



Market Growth

The informatization of enterprises continue to gain momentum in line with economic growth of China



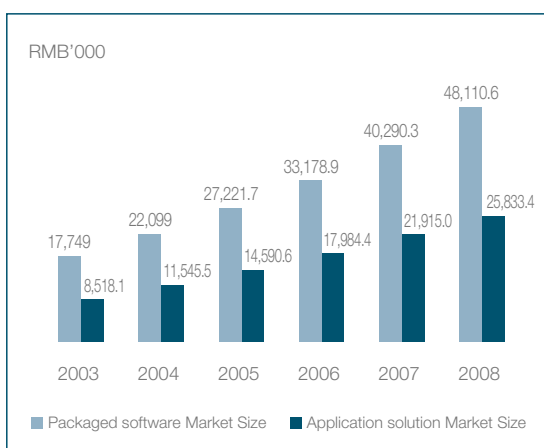
MANAGEMENT DISCUSSION AND ANALYSIS

Industrial Overview

1. The market of application software and middleware

Application software market

According to IDC, the revenue generated from packaged software in China amounted to RMB27,221,700,000 in 2005, in which application solutions accounted for approximately 50%, amounting to RMB14,590,600,000. According to the forecast of IDC, China's packaged software market will grow at a CAGR of 24.3% from 2003 to 2008, reaching approximately RMB25,833,400,000 by 2008.



Source: IDC, China Packaged Software Market Forecast and Analyst, 2004-2008

In China's application software market, the SME market shows the fastest growth and the strongest market potential. According to statistics, as at the end of 2004, SMEs accounted for 99.6% of the total number of enterprises in the PRC and the turnover of SMEs accounted for 58.5% of the GDP. However, among the over 10 million SMEs, less than 10% has adopted higher-end computer

system applications, far lower than the average of 60% in the overseas and mature market. This represents a huge potential for SME application software market, the Group's key target market.

Middleware market

The middleware market in China is an emerging market. According to IDC's forecast in 2003, China middleware market would grow at a CAGR of 35.2% from 2002 to 2007, reaching approximately RMB2,043,100,000.

2. The Group's market position

Leveraging on the extensive marketing, servicing and partnership network and the huge customers base, the Group, as shown in the research of independent evaluation organizations, maintained its leading market position in 2005:

- Ranked No. 1 in terms of market share of SMEs (IDC "Enterprise Applications Tracker in the Asian-Pacific region for the second half of 2004" (2004下半年亞太區軟體跟蹤重點) and "Enterprise Applications Tracker in the Asian-Pacific region for the first half of 2005" (2005上半年亞太區軟體跟蹤重點))



- Ranked first in terms of mentioning frequency among the ERP software providers (AMT Research Institute "Rating of China's management software and its providers in 2005" (AMT研究院《中國管理軟件與實施商2005年度評選》))
- The first-choice brand of ERP software product in China's IT industry and the leading software provider in terms of number of SME users in 2005 (China Computer User Association in January 2006)

Business Review

During the reporting period, the market demand for ERP in China continued to grow. On the one hand, the SME application software market remained robust, as a result of an increasing number of SMEs becoming aware of the importance and necessity of informatization in strengthening internal management and hence their commitment to devoting more resources in this respect. On the other hand, the requirement for enterprise management software from enterprises which have already achieved a certain scale of operations and standard of management continued to rise, as such enterprises saw the need for enterprise management software to meet the changing needs of business management.

During the reporting period, in response to the diversified market demand, the Group was committed to differentiating itself by innovative products and services and reinforcing its distribution channels under the corporate development strategy of "Product leadership, Partner oriented, Proactive services, Prompt response". While furthering its efforts in consolidating the SME market, the Group was also committed to increasing its market share of accounting and human resources management software application market. Every business segment maintained a stable growth.

1. Products and research and development

During the reporting period, the Group continued to investment substantially in the research and development of ERP and middleware. The Group launched various upgraded versions for ERP products and according to the researches of independent evaluation institutions, the Group's products maintained the leading market position in 2005.

