

Management Discussion and Analysis

Financial review

Results

Turnover of the Company and its subsidiaries (the "Group") for the year surged substantially from HK\$163,947,000 to HK\$249,058,000 which represents an increase of 52% as compared with the previous year. The significant increase for the current year is mainly due to the full year revenue contribution from 北京鴻聯九五訊息產業有限公司(Beijing Honglian 95 Information Industries Company Limited*) ("HL95")'s Telecom VAS business whereas HL95 only provided 1.5 months of turnover in the previous year since the Group acquired 45% of HL95 in February 2004 and an additional 4% of HL95 in June 2004. A substantial portion of the Group's turnover for the current year was due to its proportionate share of turnover of HL95's Telecom VAS business which amounts to HK\$189,767,000 (2004: HK\$24,493,000).

The Group recorded an operating profit of HK\$34,711,000 for the year as opposed to an operating loss of HK\$800,000 last year. The Group has also turned around from a net loss of HK\$2,035,000 to a net profit attributable to shareholders of HK\$25,420,000 in the current year. The operating profit for the current year was mainly attributable to:

- (1) contribution of HK\$25,358,000 operating profit from HL95;
- (2) recovery of HK\$10,000,000, being a debt which was previously fully provided for;
- (3) write back of certain long outstanding payables of HK\$6,775,000;
- (4) negative goodwill of HK\$20,403,000 arising mainly from the acquisition of 30% equity interest of 東方口岸科技有限公司(Dongfang Customs Technology Company Limited*) ("Dongfang Customs Technology") and acquisition of additional interest in HL95; and
- (5) gain on disposal of certain subsidiaries to third parties amounting to HK\$13,103,000.

Significant investments and capital expenditures

In June 2004, approval from relevant government authorities on the acquisition of an additional 4% of HL95 was obtained and HK\$3,028,000 was paid for such acquisition. As a result, the Group's equity interest in HL95 increased from 45% to 49% during the year.

On 20th September 2004, the Group entered into a sale and purchase agreement with its substantial shareholder, CITIC Group, where the Group would acquire 30% equity interest in Dongfang Customs Technology from the CITIC Group. The acquisition was completed on 31st March 2005 and the consideration amounted to RMB59,806,211 (equivalent to approximately HK\$56,636,000) which was settled in cash upon completion.

* for identification purposes only

Management Discussion and Analysis

Financial review *(Continued)*

Significant investments and capital expenditures *(Continued)*

An agreement was entered into on 20th January 2005 to establish a joint venture company, 中國檢信息技術有限公司 (CITIC Quality Supervision Information Technology Company Limited*) ("CITIC QSIT") of which the Group will have 50% equity interest, 中華人民共和國國家質量監督檢驗檢疫總局信息中心 (Information Centre of the General Administration of Quality Supervision, Inspection and Quarantine of the PRC*) ("AQSIQ") will have a 30% equity interest, and 中國電信集團公司 (China Telecommunications Corporation*) ("China Telecom") will have a 20% equity interest. In accordance with the joint venture agreement, the total investment in CITIC QSIT is RMB150,000,000 (equivalent to approximately HK\$141,509,000). The registered capital is RMB60,000,000 (equivalent to approximately HK\$56,604,000), of which RMB30,000,000 (equivalent to approximately HK\$28,302,000) has been contributed by the Group, as at 31st March, 2005. The Group has also agreed to advance to CITIC QSIT RMB18,000,000 on behalf of AQSIQ which represents AQSIQ's capital contribution in view of the importance to the operation of CITIC QSIT. As of 31st March 2005, the advance on behalf of AQSIQ has not yet been made.

Liquidity, Financial Resources and Foreign Exchange Exposures

The total assets of the Group as at 31st March 2005 was HK\$449,146,000 which was financed by shareholders' fund of HK\$308,787,000, current liabilities of HK\$133,065,000 and minority interest of HK\$7,294,000. The current ratio of the Group as at 31st March 2005 was 2.3.

The outstanding bank loans of the Group amounted to HK\$11,583,000 as at 31st March 2005 which were repayable within one year and carries interest at prevailing market rate. All bank loans are denominated in Renminbi, of which HK\$3,956,000 related to the operation of the system integration business and was secured by bank deposits of HK\$5,000,000, and the remaining balance of HK\$7,627,000 related to the portion of loan attributable to the Group in HL95, a jointly controlled entity, which was guaranteed by the major shareholder of HL95. The gearing ratio, calculated as the interest-bearing bank borrowings over the shareholders' funds, was only 3.75%.

