

Management Discussion and Analysis

FINANCIAL REVIEW

For the year ended 31 December 2005, the Group recorded a turnover of approximately RMB97,315,000 (2004: RMB108,226,000), representing a decrease of 10.1% as compared to that of last year. Of these, turnover derived from the sales of self-developed software was approximately RMB33,054,000 (2004: RMB38,635,000), representing a decrease of 14.4%. Turnover derived from sales of third party software and hardware in relation to system integration increased from approximately RMB55,543,000 in last year to approximately RMB60,428,000, representing an increase of 8.8%. Turnover derived from system integration, maintenance and other services was approximately RMB3,833,000 (2004: RMB14,049,000), representing a decrease of 72.7%.

The Group recorded a gross profit of RMB35,983,000 (2004: RMB49,876,000). The overall gross profit margin was approximately 37.0%, of which the gross profit margin in respect of the sales of self-developed software decreased from 70.7% of last year to 40.3% of this year, while the gross profit margin in respect of sales to third party software and hardware increased from 17.9% of last year to 19.8% of this year. Gross profit margin of system integration, maintenance and other services decreased from 66.5% of last year to 55.5% of this year. Profit attributable to shareholders was approximately RMB9,256,000 (2004: RMB28,280,000), representing a decrease of 67.3% as compared to last year. Basic earnings per share were approximately RMB2.31 cents (2004: RMB9.06 cents).

The Board of Directors of the Company did not recommend to pay any dividend for the year ended 31 December 2005 (2004: HK1.7cents).

In 2005, signed new contracts (pre-tax) amounted to approximately RMB115,734,000, which was 12.3% higher than the total amount of the whole year of 2004. As most contracts were only signed in the second half of the year and had not been inspected and confirmed prior to 31 December 2005, certain portion of the related revenue was not reflected on the year end results of 2005 and consequently, turnover for year 2005 decreased.

With the sizeable increase in investment by the Group towards 3G OSS in 2005, our research and development expenses increased by 59.7% to RMB13,383,000 (2004: RMB8,381,000). As at 31 December 2005, the total number of employees of the Group increased from 275 to 315 and had resulted in higher overall costs. The Group had adopted HKFRS 2 "Share-based payment". Expense related to the share-based payment was approximately RMB1,268,000 (2004: RMB244,000). All of the above were attributable to the decline in overall profit as well as gross profit margin of self-developed software.

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BUSINESS REVIEW

The Group principally engages in provision of OSS software products and one-stop integration services to telecommunications service providers. Our end users include the four major PRC telecommunications service providers (including the China Mobile Group).

During the year under review, the Group had expanded its market coverage in PRC mobile data network solutions to 10 provinces. It had successfully concluded second phase capacity expansion contracts with 8 provinces and was a uncontested second largest player in the market. In integrated transmission network solution market, the 3-layer system of next generation's OSS advocated by the Group had been accepted by China Mobile. The Group had also passed the process of vendor selection for each layer. In fixed line market, the Group had been seeking for expansion into new markets while strengthening its position in existing markets. It had expanded its market coverage in fixed line to two head offices of enterprise groups and six province branches of certain enterprises. Through collaboration with other enterprises, the Group had also diversified its product applications and sales coverage.

During the year under review, the middleware of object management platform (OMP) for voice mobile telecommunication networks of ZZNode (Beijing) in 24 provinces had been successfully inspected. At the same time, we keep on seeking contracts related to extension and upgrading of that line of product's application in OSS for mobile communication network and data network. The Directors are confident that this product enhancement will contribute meaningful turnover to the Group in 2006. In the data network solution, the Group had also achieved the ongoing development of later versions of product modules and they had been widely applied to fixed line and mobile markets. Business focus for ZZNode (Shanghai) had been on the core 3G integrated service management platform (ISMP). It had passed numerous rounds of testing by telecommunication carriers groups and achieved satisfactory results. Through ongoing research and development, upgrade and optimization of products, the Group developed 8 product lines during the year, thereby consolidated our foundation as an OSS products vendor in a full range of telecommunication business. The Group added 12 software copyrights to its product portfolio, and one application for patent had been accepted. As at the year end, the Group had been issued with a total of 39 software copyright certificates.

CUSTOMER BASE

The Group's customers comprise the four major telecommunications operators including China Mobile Group, covering 31 provinces in the PRC, as well as enterprises and private network customers. The Group has formed strategic partnership with various reputable multinational telecommunications conglomerates both in the PRC and outside to provide services to end users of telecommunications services.