- Ranked the first in application satisfaction of ERP software industry, overall users satisfaction of HR software, users satisfaction of business infrastructure software platform, satisfaction of application servers' services (CCW Research "Research on IT users' satisfaction in China in 2005").

- Innovative product for 2005 - BOS integrated platform (China Computer User Association in January 2006).

2005 was a year with significant development in enterprise informatization application. Supported and propelled by the strong IT capability, enterprises were capable of restructuring its mode of management. As the management capability of enterprises in China differed, the extent of informatization also varied. Kingdee's highly competitive products offered a full coverage of low, medium and high-end products.

Launched Kingdee KIS professional version and Kingdee K/3 10.2 version to further consolidate its low to mid-end ERP market

During the reporting period, the Group launched two updated versions – Kingdee KIS professional and Kingdee K/3 10.2. Kingdee KIS professional version further strengthened the market position in the low-end market and allowed the flexibility in business operation and accounting application. By launching Kingdee's new K/3 version, the Group has also consolidated its market position in the mid-end market, assisting enterprises in the integration of production, accounting, logistics, human resources and knowledge management and reducing the subsequent maintenance costs. Kingdee KIS and Kingdee K/3 can be smoothly upgraded to higher end products, minimizing the SME's subsequent investment in informatization and increasing the rate of investment return.

Improved Kingdee EAS to enter into the high-end ERP market of group accounting and human resources

During the reporting period, the Group launched a fundamental software platform – Kingdee BOS and a high-end ERP product – Kingdee EAS 5.0 version. As Kingdee BOS can solve the conflict between ERP standard product and customer's diversified demand, and satisfy enterprises' customized requirements for higher efficiency and lower costs and risks. A renowned independent research institute in China, CCW Research, has mentioned Kingdee BOS as the sign of the third technology reform in China's management software. EAS based on Kingdee BOS platform is China's first management software package of "middleware + ERP", it can satisfy corporate users' requirements on integrated management and prompt responses, given its outstanding performance in terms of its applicability, openness, adaptability, extensibility, compatibility, succession and lower costs. During the reporting period, Kingdee EAS 5.0 helped the Group to achieve breakthrough in the application of group accounting management and human resources management. The product, after gaining the





accreditations from Jinling Hotel Nanjing (南京金陵飯店)、Yingkou Port Group Co., Ltd. (營口港務集團有限公司)、Shanghai ChengTou Corporation (上海市城市建設投資開發總公司), has become a major product for market promotion.

Formed strong alliance for entering into the mobile commerce and internet market

During the reporting period, to explore the enormous market potential of mobile commerce and meet the emerging requirements on mobile management from corporate managers, the Group launched the first mobile commerce product with China Mobile. The product has manifested the technology essences of “management software + internet + mobile communications” and extended the ERP application from desktop to mobile terminals, allowing enterprises to manage the business at any time and at any place.

