efforts of R&D and marketing activities in order to maximize customer satisfaction. The Group's R&D team works closely with the sales and marketing staff, who provide customers' feedback on the Group's products and solutions. The following chart illustrates the R&D activities within the Group structure.



R&D capabilities

As at 31 December 2001, 2002, 2003 and the Latest Practicable Date, the Group's R&D team comprises 191, 162, 202 and 231 professionals. The Group's R&D staff includes engineers who station in the Group's headquarters in Shenzhen for core technologies development and teams responsible for on-site development. Most of the Group's R&D professionals have obtained bachelor's degree or above, specialising in telecommunications technology, electronics engineering and/or other wireless telecommunication related subjects. The R&D staff collect and analyse clients' feedback for consideration in the research and development process to improve the Group's products and solutions.

As at the Latest Practicable Date, the Group's R&D team are organised into four function groups, with Mr. Guo responsible for the overall strategic R&D directions and Mr. LI Ming and Mr. DONG Yongquan responsible for overseeing the daily R&D operation: (i) hardware group, which consisted of 42 staffs, is mainly responsible for designing the core hardware components of the wireless terminal products and wireless system solutions, such as the printed circuit boards, and the exterior design of the wireless terminal products; (ii) testing group, which consisted of 25 staffs, is responsible for testing the Group's products and solutions; (iii) software group, which consisted of 138 staffs, is responsible for designing the operating system and industry applications of the wireless terminals, software part of the wireless system solution and other value-added features of smartphones. The software group also studies the latest technologies, and research on the application of such technologies on the Group's products and solutions; (iv) 3G/multimedia team, which consisted of 26 staffs, was set up in expectation of the launch of 3G in the PRC, and is responsible for upgrading its existing products and solutions to be 3G compatible.

All of Mr. Guo, Mr. DONG Yongquan and Mr. LI Ming have over 10 years experience in R&D in telecommunication industry in the PRC and received relevant academic qualifications. Particularly, Mr. LI Ming and Mr. DONG Yongquan had prior experiences in R&D of fixed wireless terminals and smartphones. For details, please refer to the section headed "Directors, audit committee, senior management and staff" in this prospectus.

Since its establishment, the Group has obtained many accreditations and official recognitions on its products and solutions, which illustrate the quality of the Group's R&D work. For details of such accreditations and official recognitions, please refer to the paragraph headed "Accreditations and official recognitions" in this section.

With a view to strengthening its R&D capabilities and to improving the quality of its R&D work, the Group provides ongoing technical training and seminars to its R&D staff. These staff also attend and participate in industry exhibitions and trade fairs to keep abreast of the latest technological developments and have regular technical discussions and exchange with customers to keep abreast of market needs and to enhance the Group's understanding of their requirements.

Collaboration

In order to follow 3G technology development and study on application of 3G technologies, in March 2004, the Group entered into strategic partnership agreements with a 3G module developer which is engaged in the design and manufacturing of CDMA wireless modules. In October 2004, the Group entered into a strategic partnership agreement with a wireless telecommunication component and system provider for developing 3G smartphone.

The Group's 3G multimedia team has also been in frequent contact with and is in negotiation with a core 3G technology developer in the PRC for collaboration in R&D of 3G technologies. As at the Latest Practicable Date, the Group has also signed agreements with a few application developers for developing applications software for the Group's smartphone products.

RAW MATERIALS

Principal components and materials used by the Group are procured in the PRC. These principal components and materials include electronic components, batteries, outer cases, mobile phone modules, LCDs, power supplies, computer servers and integrated circuits. For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, these principal components and materials accounted for approximately 96%, 96%, 97% and 97% of the Group's total purchases, respectively.

During the Track Record Period, all purchases were settled in RMB. The Group has established and maintained long term business relationship with components and materials suppliers in the PRC and has entered into purchase agreements with these suppliers.

SUPPLIERS

The Group maintains a list of about 210 suppliers from which the Group purchases components or materials. During the Track Record Period, the Group did not encounter any production disruption due to the shortage of supply of components or materials. The Directors believe that most of the Group's major components or materials can be purchased from a number of different suppliers at prices comparable to those charged by the Group's current suppliers. The Group's suppliers generally require cash on delivery or allows the Group with credit periods up to 180 days. Part of the Group's purchases were settled by bank draft against acceptance (承兌滙票). For each of the two years ended 31 December 2003 and the five months ended 31 May 2004, approximately 32%, 53% and 39% of the purchase was made by bank draft against acceptance respectively, while the rest was settled by telegraphic transfer.

