

M ANAGEMENT DISCUSSION AND ANALYSIS

OPERATION REVIEW

During the year, the Group was principally engaged in information technology business, provision of financial information and related services, distance learning and application services, property investment and development and through its listed subsidiary, South Sea Holding Company Limited ("South Sea"), was engaged in property development; design and marketing of consumer packaged electronics. Turnover for the year was approximately HK\$681.4 million (9 months ended 31 December 2003: HK\$404.2 million) and a net profit of HK\$82.6 million (9 months ended 31 December 2003: HK\$81 million) was recorded. The net assets value of the Group amounted to approximately HK\$3,471.8 million, representing a value of HK\$0.17 per share.

In 2004, the Company's earnings compared to last period's did not achieve optimum results. China implemented the macroeconomic control policy in 2004, but did not consider in detail some of the requirements of corporations. The policies lead to an overall environment, which to a certain extent hindered the growth of the Company's business. At the same time, the personnel changes caused by internal management reorganization also had certain transitional effects. However, as the initial earnings results in 2005 indicate, the positive outcome is evident even before the management restructure has been fully implemented. The figures indicate that the company reorganization was on target and necessary. With strengthened management structure and business network expansion, the Company's growth in 2005 is now accumulating strength for a take-off.

Information Technology Business

This business division offers Internet Application Services to corporate clients, especially those small to medium enterprises, and continues to post strong performance during the year. This division recorded a revenue of approximately HK\$378.2 million (9 months ended 31 December 2003: HK\$211 million) and a segment profit of approximately HK\$89.8 million (9 months ended 31 December 2003: HK\$47.2 million).

In 2004, the Company implemented comprehensive management restructure and business enhancement with positive results. The Company also reorganized its subsidiary's technology team, advanced production research and development capability as well as operation maintenance standards, which in turn has advanced the technology platform's stability and efficiency. In July 2004, the Company also moved its business units' IDC (internet data centre) into Asia's largest IDC, China Netcom's Super IDC located in the Beijing Economic-Technological Development Zone, and set up a super-sized stand-alone data and network operation centre. This is the first 7x24 operated and maintained system management structure within the IT service industry. The Chinese government and the corporate sector have recognized our hard work. CE Dongli Technology Company Limited ("CE Dongli") has been selected by professional rating institutions and the media as "China's Top Internet Service Top Brand Name in 2005".

Financial Information Provision

During the year, this division of business posted steady income and profit contribution for the Group. Turnover for the year was approximately HK\$78.5 million (9 months ended 31 December 2003: HK\$73 million) and a segmental profit of approximately HK\$22.4 million (9 months ended 31 December 2003: HK\$34.9 million) was recorded. The Group dominates 85% of the futures market and 65% of the banking sector providing personal FOREX information market in China.

In this reporting year, the Company successfully transformed Beijing Shihua International Financial Information Company Limited ("Shihua") into a professional financial information service provider. Through standardized information exchange, professional content and analysis, real-time information delivery, Shihua has contributed significantly to the standardization of Chinese information market and advancement of information industry standards. Shihua has added energy related information and analysis services on its information platform, including reports on international macroeconomic policy and energy sector trends, expert oil industry analysis and price data. Through strategic cooperation efforts with international institutions and financial information service providers, Shihua's information standards, authoritative and objective analysis are not only acknowledged in China but are also being recognized by the international financial information community.

Distance Learning and Application Services

Turnover for the year was approximately HK\$71.3 million (9 months ended 31 December 2003: HK\$43 million) and a segmental profit of approximately HK\$53.2 million (9 months ended 31 December 2003: HK\$34.5 million) was recorded.

In the report year, Beijing Chinese Dadi Distance Education Limited (“Huaxia”) has achieved periodic development results in this reporting year, Sina and Sohu selected Huaxia as the “Top Ten Online Education Organization” for two consecutive years. As the leader in China’s long distance education market, Huaxia’s online student recruitment distributorship has increased by one hundred to reach more than 300 distribution agencies. Huaxia has established broad cooperative efforts with the Ministry of Education, examination offices at the national, provincial and municipal level as well as authoritative educational institutions. It has also collaborating with more than 70 major websites, including main Chinese Internet portals such as Sina, Sohu and Netease.

Property Development

During the year, the Group recorded no turnover (9 months ended 31 December 2003: Nil) and a segment profit of approximately HK\$0.7 million (9 months ended 31 December 2003: loss of HK\$9.6 million) for this business division. The profit was mainly attributable to negative goodwill recognised as income and surplus on revaluation of properties under development.

In this reporting year, the Company operated property development business through its subsidiary South Sea. The subsidiary’s Shenzhen property received the government’s approval as planned, and “The Peninsular” has initiated construction and entered into marketing phase. Based on current market price and demand, the project’s investment return will be optimistic. Based on the approved construction plans and concept, the unique cultural community will consist total floor area of about 1 million sq.m.. The pre-sale of the Phase I of “The Peninsular” is expected to be commenced in September 2005, and this project is expected to generate strong cash income in the coming few years.

Since the new Baiyun international airport has brought about many new vibrant opportunities, the development plan of our Guangzhou Huadu project, a super sized international contemporary commercial and residential community integrating cultural recreations and commercial amenities, is being reviewed in detail. All approval procedures are progressing as planned, with overall construction and the first phase opening to be expected soon. The project’s presale price has been rising, expected value to exceed RMB4,500 per sq. m. on opening day. The Company predicts this development of this approximately 1.08 million sq. m floor area property will continue to generate large profit for the Company for the coming years.

Consumer Packaged Electronics

During the year, turnover from this division was approximately HK\$1.2 million (9 months ended 31 December 2003: HK\$2.2 million) and a reduced segmental loss of approximately HK\$4.8 million (9 months ended 31 December 2003: HK\$6.7 million) was recorded.