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During the year under review, the overall strategy of the Group was that to enhance our customer base in the mobile market through continued upgrade of products and new contract signings. Of mobile data network solutions, the Group added two new customers and our market coverage in this segment had reached ten provinces and owned about 1/3 of the total market share of the China Mobile. In the fixed line market, through development of data network solutions and integrated inventories management system, our customer base had expanded to two head offices of enterprise groups and six province branches of these enterprise groups. Regarding 3G-oriented operation management and element management products, test version of new generation of the relevant products had been completed, and commercial trial run has been scheduled in 2006.

SALES STRATEGIES

The Group has established marketing teams in Beijing, Shanghai and Guangzhou, being responsible for formulation of overall marketing strategy, sales promotion, market analysis, identification of customers' needs, new business development, provision of technical support to the sales division and customer service. The sales and marketing team of the Group currently has 33 staff members. During the year under review, the Group had, pursuant to the need of market conditions, opened operational offices in Chengdu and Anhui, in addition to the current corporate structure of subsidiaries and branch offices.

2005 was marked by the Group as its year of channel development. In mobile market, the Group had continued its effort in exploiting its "base" markets. In fixed line market, the Group leveraged on the niche its products offered to gain new contracts through our sales and marketing teams and expand our market share. In data network solution segment, market coverage reached ten provinces, and the successful application of the integrated resources management products gained praises from the telecommunication operators. 3G integrated service management platform (ISMP) had, through expansion of modules, gained its first commercial contract from fixed line carrier in PHS (personal handyphone system) market, symbolizing the Group's attaining a high level in technical competence in 3G mobile data service platform. Our MPLS VPN Service Provisioning Product had been applied successfully in the next generation of IP-based backbone as its core technological foundation.

During the year under review, the Group, through collaboration with its strategic partners, actively sought to explore business opportunities. The Group reached agreement with SUN Microsystems for software distribution in December 2005 to become a major "iforce specialist partner" of SUN's software project in the PRC, therefore officially commencing our channel sales of products business. As the original enterprise of JAVA technology, SUN plays an important role in OSSJ standard of NGOSS. The Group plans to establish an OSS laboratory jointly with SUN to enhance our competitiveness in integration.

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To strengthen the business of the Group, we had also been actively exploring business opportunities beyond telecommunications industry, so that our future income base can be expanded. During the year under review, in cooperation with China Mobile and another corporation, the Group has been granted with the China Next Generation Internet network control management project headed by National Development and Reform Commission of the PRC, and to participate in the research & development of management of network IPv6 (Internet Protocol version 6).

PRODUCT RESEARCH AND DEVELOPMENT

During the year, the Group had continued to modify and fine-tune its products and services. With ongoing process of R&D, upgrade, polish, six product lines had been formed during the year, namely data network solution, transmission network solution, MPLS VPN integration management, OSS middleware, element management, and integrated inventories management. The Group had also added two major product lines in 3G/NGN integration network solution and 3G integration operation management platform, while the functionality features of its element management products also extended into the 3G area. Sales and market share of self-developed software products had also been expanded. Competitive edge of core products had also been strengthened by ongoing project implementation in the existing markets;

- In R&D of platform, on the basis of the experience gained in platform software development and application in the past years, the Group launched the E2EVIEW 2.x platform developed from the OMP core during the year, and had built up a series of middleware products for the data network and transmission network. The framework of its software system has been widely accepted by domestic carriers, and brought a strong impact under the required standard of carriers' NGOSS (NEXT GENERATION OSS). As such, the market and technological foundation for the Group's involvement in OSS construction among major mobile carriers had been firmly established.
- The Group is fully committed to the R&D of 3G OSS and has invested heavily to this end. We had finished the R&D of a horizontal integrated service management platform specifically for 3G value-added service, to support carriers in launching a rich variety of 3G mobile data via a single platform. The product should help the Group to enter into the core business support of carriers by laying the foundation in terms of product offering. Being a principal partner of China Mobile, the Group has involved in the standardization and software testing of China Mobile 3G OSS. Since 2002, the Group had been allocating substantial amount of resources to the development of 3G OSS. Our R&D team for 3G-related products now has more than 90 people. The finished products of 3G OSS have been scheduled to commence trail run in the second half of 2006, and the management believes that they will generate considerable revenue to the Group in future.

- As the two major mobile carriers in the PRC had been focusing in building up their transmission networks, the Group had sought the opportunity and, leveraging on its platform line of products, developed its transmission network management system in a short span of time. The 3-layer structure of software design pattern of the Group has been accepted by China Mobile.
- Capitalizing on the trend in telecommunications OSS of shifting from highly specified to highly integrated, the Group has launched a telecommunication integrated inventories management system encompassing such specific areas of transmission, data, voice, network solution, and which is designed to address the need of both front office (production) function such as marketing and finance, and back office (support) function such as maintenance. As such the Group has realized the end-to-end resource management and application in the truest sense. The intelligent function of resource identification meets international standard with relevant patent application has been successful accepted, and had received praises from telecommunications carriers

The Group currently has 245 staff members in its R&D team.