At 31st March 2005, bank deposits of HK\$6,057,000 are restricted, of which HK\$5,000,000 has been pledged as security for a short term bank loan and is not classified as a non-current asset and the remaining balance of HK\$1,057,000 is included in non-current assets.

In February 2005, the Company successfully raised funds by way of rights issue of warrants at a subscription price of HK\$0.10 per warrant on the basis of one warrant for every six shares of HK\$0.10 each in the share capital of the Company ("Shares"). A total of 550,697,664 warrants were subscribed and an aggregate subscription sum of HK\$55,069,766 was received. Each warrant can be converted into one Share at an exercise price of HK\$2.40. The warrants are exercisable within 18 months from the date of issue. If all warrants are exercised within 18 months, the Company will receive approximately HK\$1,321,674,000 from the issue of new Shares of the Company.

* for identification purposes only

Management Discussion and Analysis

Financial review *(Continued)*

Liquidity, Financial Resources and Foreign Exchange Exposures *(Continued)*

The Group's operation and transactions are principally located in the People's Republic of China (the "PRC") and all assets and liabilities are mainly denominated either in Hong Kong dollars or Renminbi. The Directors believe that the exchange rate for Renminbi is likely to be stable for the foreseeable future and the operations of the Group are not subject to significant exchange risk.

Contingent Liabilities

The Group had no material contingent liabilities as at 31st March 2005.

Business Review

Telecom VAS business

The Group's results from Telecom VAS business are derived from the investment in a 49% jointly controlled entity, HL95. HL95 is one of the leading nationwide Telecom VAS companies in the PRC, with prominent brand name and nationwide coverage. HL95 provides fixed line and mobile phone users in the PRC with the largest IVRS and SMS coverage, offering governmental, commercial and entertainment contents.

The turnover of HL95 for the current year was HK\$403,307,000 (for the period from 11th February to 31st March 2004: HK\$55,522,000) and the Group's proportional share was HK\$189,767,000 (for the period from 11th February to 31st March 2004: HK\$24,493,000). The Group's share of HL95's turnover increased in the current year because of the full year consolidation of HL95 in the current year, whereas in the previous year the Group's turnover only included 1.5 months of HL95's turnover.

The turnover of HL95 can be analysed as approximately 38% (2004: 43%) from IVRS, 34% (2004: 44%) from SMS, 12% (2004: 10%) from Internet-protocol phone, 14% (2004: 2%) from call centres and 2% (2004: 1%) from other operations. As compared with the turnover in the previous year, turnover from IVRS and SMS showed a drop of 5% and 10% respectively. Such drop was mainly due to actions taken by telecommunications service operators to tighten the industry regulations during the current year. Such actions caused certain negative impact in the industry and as a result hindered the development and growth of the SMS and IVRS business of HL95 in the current year. However, the Group believes that such regulatory measures have long-term positive impact to HL95 and the industry as a whole.

Net profit of HL95 for the current year was HK\$35,845,000 (for the period from 11th February to 31st March 2004: HK\$4,671,000) and the Group's proportionate share was HK\$16,998,000 (for the period from 11th February to 31st March 2004: HK\$2,102,000). In the current year, HL95 expanded its product range to Telecom VAS services that contribute higher margins such as Information Processing Centre, a call center service established in Beijing in early 2004.

Management Discussion and Analysis

Business Review *(Continued)*

Telecom VAS business *(Continued)*

As HL95 has already set up a nationwide network with coverage to over 300 cities, and with its nationwide uniform access number for both fixed line and mobile phones, HL95 has strengthened its role as a Telecom VAS provider which will support the Group in its future development.

Dongfang Customs Technology

Dongfang Customs Technology provides the platform for import and export enterprises, manufacturers and trading companies in the PRC with electronic customs processing, other electronic government services and electronic commerce transactions capability, as well as identifying authenticity, online payments and billing services. The shareholders of Dongfang Customs Technology comprise 中國電子口岸數據中心 (China Electronic Customs Data Centre*) which is an organization directly under the PRC Customs, China Telecom and the Group. Dongfang Customs Technology is the only operator in China providing the access platform for electronic customs clearance and processing services in the PRC. Using this advanced technology, enterprises in the PRC can save time in customs processing so that business transactions will be more interactive, accurate and timely, enhancing import and export efficiency.