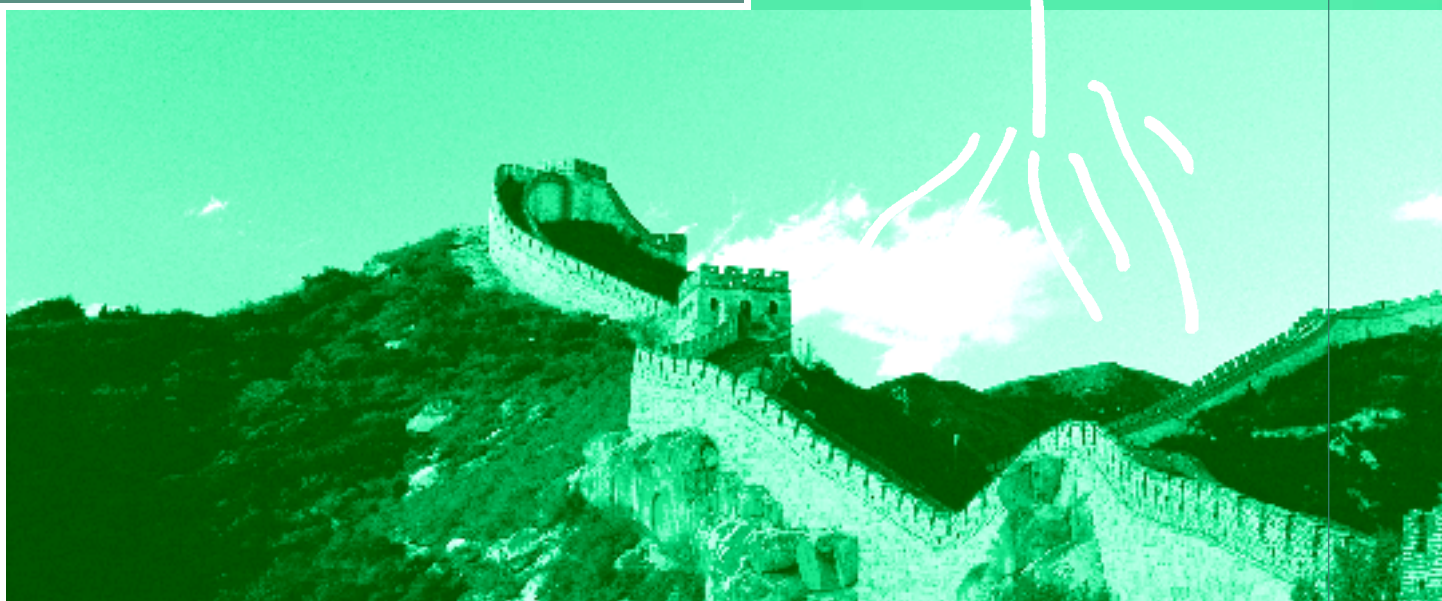
Filled up the gap of domestic-produced middleware market and applied middleware to various e-government projects

