Management Discussion and Analysis

REVIEW OF RESULTS AND OPERATIONS

The Group's consolidated turnover for the year ended 31 December 2004 was approximately HK$ 178,309,000, representing an increase of approximately 55.7% when compared to 2003. Outsourcing software development work from the Group's existing Japanese customers and the provision of technical support services continued to grow in 2004. Turnover derived from outsourcing software development work increased by approximately 56.2% to approximately HK$166,330,000. This increase was mainly attributable to the growth in business volume from the Group's two largest Japanese customers. Inflation of Japanese Yen during the year also contributed to approximately 6.6% of the turnover growth. Ratio of turnover under the agreed man-month basis business model and under the project basis model for the year was 31:69. Turnover derived from technical support services increased by approximately 49% to approximately HK$11,979,000. Six additional service points were set up by the Group in 2004 to enlarge its service network coverage for its existing international technical support service business partner in China which mainly accounted for the increase.

There were 1,000 staff headcounts as at 31 December 2004, an addition of 275 from 725 at beginning of the year. Most of the increases in headcount comprised of software engineers employed to cope with the increase in business volume. Headcount growth, which was approximately 38%, was less than the turnover growth of 55.7% due to improved recovery rate, increased volume of work sub-contracted out, and business growth with a customer at a higher billing rate. Recovery rate (i.e. chargeable headcount divided by actual working headcount) of the Group's work force improved in 2004. This was mainly due to the learning curve effect in large projects during which both efficiency and productivity improve as the projects move and better project development software tools developed by the Group. The recovery rate in 2004 was 82%, a 0.5% increase when compared to 81.5% in 2003. Work sub-contracting out amounted to approximately HK$5.25 million, or approximately 2.9% of the total turnover in 2004. The corresponding amount in 2003 was HK$2.11 million. The billing rate to a particular Japanese customer is higher than to the others due to the complexity of its projects. Nevertheless, the customer was very satisfied with the Group's quality work and continued to increase the volume of work outsourced to the Group in 2004.

The Group was able to maintain its high gross profit margin at approximately 48.7% in 2004, the same gross profit margin in 2003. As a result, gross profit for the year increased to approximately HK$86,731,000 at the same growth rate of turnover growth from 2003. To this end, the Group successfully controlled its manufacturing staff costs, which was the major cost item of its cost of sales, at approximately 37.8% of total turnover in 2004 (2003: 37.7%). Notwithstanding the average salary increment to manufacturing staff of approximately 11.3% in 2004, manufacturing staff cost was controlled by optimal project team engineer mix comprising a reasonable composition of junior engineers. Typically, an optimal project team mix is only achievable for large scale projects in which there is room for a relatively large pool of junior engineers' participation. The Group puts a lot of emphasis on project selection. Given its leading position in a seller

market, the Group prefers to select long term stable large scale projects with subsequent maintenance and upgrade work when the project is finished as its operating strategy.

Operating profit and net profit attributable to shareholders in 2004 increased by approximately 62.7% and 63.6% to HK$61,940,000 and HK$55,367,000 respectively. Operating margin and net profit margin in 2004 were approximately 34.7% and 31.1% respectively and the effective tax rate was approximately 10.5%.

LIQUIDITY AND FINANCIAL RESOURCES

Since inception, the Group has funded its operations through equity funding and cash from operation and has no bank borrowings. The Group continued to maintain this strong cash generating capability for the year. During the year, the Group financed its operations and investing activities solely with internally generated cash flow.

SHARE CAPITAL

Neither the Company nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the period from the date of listing to 31 December 2004.

As at 31 December 2004, the number of shares in respect of which options had been granted and remained outstanding under the share option scheme of the Company was 17,730,000, representing approximately 6.67% of the shares of the Company in issue at that date.

PLEDGE OF ASSETS

As at 31 December 2004, the Group had not pledged any of its assets.

APPLICATION OF PROCEEDS OF SHARE OFFER

The net proceeds from share offer in connection with the listing of the shares of the Company on 30 April 2004 have not been used. The planned applications of the net proceeds, namely training and recruitment, development of in-house use software, sales and marketing, expansion of technical support services were funded by cash generating from operations. The Group postponed its plan to integrate and centralize its resources in Beijing because of the current overheated real properties market in Beijing. The Group will re-consider this plan when the Beijing real property price falls to a reasonable level. Strategic acquisitions and investments of two companies in China which were expected to be completed by end of 2004 have been delayed as a result of extended negotiations over the terms of the legal documents involved. Such negotiations are still being in process and nearly finalized. These strategic acquisitions and investments if materialized will be financed by the net proceeds.

Management Discussion and Analysis

EMPLOYEES AND REMUNERATION POLICY

The Group had 1,000 full time staff as at 31 December 2004, 60 of which were located in Japan and the remaining 940 were located in China. Most of the staff in Japan were bridged system engineers working at customers' sites. There were 813 software engineers, 59 technical support engineers, and 68 management and administrative staff in China. Their remuneration, promotion and salary review are assessed based on job responsibilities, work performance, professional experiences and the prevailing industry practice. The Group also offers project bonus and performance bonus to its staff. Project bonus is calculated by providing a fixed amount per man-month of work completed in a project and distributed among staff engaging in such project according to their respective contributions. Performance bonus is calculated based on an evaluation of individual efforts and the financial performance of the Group. Adequate resources are preserved for Japanese language training on regular basis, new I.T. knowledge training and business domain knowledge training for each project before its commencement. On-the-job training is also provided after a project has commenced. The Group maintains social insurance schemes for retirement, unemployment, personal injury and hospitalization for all of its employees in China. A housing provident fund system has also been implemented for its employees in China. Staff in Japan are enrolled under the requisite pension fund and health scheme as required under Japanese law.

The Group further improved the incentive bonus reward system. Senior and middle level staff, depending on their working years and positions, have been rewarded by way of different amounts of share options. The Group is confident that such reward could increase the motivation and cohesion of our workforce.

FOREIGN EXCHANGE AND CURRENCY RISKS

Since most of the Group's revenue was generated from software development outsourced from Japan in Japanese Yen while expenses were settled in RMB, any depreciation of Japanese Yen against RMB, will reduce the income of the Group and have an adverse impact on the profitability of the Group. Japanese Yen was very strong in 2004 and the revenue of the Group was increased by approximately 6.6% as a result. The Group had not adopted any hedging policy to reduce its exchange rate exposure in 2004 and will address to this currency risk when the Japanese Yen loses its appreciation momentum.

CONTINGENT LIABILITIES

As at 31 December 2004, the Group had no material contingent liabilities.

CAPITAL COMMITMENTS

As at 31 December 2004, the Group had no material capital commitments.