For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, the five largest suppliers of the Group accounted for approximately 19%, 42%, 63% and 72% respectively of the Group's total purchases; whilst the largest supplier of the Group accounted for approximately 5%, 15%, 33% and 25% respectively of the Group's total purchases. The Directors advise that the increase of purchase from the five largest suppliers during the Track Record Period were mainly due to the increase in sales of wireless terminals, the raw materials of which, such as CDMA modules and LCDs, accounted for a higher percentage to the relevant sales than the components used for wireless system solution (i.e. electronic components, batteries, computer servers, etc).

All the five largest suppliers of the Group during the Track Record Period are Independent Third Parties. None of the Directors, their respective associates nor any shareholders of the Company who own more than 5% of the issued share capital of the Company has any interest in any of the Group's five largest suppliers during the Track Record Period.

INVENTORY CONTROL

In order to retain flexibility, the Group normally prepares purchasing plan on a monthly basis based on the selling condition of the products and usage of hardware components. The Group's production and quality control team monitors the Group's stock levels from time to time. Whenever the inventory level of materials falls below the scheduled production requirement, the Group will restock materials from its suppliers after careful calculation of the equilibrium order quantity to ensure continual supply of materials for its production according to the pre-set manufacturing control schedule. It is also the Group's policy to secure order before production so as to minimise obsolete stocks.

Typically, the Group undertakes physical count of its inventory and reports to the management of the Group on a monthly basis. The management team of the Group will determine the items to be written off based on their information and its experience. During the year ended 31 December 2001, stock written off amounted to approximately RMB804,000 (approximately HK\$758,000), while for the two years ended 31 December 2003 and the five months ended 31 May 2004, the Group did not write off any stock.

COMPETITION

The telecommunication industry grows rapidly and competition is keen with numerous network solutions and equipment providers. The Directors believe that the entry barrier for wireless communication solutions industry in the PRC is relatively high as participants need to rely on trusted relationships with major players in the industry, market reputation and technical expertise required to provide wireless system solutions and terminal products. The Directors consider that the primary elements for establishing relationship with customers are technological innovation, capability to adapt to the quickly changing technologies, reliability and quality of the products and solutions, and pricing. The Directors consider that the Group's main competitors are medium to large-sized network solutions and equipment providers in the PRC. The Directors believe that product and solution providers need to be technologically reliable, innovative and flexible on designing a solution and competitive in terms of pricing and services quality. It is the Directors' belief that these can be achieved with experience and expertise in the telecommunication industry and related technologies, continuous investment in R&D and in-depth understanding of local requirements and a comprehensive local services network. To remain competitive, the Group strives to maintain and enhance its competitive edge in all these fronts.

The Group adopts different competition strategies for its products and solutions. For the *Coolpad* smartphones, the Group intends to place more emphasis on corporate clients as well as business executives. The Directors believe that the Group's smartphone products would be well positioned to capture opportunities in the PRC market due to the Group's self-developed operating system designed specifically with reference to local needs. For fixed wireless terminal products and wireless system solutions, the Group intends to continue to leverage on its experience and good relationship with the telecommunication operators, especially the China Unicom Group, to expand the market share. The Directors believe that the Group has proved to be a trusted partner for major telecommunication operators. Moreover, the Directors believe that the Group is among a limited number of products and solutions providers that could provide a total solution covering back-end system level to user terminal level. Such expertise enables the Group to provide effective and cost efficient industry applications based on the Group's wireless system and terminal products. Though the Directors are confident about the Group's ability to remain competitive, there is no

guarantee that the Group would continue to achieve growth in its business or maintain its relationship with its customers. The Directors also expect that competitive pressure will likely increase, when the PRC telecommunication industry continues to attract new entrants as it grows in a relatively high rate as compared to other markets in the world.

COMPETITIVE STRENGTHS

The Directors consider the Group's competitive strengths to be as follows:—

- **Understanding of the PRC's wireless communication industry**

Founded in 1993, the Group has been providing wireless solutions and equipment to telecommunication operators in the PRC. During the years, PRC's wireless telecommunication industry witnesses quick advancement in technology and de-regulation. The Group has accumulated expertise and experience in multiple wireless networks, including paging, GSM, GPRS, CDMA and PHS. The Directors believe that such expertise and experience are not common attributes among wireless communication solution providers in the PRC and could offer the Group significant competitive edge over its competitors in the future.