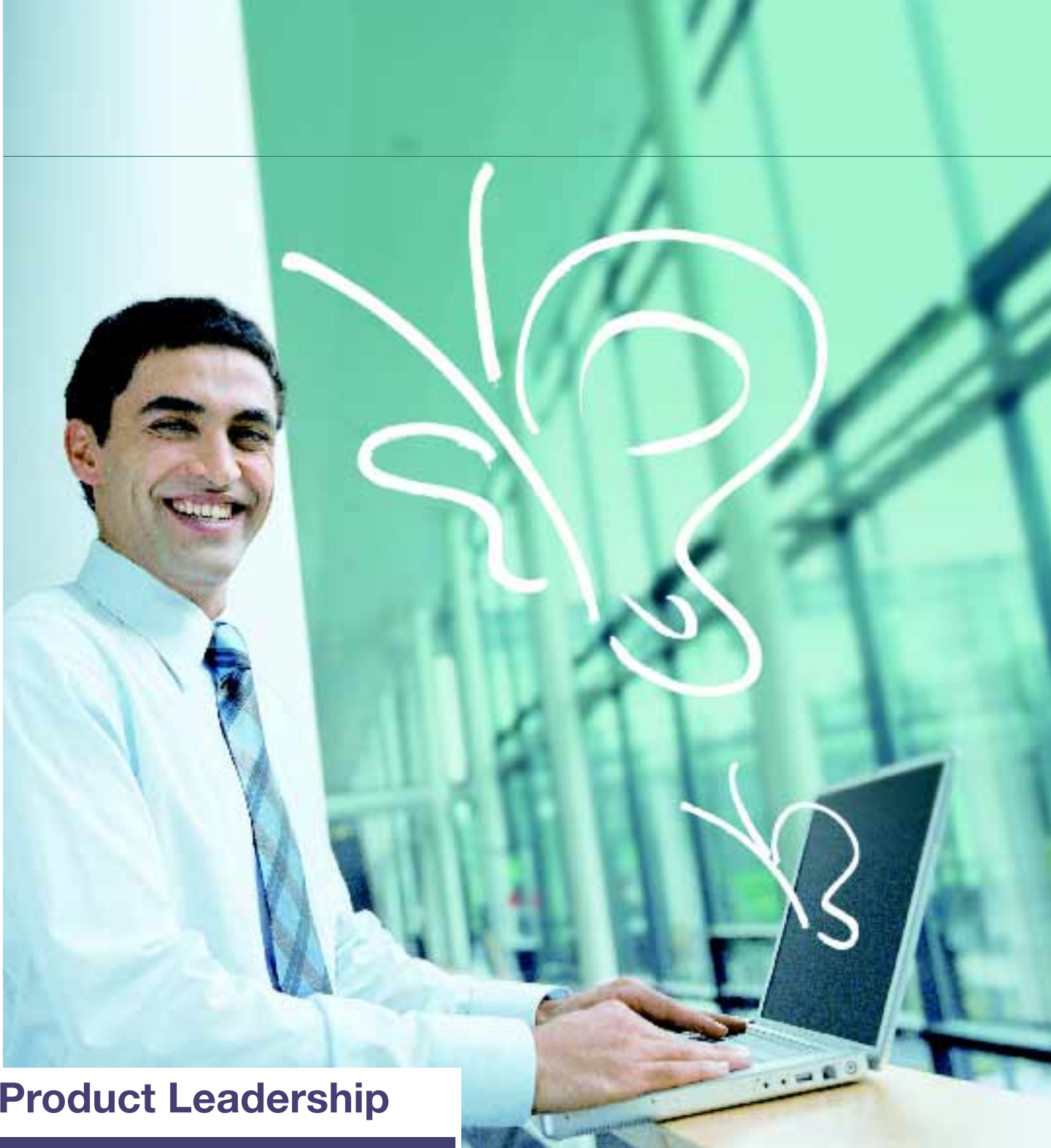
During the reporting period, the Group launched Kingdee Apusic application server 4.1. Kingdee Apusic is the first in the Mainland China and the eleventh in the world that has passed the J2EE1.4 international standard accreditation. Kingdee Apusic has been applied in various major projects, such as the industrial and commercial system of Liaoning Industry and Commerce Bureau (遼寧省工商局工商系統), the emergency system for homeless of Ministry of Civil Affairs (國家民政部流浪者救助系統), the system under General Administration of Quality Supervision, Inspection and Quarantine (國家質檢檢驗檢疫系統), the paper examination system for higher education of the Education Department (教育部高考閱卷系統) and the training system of PBOC (人民銀行培訓系統).

Kingdee®

Brand Reputation

Leading brand in China's application software market with extensive servicing and partnership network and huge customer base





Product Leadership

Commit resources in the research and development of products for providing customized ERP products and applications



2. Sales and distribution

During the reporting period, on the basis of the 40 direct sales branches in the Mainland China and Hong Kong, the Group substantially expanded its distribution channels, with over 200 newly-added distribution partners, thereby further consolidating the distribution network.

Direct sales grew stably

During the reporting period, notwithstanding that Kingdee KIS products were wholly sold through distribution channels, the Group still achieved a stable growth in direct sales, with more than 16,000 ERP newly-signed contracts, including Wuhan Tobacco Group Co., Ltd. (武漢煙草(集團)有限公司), Guangdong Wen's Group Co., Ltd. (廣東溫氏食品集團有限公司), Shanghai Target Media Co., Ltd. (上海聚眾目標傳媒有限公司), Inner Mongolia Mengniu Dairy (Group) Co., Ltd. (內蒙古蒙牛乳業(集團)有限公司) and Jia Zhao Ye Properties (Shenzhen) Co., Ltd. (佳兆業房地產(深圳)有限公司).