ADVANCED MANAGEMENT

In respect of management objectives, the Group had during the year under review promoted the in-depth implementation of the CMMI Level III assessment passed by the Group in the 4 main objectives of “Specialisation in R&D”, “Product seriation”, “Standardisation of engineering” and “Refinement of management”. The Group had during the year commenced the internal enhancement project of CMMI Level IV. Through informatized overall planning and application of various tools based on such planning, the operating efficiency of the Group had improved in general, thus layed down the foundation of sustainable growth of the Group. The Group envisages to pass the assessment of CMMI Level IV in 2006 and become one of a handful of PRC software companies having passed the high rank assessment on sophistication of software development process.

AWARDS AND HONOURS

The R&D capability and high quality management of the Group had gained recognitions in national level. Subsequent to its selection as the 二零零四年國家規劃布局內的重點軟件企業 (Focused Software Enterprise under the State Plan in 2004), the Group had also been acknowledged by Beijing Commercial Bureau as the 外商投資先進技術企業 (Technologically Advanced Foreign Investment Enterprise) and become the first software company awarded with such honour in Beijing. The benefits gained from such status includes a further 3 years of 50% corporate income tax concession after the end of tax concession period allowed by the State. The effective tax rate after the 50% reduction is 10%.



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The innovation ability of the Group had also been widely recognized and was selected from several thousands of participating enterprises in the Changping Sector of Zhongguancun Science Park as 創新型企業 (Innovative Enterprise). This award represents the high regard and recognition of Changping Sector of Zhongguancun Science Park towards the Group's innovation ability and promising prospect.

OUTLOOK

2006 will be a year of opportunity to the Group. Given a complete removal of the stumbling effects of different system modes on the domestic launch of 3G following the designation of the domestic-made TD-SCDMA as a formal standard in the telecommunication industry by the Ministry of Information Industry, the release of 3G licences by the PRC government will be anytime in the future. As a company aiming at providing leading OSS products and solutions, the Group's effort had gained recognition from telecommunication carriers. In 2006, the management anticipates rejuvenated growth in OSS projects. On the other hand, the launch of 3G services will represent a valuable opportunity for OSS enterprises.

The 3G services business has been the focus of the Group in recently years as it had devoted great effort to this key segment of its business. To capitalize on the opportunity offer by 3G, the Group had since 2002 committed to R&D of 3G OSS-related products and nurturing more talents. Currently, the Group has completed its preparation work in respect of the 3 product lines in ISMP, E2EVIEW@3G and ISMC with trial run scheduled to commence in the second half of 2006. On the other hand, leveraging on the competency as a common platform of the horizontal organizational structure adopted in ISMP, the Group intends to first conduct concentrated promotion program within the existing mobile value-added service bureau, thereby to grow its sales and at the same time to build a solid foundation for its application upon the arrival of 3G in the PRC.

2006 has been proclaimed by the Group as a year of brand building. The Group has long envisaged the trend in OSS market of shifting from highly specified to highly integrated in network management, and from monitor-focus to focus on control, analysis and micro-management. The structural pattern of telecommunications carriers is also shifting from diversification in establishment towards unity in regulation and concentration in establishment. And the market will evolve from highly diversified with lot of participants to a more rational form of oligopoly. The Group will launch full range of its product lines with its edge in organizational structure through a platform-based strategy. This will not only enable the Group to realize the potential in 3G services, but also to gain market share in transmission network solution and integrated inventories management solution markets of telecommunications carriers such as China Mobile.

On the basis of continuous increase in customers and market share, through full participation in OSS standardization setting up of telecommunications carriers, the Group's products have also succeeded in creating value to their customers, thus building up the reputation of our brand as "the expert in network management".

On R&D, the Group will further its edge on information management platform based on product planning. Apart from enhancing its product lines of E2EVIEW and E2EEASY, it will also identify and develop network and operational quality management platform (QMP) aiming at the market segment of business qualitative analysis, thereby building a foundation for the launch of E2EVAS product line.

The Group will adopt the format of integrated product development (IPD) in order to further enhance its R&D capability which it aims to be one of market-oriented, technology-based and with the tool in innovation. It also hopes to achieve accuracy in R&D objectives and to improve efficiency and lower cost with the support of informatisation, and through quantitative analysis, to facilitate its preparation to pass the CMMI Level 4 assessment.