- **Proximity to local market**

As a domestic enterprise with years of business relationships with PRC's major telecommunication operators, the Group has nurtured close relationships with its customers. This enables the Group to have a good understanding of the requirements of the telecommunication operators so as to provide timely responses to market changes.

- **Nimble and cost-effective R&D**

The Directors believe that the Group's R&D activities are both nimble and cost-effective, and the Group has a very strong R&D team. As at 31 December 2001, 2002, 2003 and the Latest Practicable Date, the Group had 191, 162, 202 and 231 staff respectively responsible for R&D with most of them obtained bachelor's degree or above. During the Track Record Periods, all of the Group's products and solutions are designed and developed by the Group's R&D team. During each of the three years ended 31 December 2003 and the five months ended 31 May 2004, the Group's R&D expenses were approximately RMB8.5 million (approximately HK\$8.0 million), RMB10.7 million (approximately HK\$10.0 million), RMB11.3 million (approximately HK\$10.7 million) and RMB6.3 million (approximately HK\$5.9 million) respectively, representing approximately 10%, 11%, 7% and 8% of the Group's turnover respectively. With such R&D expenditure, the Group has been able to develop and design its own products and solutions in line with the development trend of the wireless telecommunication industry in the PRC and have received a number of awards and official recognitions from a number of PRC authorities and professional bodies as set out in the paragraph headed "Accreditation and official recognitions" in the section headed "Business" in this prospectus. The Directors believe that this has enabled the Group to provide a variety of R&D intensive products and to launch innovative products and solutions at competitive costs.

- **Portfolio of core technologies**

Through years of experience of offering solutions ranging from back-end to front-end applications for wireless telecommunication, the Group has developed and accumulated core technologies in the areas of telecommunication protocol software development, RF system design, embedded real-time control and proprietary operating system for wireless terminals.

- **Recognition and reputation**

The Group has been providing products and solutions for wireless telecommunication and support services in the PRC for years. The Group's products and solutions have been recognised and accredited by various authorities. The Directors believe that the Group has also gained a reputation for quality products and solutions among many of its customers.

- **Extensive sales, after sales support and technical support services**

The Group has delivered wireless telecommunication solutions covering extensive parts of the PRC. As at the Latest Practicable Date, the Group employed a sales team comprising 105 people, who stationed in the Group's headquarters in Shenzhen, representative office in Beijing and sales liaison points in Shanghai, Chongqing, Tianjin and 20 provinces in the PRC. The team provides installation and maintenance services, and after sales support services to the Group's customers.

INTELLECTUAL PROPERTY RIGHTS

The Group relies on a combination of copyright, non-disclosure, confidentiality and segregation of custodians to protect and limit access to and prevent infringement of the intellectual property rights which the Group owns. In order to protect the Group's confidential information, the Group has entered into confidentiality agreements with its key employees.

During the Track Record Period, all of the Group's wireless terminals were sold under the "Coolpad" trade name, which has been registered as trade mark under Class 9 in the PRC.

As at the Latest Practicable Date, the Group was the (i) registered proprietor and beneficial owner of five trademarks; (ii) proprietor and beneficial owner of two patent for designs; (iii) registered copyright holder of three works; (iv) registered copyright holder of 33 computer softwares; and (v) owner of seven domain names. As at the Latest Practicable Date, the Group were granted the following 15 software products registration certificates:—

Date	Certificate number	Product name
12 November 2002	深DGQ-2001-0005	YL6400B 無線尋呼發射系統 V6.0 (Radio paging transmission system V6.0)
12 November 2002	深DGY-2001-0186	P4/P6 高級尋呼系統 V6.0 (P4/P6 High-level paging system V6.0)