The Group also expanded its application software market in the Asian-Pacific region and in the international market by satisfying the requirements of international customers with its multi-lingual, price advantage products and its prompt and proactive services. The Group has entered into contracts with Pan-West, the largest golf products retailer in Asia, Fruit of the loom, a US company with 150 years history of development and Hong Kong Productivity Council, for assisting them to apply Kingdee K/3 ERP.

Substantially increased number of distribution partners and made initial achievements after changing distribution mode

The Group always pays attention to explore business opportunities with partners and to provide values to customers, with a view to ensuring the persistent rise in values and wealth creation capability of its partners while acquiring higher market share, saving the distribution costs and enhancing the profitability.

- During the reporting period, the Group further expanded its distribution channel network and recruited 200 distribution partners with its "low investment with high returns" program and its nationwide product promotion. The Group's distribution partners not only distribute software products but also provide after-sales services and support to customers. The Group continued to perfect its distribution channel management and help partners to increase capability of management and promotion through project cooperation, training and marketing activities. From 2005 onwards, Kingdee KIS products have been distributed solely through distribution channels and the volume of packages sold was 40% more than that of the corresponding period in 2004. From 2001 onwards, partners' contribution to Kingdee's turnover kept on rising, from accounting for 16% of the Group's turnover in 2002 to 22% in 2005.

- During the reporting period, with its proprietary Kingdee BOS platform, the Group established a customer partner laboratory and strived to establish value-added partnership which is capable of tailoring the products in response to the customers' requirements. As at the end of 2005, the Group has formed partnership with 30 K/3 value-added partners and has successfully developed 20 products for various industries on the basis of K/3 BOS products. The Group has also entered into cooperation agreements with leading proprietary software providers for the development of EAS BOS and shifting their research and development of the next generation products to EAS BOS platform.
- During the reporting period, the Group maintained close cooperation with global IT vendors, such as IBM, CITRIX and HYPERION in areas of technology and market development. Since the Group's participation in IBM's Independent Software Vendors Advantage Agreement (IAA), the relationship between the Group and IBM was reinforced. Under the plan, IBM provided assistance for allowing the Group's software product to be used in its software and offered Kingdee support in technology, marketing and sales. The Group uses IBM's DB2 and eServer databank as Kingdee EAS's major infrastructure platform and promotes IBM products through the distribution channel of Kingdee.

3. Customers services

The Group's major source of revenue is generated from new clients' license purchase and existing clients' upgrade, additional purchase of license and providing services. During the reporting period, the Group, adhering to the strategy of "Proactive service, Prompt responses", enhanced the standardization of services and perfected the service management with a view to improving customers' service quality and enhancing the satisfaction and loyalty of existing customers. The revenue from the product upgrade and additional license purchase from existing customers accounted for 47% of the total revenue.

During the reporting period, the Group has, by accumulating years of experience, launched five major services that cover the whole ERP application process, comprising training, management consultation, system implementation, operation maintenance and IT system services, to satisfy customers' diversified requirements.

During the reporting period, the Group has, based on customers' different requirements on products and services, classified customers into different categories. It helped the Group to develop and promote its services that are in line with the existing and potential service requirements of our customers. Meanwhile, through perfecting the customer service support platform, amending and revising "Regulation on customer services behaviour" and "Standard of workflow of customer services", centralizing the management of customers information and service procedure, the Group is capable of ensuring the standard of service procedure and manners, resulting in higher customers' satisfaction.

To further improve staff's awareness of providing better customer services, during the reporting period, the Group worked with a top international consultancy company to undertake a research to study the degree of satisfaction of our customers, and the results of which will be one of the evaluation criteria for each level of managers of the Group.

4. Corporate culture and social responsibility

During the reporting period, the Group, adhering the core human resources strategy of "Enable staff's success" and reinforcing the core corporate culture of "love, trust and innovation", implemented a dual career development ladder to satisfy the requirements on staff training and development. The Group has systemically formulated an individual development plan for the staff with the objective of allowing them to have both material and spiritual satisfaction.