Dongfang Customs Technology recorded revenue of RMB92,166,265 and net profit of RMB56,771,352 for the 15 months ended 31st March 2005. However, the necessary approvals for the acquisition of the 30% of Dongfang Customs Technology were completed on 31st March 2005. Accordingly, the results of Dongfang Customs Technology have not been incorporated into the Group's results for the year ended 31st March 2005. The Group has early adopted new or revised HKAS 36 and 38 and HKFRS 3 in the preparation of financial statements for the year ended 31st March 2005 which result in a change of accounting policy for goodwill recognition. As of the completion date of the acquisition, the fair value of net assets of Dongfang Customs Technology was ascertained at HK\$255,201,000 by reference to valuation reports issued by professional valuer, Sallmanns, resulting in a negative goodwill on acquisition of HK\$19,215,000 being recorded as other revenue.

The Group anticipates that the number of users will increase in line with the economic growth of the PRC. The number of customers increased from approximately 130,000 as at 31st March 2004 to about 200,000 as at 31st March 2005. The Group is optimistic that the number of users of Dongfang Customs Technology will continue to grow since there is no other operator for electronic customs clearance and processing in the PRC.

* for identification purposes only

Management Discussion and Analysis

Business Review *(Continued)*

System Integration and Software Development

廣東天圖科技有限公司 (Guangdong Tian Tu Technology Co. Ltd.*) ("Tian Tu") is one of the subsidiaries of the Company engaged in the system integration and software development business in the PRC. The revenue derived from the sale of computer products, provision of system integration services and software development business for the current year was HK\$59,291,000 (2004: HK\$137,228,000) and the attributable profit for the year was HK\$939,000 (2004: HK\$1,433,000). The decrease in turnover for the current year was mainly attributable to the severe competition in the system integration business resulting in lower profit margins. As a result, the management decided to focus more on the software development and technical support services. The management also plans to utilize the technical expertise of Tian Tu to provide service to other business units of the Group.

Prospect and Outlook

As a pioneer in the Telecom VAS in the PRC, the Group will strive to develop more information value added services in cooperation with governmental agencies to provide service to businesses in the PRC.

HL95, with its enormous nationwide network distribution coverage, provides the platform for consumers all over the PRC to access Telecom VAS provided by the Group easily. Since many consumers across the PRC are already using HL95's various Telecom VAS, it provides a scalable platform for the Group to launch other information and Telecom VAS.

Dongfang Customs Technology is the only operator in the PRC which provides electronic customs clearance and processing services. The Group's investment in Dongfang Customs Technology allows it to expand into other information and Telecom VAS.

On 20th January 2005, the Group entered into a joint venture agreement to establish CITIC QSIT with AQSIQ and China Telecommunications Corporation where the Group has an equity interest of 50%. The objective for the formation of CITIC QSIT is to provide a system to identify, authenticate and track products manufactured in the PRC through the operation of the Quality Supervision Platform ("QSP") in order to reduce the impact of forged products and provide logistic and supply chain management services. QSP is the only product identification, authentication and tracking platform in the PRC that cooperates with the government authority AQSIQ. AQSIQ is the central government department responsible for the administration, supervision and enforcement of laws to tackle manufacturers of forged products. Every product passing through QSP will be allocated a unique code that stores information of a product's specifications, logistics and distribution details. A consumer who has doubts about a product can check whether the product is genuine or not by accessing the QSP through various telecom channels such as mobile phone, fixed-line phone, internet or enquiry terminals at shopping centres. The commercial launch of the services of QSP is expected to begin in the second half of 2005.

* for identification purposes only

Management Discussion and Analysis

Prospect and Outlook *(Continued)*

With Dongfang Customs Technology, the access point of the “China Electronic Customs”, and QSP, which can access the databank on products manufactured in the PRC, the Group will further strengthen its position in information and Telecom VAS platform for business and government applications.

The Group also plans to participate in the PRC’s national project to digitalize all television broadcasting in the PRC by year 2010. The Group has announced its intention to establish a joint venture with Hebei Board of Radio and Television to provide various digital media-related services on an exclusive basis. The Group plans to expand the scope of such business to other provinces in the future if appropriate.

Human Resources

As at 31st March 2005, the Group employed a total of 67 full-time employees, of whom 13 were based in Hong Kong and 54 were based in mainland China. Total staff costs for the year amounted to HK\$52,160,000 of which HK\$33,316,000 was attributable to the jointly controlled entity. The Group’s policy is to maintain a competitive pay structure and employees are rewarded on a performance related basis.

The Group has also set up share option schemes pursuant to which employees of the Group may be granted options to subscribe for the Company’s shares at their absolute discretion. The subscription price, exercise period and the number of options to be granted are determined in accordance with the prescribed terms of the schemes. During the year, a total of 73,300,000 share options were granted to a director and employees and other eligible persons.