The Group has been actively seeking for opportunity to work with its strategic partners so as to raise its competitiveness further and to expand the sales network of its products. In the area of 3G /NGN integrated network management products, other than its success in gaining a leading position in domestic carriers market through its leading advantage in terms products and technical know-how, the Group also intends to gain overseas experience through cooperation with international corporations, and is confident that it will achieve important progress in 2006 in overseas market development.

Since its listing on the Stock Exchange of Hong Kong Limited for a year, the Group has reported satisfactory results in market development, R&D of products and seeking strategic partnership. Looking forward, the Group will continue to strive to become a world renowned and PRC's leading OSS products and solutions provider and via providing industrial leading products and solutions, to create maximum commercial values to its customers, and bring the best interests to the shareholders.

LIQUIDITY AND FINANCIAL RESOURCES

The Group generally finances its operations with internally generated cash flows and the balance of proceeds from the Placing and IPO (collectively referred to "Share Offer").

As at 31 December 2005, the Group had bank balances and cash of approximately 46,033,000, bank deposits of approximately RMB25,052,000 and non-current bank deposit of approximately RMB2,438,000 as compared to the bank balances and cash of approximately RMB90,953,000 as at 31 December 2004.

The Group's net current assets totalled approximately RMB93,338,000 as at 31 December 2005, against approximately RMB110,049,000 as at the end of the previous financial year. Current ratio decreased from last year's approximately 4.8 to approximately 4.0 this year mainly due to the decrease in cash and bank balances as the utilisation of proceeds from share offer from the Listing in 2004.

The Group's trade receivable turnover as at 31 December 2005 was 138 days as compared to the 129 days as at 31 December 2004. The increase in turnover days was as a result of increase in number of projects just completed before year end.

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The Group's shareholders' funds increased by approximately RMB3,324,000 to RMB126,846,000 as at 31 December 2005 as compared to RMB123,522,000 as at the end of the previous financial year.

GEARING RATIO

As at 31 December 2005, the Group did not have any long-term debts while its shareholders' funds amounted to approximately RMB126,846,000. In this regard, the Group holds a net cash position with nil gearing ratio (net debt to shareholders' funds) as at 31 December 2005.

CAPITAL STRUCTURE

The shares of the Company were listed on the Main Board of the Stock Exchange on 18 November 2004. There has been no change in the capital structure of the Company since the Company's Listing. The capital of the Company comprises only ordinary shares. The Company and the Group have no borrowings or long-term debts.

MATERIAL ACQUISITIONS AND DISPOSALS/FUTURE PLANS FOR MATERIAL INVESTMENT

As at 31 December 2005, the Group had invested RMB8,100,000 in acquisition of shares of an associated company. Details of the investment in the associated company was disclosed in circular sent to shareholders dated 8th June 2005.

After year end and up to the date of this report, the subsidiary of the Company had entered into an agreement with an independent third party to dispose its entire investment in Capital Engineering & Research Incorporation Limited (中治京誠工程技術有限公司) for RMB6,600,000. Details of the disposal set out in note 32 to the consolidated financial statements. Save as disclosed above the Company and the Group have no plans for material investments or material acquisitions of capital assets other than those set out in the Prospectus.

SIGNIFICANT INVESTMENT

As at 31 December 2005, the Group did not have any significant investments.

USE OF PROCEEDS FROM SHARE OFFER

The proceeds from the Listing were approximately HK\$40,500,000, net of the relevant expenses. Such will be applied as set out in the Prospectus. To the extent any proceeds were not applied, they are placed in banks in Hong Kong and the PRC as short term deposits.

FOREIGN EXCHANGE EXPOSURE

The Group mainly earns revenue and incurs costs in Renminbi and Hong Kong dollars. Risk on exposure to fluctuations in exchange rates should be minimal as there is no material fluctuation in the exchange rate between Hong Kong dollars and Renminbi.

CHARGES ON GROUP ASSETS

As at 31 December 2005, the Group did not have any charges on its assets.

CONTINGENT LIABILITY

As at 31 December 2005, the Group did not have any significant contingent liabilities.

EMPLOYEE INFORMATION

As at 31 December 2005, the Group has 315 employees (2004: 275). Total staff costs being charged to profit for the year, including the Directors' emoluments, amounted to approximately RMB18,638,000 (2004: approximately RMB19,134,000). The Group remunerates its employees on their performance, experience and prevailing industry practices. We are confident that our employees will continue to provide a firm foundation for the success of the Group and will maintain high standard of service to our clients.