The Group is proud to take an initiative in promoting community services. The Group, in addition to enable customers' and staff's success, actively participates in community services in rewarding the society. Over the past few years, the Group has contributed to the society by donating software, and establishing education subsidy funds and other community funds. The Group will continue to contribute to the society and support the development of charity and social welfare works under its core values of "love, trust and innovation".

Financial Review

For the year ended 31 December 2005, the Group's turnover amounted to RMB529,343,000, representing an increase of 19% over 2004 (2004: RMB445,922,000). This was mainly attributable to strong demand for enterprise application software from Chinese enterprises and manufacturers, as well as the edges of the Group's products and the success of its strategy in distribution and customer services.

During the year, the Group realized revenue of software of RMB377,105,000, representing an increase of 16% over 2004 (2004: RMB323,811,000), and service revenue of RMB147,137,000, representing an increase of 25% over 2004 (2004: RMB117,827,000). During the year, the Group's net cash flow generated from operating activities was RMB140,523,000, representing an increase of 20% over 2004 (2004: RMB116,686,000).

During the reporting period, the debtor turnover days was 85 days (the average of the debtor balance at the beginning and the end of the year divided by the total revenue of the year times 365 days), (2004: 82 days). During the reporting period, the Group paid efforts in managing and recovering the receivables and hence maintaining the account receivables turnover at a reasonable level.

For the year ended 31 December 2005, the profit attributable to equity holders of the Company was RMB72,290,000, representing an increase of 40% over 2004 (2004: RMB51,728,000). During the year, the net profit margin was 14% (2004: 12%) and the earnings per share was RMB0.16 (2004: RMB0.12). The improvement of net profit was attributed to the Group's appropriate control over the costs and expenses while maintaining a growth in revenue, reflecting the Group's achievement in economies of scale.

Gross profit

Gross profit of the Group increased by approximately 18% from RMB361,246,000 for the year 2004 to RMB425,497,000 for the year 2005. During the period, the gross profit margin was approximately 80% (2004: 81%). The decrease of gross profit margin was mainly attributed to the increasing turnover from EAS and software implementation service. Involvement of more service requires more manpower, which results in the increase of staff cost.

Selling expenses

The selling expenses for the year 2005 was approximately RMB256,134,000 (2004: RMB228,789,000), representing an increase of 12% over last year. The selling expenses accounted for 48% of the turnover while the percentage for 2004 was 51%. The reduction in proportion of selling expenses was mainly due to the fact that the spending on advertisement in 2004 reached a certain scale and there was no need to invest more in 2005. In addition, the salary of sales staff increased at a slower pace during the year after implementing the distribution strategy.

General and administrative expenses

The general and administrative expenses for 2005 amounted to RMB150,340,000 (2004: RMB130,568,000), representing an increase of approximately 15%. During the period, the general and administrative expenses accounted for 28% of the turnover while the percentage for 2004 was 29%. Although there were option expenses pursuant to the international accounting standard and the expenses in relation to the listing on the Main Board, the most significant part, research and development expenses were reduced. It was due to the fact that the products of the Group are relatively mature. In addition, the Group restructured R&D staff, perfected R&D management system, and improved the management of cost control, so as to enhance the overall efficiency. The option expenses amounted to RMB5,589,000 (2004: 3,237,000) while the fee of listing was RMB5,055,000 (2004: 3,131,000). Among the general and administration expenses, the cost of R&D was approximately RMB50,476,000, representing a slight decrease of 6% as compared with 2004 (2004: RMB53,792,000).

Capital expenditure

For the year ended 31 December 2005, the Group's major capital expenditure included the construction cost for Shanghai Research Center of RMB12,271,000 (2004: RMB917,000), the R&D capitalized expenses of RMB39,128,000 (2004: RMB40,494,000), and the purchase of computer and related equipments of RMB8,530,000 (2004: RMB12,929,000).