Date	Certificate number	Product name
12 November 2002	深DGY-2001-0187	尋呼營業管理系統 V6.02 (Paging business management system V6.02)
12 November 2002	深DGY-2001-0188	PPS 高速尋呼系統 V3.01 (PPS High speed paging system V3.01)
12 November 2002	深DGY-2001-0189	發射機遠程監控系統 V2.0 (Transmitter long-distance supervision system V2.0)
12 November 2002	深DGY-2001-0190	短消息增值系統 V1.10 (Short messages value-added system V1.10)
12 November 2002	深DGY-2001-0191	SMS 移動短消息系統 V1.20 (SMS Mobile short messages system V1.20)
12 November 2002	深DGY-2002-0206	宇龍 CDP-300 證券信息終端 V1.0 (Yulong CDP-300 securities information terminal V1.0)
12 November 2002	深DGY-2002-0207	宇龍呼叫中心系統 V1.0 (Yulong call centre system V1.0)
12 November 2002	深DGY-2002-0208	宇龍 CDP-400 證券信息終端 V1.0 (Yulong CDP-400 securities information terminal V1.0)
12 November 2002	深DGY-2002-0209	宇龍信息平台系統 V2.1.0 (Yulong information platform system V2.1.0)
12 November 2002	深DGY-2002-0476	宇龍理財寶信息終端嵌入式軟件 V2.0 (Yulong finance management information terminal embedded software V2.0)
12 November 2002	深DGY-2002-0487	宇龍 COOLPAD 智能終端嵌入式軟件 V1.0 (Yulong COOLPAD intelligent terminal embedded software V1.0)
21 June 2004	深DGY-2004-0407	宇龍 CoolPAD 手機嵌入式軟件 V1.0 (Yulong COOLPAD handset embedded software V1.0)
21 July 2004	深DGY-2004-0533	宇龍 PHS 智能覆蓋系統軟件 V2.52 (Yulong PHS intelligent coverage software V2.52)

As at the Latest Practicable Date, the Group had applied for registration of 11 trademarks and nine patent of designs. Based on the Directors' experience, it normally takes about 18 months and two years respectively between application and grant of approval for the trademarks and patents of designs. Details of the Group's intellectual property rights are set out in the paragraphs headed "Intellectual property rights" in Appendix VI to this prospectus.

INSURANCE

Although the Group has taken general insurance coverage in respect of damage to its existing properties, it has not secured any product liability insurance or any third party liability insurance. There may be circumstances in which the Group would not be covered or compensated by insurance in respect of losses, damages, claims and liabilities arising from or in connection with product liability or third party liability. These events could adversely affect the profitability of the Group. The Directors, however, having considered the industry practices, consider the insurance coverage currently taken out by the Group is adequate.

CONNECTED AND RELATED PARTY TRANSACTIONS

During the Track Record Period, the Group had entered into the following connected and related party transactions:—

(i) Lease of properties from Space Star

During the year ended 31 December 2001, Yulong Shenzhen used the office building facilities of Space Star (a connected person of the Company) free of charge. The market value of rental expenses for leasing the office building facilities was RMB824,000 (approximately HK\$777,358) for the year of 2001. Yulong Shenzhen has stopped using the office building since 1 January 2002.

During the years ended 31 December 2001 and 2002 respectively, Yulong Shenzhen used the warehouse facilities of Space Star free of charge. The market value of total rental expenses for leasing the warehouse facilities was RMB220,000 (approximately HK\$207,547) for 2001 and 2002.

During the year ended 31 December 2003 and the five months ended 31 May 2004, Yulong Shenzhen used the warehouse facilities of Space Star for annual rental of RMB109,936.80 (approximately HK\$103,714). The rental charge was determined based on the market value.

For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, total rental expenses paid by the Group to Space Star for the above was nil, nil, RMB109,936.80 (approximately HK\$103,714) and RMB45,807 (approximately HK\$43,214), respectively.

(ii) Interest expenses on amount due to a Director

For each of the three years ended 31 December 2003 and the five months ended 31 May 2004, the Group paid interest expenses of approximately RMB474,000 (approximately HK\$447,000), RMB661,000 (approximately HK\$624,000), RMB120,000 (approximately HK\$113,000) and nil, respectively, for amount due to Mr. Guo, who is an executive Director. The amount due to Mr. Guo was unsecured and interest free, save for that for the mortgage loan from China Merchant Bank, which was calculated at 6.9% per annum. The amount due to Mr. Guo has been fully settled in June 2004.

The lease of warehouse facilities from Space Star mentioned in paragraph (i) above is expected to continue after the Listing Date and will constitute continuing connected transactions (as defined in the Listing Rules) for the Company. However, as the annual amount of the transactions is expected to be less than HK\$1,000,000, the transactions will fall within the threshold of de minimis transactions under the Listing Rules and will be exempted from the reporting announcement and independent shareholders' approval requirements under the Rule 14A.33 of Listing Rules.