The market in this industry has always been very competitive and as a result, the turnover in this division has been decreasing during the year. However, our management would continue to monitor the market and to make necessary steps to reduce the negative impact from such competitive environment.

MANAGEMENT DISCUSSION AND ANALYSIS

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL

The Group continues to adopt prudent funding and treasury policies. As at 31 December 2004, net assets value of the Group amounted to approximately HK\$3,471.8 million, including cash and bank balances of approximately HK\$52.2 million, which was denominated mainly in Renminbi and Hong Kong dollars. As at 31 December 2004, the Group's aggregate borrowings decreased to HK\$406 million (at 31 December 2003: HK\$1,180.9 million), including approximately HK\$210.5 million were bearing interest at fixed rates while approximately HK\$195.5 million were bearing interest at floating rates. The decrease in borrowings is mainly due to net repayment of approximately HK\$192.7 million and conversion of convertible loan notes of HK\$400 million during the year. The gearing ratio of the Group, measured on the basis of total borrowings as a percentage of total shareholders' equity, decreased to 11.7% as of 31 December 2004 from 39.5% as at 31 December 2003. Such drop is mainly due to the aforesaid reduction in borrowings and notes conversion during the year. The Group's contingent liabilities at 31 December 2004 were HK\$165.2 million due to the guarantees given in connection with credit facilities.

As at 31 December 2004, property under construction in progress with a net book value of approximately HK\$13.5 million; listed securities with market value of approximately HK\$830.7 million; charge over shares in certain subsidiaries within the Group; and land held for development with land lot no. K708-5 at Liu Wan, Shekou, China together with all its sales proceeds were pledged as securities for credit facilities.

EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATE

As the majority of the Group's borrowings and transactions are denominated in Hong Kong dollars, US dollars and Renminbi, the Group's exposure to exchange rate fluctuations is relatively insignificant. In general, the Group mainly utilizes its Renminbi income receipt for operating expenditures in China and has not used any financial instruments for hedging Renminbi bank borrowings during the year and such borrowings were mainly used for Renminbi capital requirements in China.

EMPLOYEE

The Group employs and remunerates its staff based on their qualifications, experience and performance. In addition to basic salary payments, other benefits include contributions to mandatory provident fund, group medical insurance, group personal accident insurance, external training sponsorship and examination leave. Employees are eligible to be granted share options under the Company's share option scheme at the discretion of the board of directors. In general, salary review is conducted annually. At 31 December 2004, the Group had approximately 8,422 employees (at 31 December 2003: 5,931 employees). The salaries and allowance of employees for the year ended 31 December 2004 was about HK\$213.6 million (9 months ended 31 December 2003: HK\$132.4 million).

PROSPECT

In 2004, the Company launched a shareholding restructure program with its subsidiary, South Sea, as well as business reorganization plan. This plan aims for South Sea, which has large property holdings, to become the holding company, and for the Company to become the subsidiary of South Sea. Upon completion of the shareholding restructure, South Sea will concentrate on property investment and development and through shareholding scheme participate in IT business. The Company will concentrate on the operation and development of the IT business. Through this restructuring, the Company will focus more on the core business; better allocate corporate strength and resources, on one hand, with CE Dongli as the flagship, complemented by Beijing Xinet Technology Development Limited ("Xinet") and Easy-Trade Technology Services Limited ("Easy-Trade"), the Company will expand its foothold in the IT industry, On the other hand, the Company will continue to lead Shihua to further develop the financial information service industry and lead Huaxia in the long distance education and application software service sector. The successful implementation of this reorganization plan will

M ANAGEMENT DISCUSSION AND ANALYSIS

also allow investors to make better investment decisions, as each company's results will be more focused. This in turn will be significant in the Company's future development as well as increase in investor understanding and trust in the company's business. The Company has submitted petition for capital reduction and distribution to the High Court, and the shareholding restructure is expected to be completed by mid-2005. Due to technical arrangements with shareholders and creditor banks, the restructure plan was delayed. However, all issues have been completed, and the Company will expedite the restructure in 2005.

Based on past management experience, with CE Dongli as the flagship, we will build CE into an IT application service business in 2005, with an all-in-one sales, research, operation, information, administration, human resource and financial management platform. Such group will combine the forces of CE Dongli, Xinnet and Easy-Trade, to achieve resource integration and sharing, and provide mutual support in the technology and management areas. The Company believes that the centralized group management, with CE Dongli as the flagship, will be a significant step toward strengthening the Company's IT industry leadership position.

In 2005, the Company will increase investment in the IT service, financial information services, and long distance learning and application software service industries. Besides strengthening management to increase each subsidiary unit's revenue and profit, we plan to build a LINUX Research and Development Center, to lead a stronger technology R&D team. The Company will continue to merge and acquire corporations in the related areas, develop more strategic partners, advance product line, increase market share to substantiate our market leadership position.

The Company's subsidiary Huaxia has achieved major development in 2004, achieving positive earnings, successfully entered into investment return period, becoming the Company's independent business unit. Huaxia already has positive standing within the industry and has accumulated independent operation experience as well as capital. Therefore, we plan to increase Huaxia's independent operation status when the market environment and other criteria are up to par.

In 2004, the Company began entering into the outer realms of the cultural media sector. However, due to uncertainty in the direction of China's cultural media policy, we remain cautious as we observe the developments.

In the coming year, we will continue our development focus in the IT application service, financial information service, long distance education and application software service sectors. Maximize our business subsidiary's current market position, continue to strengthen and expand our leadership position, to achieve maximum shareholder value.