Financial resources and liquidity

The Group possessed a healthy cash flow position. As at 31 December 2005, the Group had cash and cash equivalents amounting to approximately RMB242,053,000 (2004: RMB214,719,000). Current ratio was 2.13 (2004: 2.08) and gearing ratio (defined as the ratio of bank borrowings to shareholder equity) was approximately 8% (2004: 8%).

The Group intends to satisfy the daily operating and product requirements by internally generated funds and any unemloyed funds will be deposited in banks for interest. If opportunity arises, the Group will consider project investment and acquisition to enhance the Group's competitiveness.

As at 31 December 2005, the Group's short-term bank loan amounted to RMB30,000,000 (2004: RMB24,000,000). As at 31 December 2005, the Group did not have any long-term bank loan.

As at 31 December 2005, the Group was not subject to any material exchange rate exposure, and had not entered into any foreign exchange futures contract to hedge against any fluctuation in exchange.

As at 31 December 2005, the Group did not have any material contingent liabilities (2004: nil).

Future Prospect

In the "Eleventh Five-year Plan", the Chinese government has placed software industry as a core industry. It is expected that in the coming five years, the informatization of enterprises will continue to gain momentum in line with economic growth of China. As a leading software provider in China, the Group will, in the coming five years, adhere to the development strategy of "Product leadership, Partner oriented, Proactive services, Prompt response", and, in line with its "Blue ocean strategy", the Group will implement the "Customized ERP plan" for undertaking innovative reform in product promotion, distribution channels and organizational structure, with a view to fostering competitive edges and creating values.

2006 will mark the starting point of the Group's next five-year strategy. The Group will continue to strengthen human resources development and build up a team of professional and innovative staff; increase the investment in research and development; initiate the "Customized ERP plan"; optimize the performance management of subsidiaries and improve the profit margin of direct sales. Leveraging on the BOS platform, the Group will cooperate with more value-added partners to increase market share. More effort will be put to enhance the relationship with, and services to, our existing customers. The Group will also consolidate its leading position in the SME's ERP market, the market for financial and human resources management softwares for large enterprises and the middleware software market in China.

Product and research

With respect to the segmentation of China's ERP market, the Group will continue to commit resources in the research and development of products for providing customers with customized ERP products and applications. In terms of the high-end market, Kingdee EAS will achieve breakthrough in group accounting management, human resources management and synergy management. With respect to the mid-end market, the Group will reinforce its competitive edge in Kingdee K/3 and further acquire the market share with the focus on achieving breakthrough in manufacturing and human resources management. For the low-end market, the Group will speed up the pace of upgrading Kingdee KIS and diversifying the products for catering the management requirements of small enterprises in a more efficient and comprehensive manner. In view of the robust demand in mobile commerce, the Group will pay more efforts in developing mobile commerce internet products, making all of the Group's products compatible with mobile commerce. In addition, the Group will commit further resources to its proprietary middleware - Kingdee Apusic and Kingdee BOS, in order to reinforce the Group's competitive edge in product differentiation.

Sales and distribution

The Group will optimize the performance management of its subsidiaries for improving the profit margin of direct sales. Leveraging on Kingdee's proprietary BOS platform, the Group will pay more efforts in increasing value-added partnership. The Group intends to enlarge the number of partners in municipal markets to form a network comprising more than 1,200 partners. It would help to improve the productivity of partners and capture more market share.

Customer services

The Group will improve the service of Call Center to realize the segmentation management of customers and the better allocation of resources. The Group will develop closer relationship with and provide better services to our existing customers. Besides, the Group will also strive to enlarge the customer base for paid services, service migration, service upgrade and renewal, with a view to generating more income from existing customers.

Corporate finance and investment

The Group will maintain an impeccable relationship with long-term investors, improve the shareholders' base, identify appropriate investment and acquisition opportunities in various ERP, mobile commerce and ASP companies and recruit talents for consolidating the Group's leading position.



Partner Oriented

Enlarge the number of partners to form a network comprising more than 1,200 partners





Customer Services

Develop closer relationship with and provide better services to existing customers

