



OPERATING INFORMATION

The following table sets forth certain operating statistics relating to our IM community and value-added services as at the dates and for the periods presented:

	For the 16-day period ended 31 December 2006	For the 15-day period ended 30 September 2006	Percentage change
	<i>(in millions)</i>		
Registered IM user accounts (at end of period)	580.5	572.3	1.4%
Active user accounts (at end of period)	232.6	221.4	5.1%
Peak simultaneous online user accounts (for the quarter)	24.5	22.1	10.9%
Average daily user hours	340.3	301.6	12.8%
Average daily messages ⁽¹⁾	3,052.5	2,928.6	4.2%
Fee-based Internet value-added services registered subscriptions (at end of period)	12.5	13.7	(8.8)%
Fee-based mobile and telecommunications value-added services registered subscriptions (at end of period) ⁽²⁾	9.9	10.1	(2.0)%

- (1) Average daily messages include messages exchanged between PCs only and exclude messages exchanged with mobile handsets.
- (2) Includes registered subscriptions for services provided directly by us or through mobile operators.

Our IM platform generally showed healthy growth in the fourth quarter of 2006, with registered IM user accounts, peak simultaneous online user accounts, average daily user hours and average daily messages all showing increases. The seasonal impact of year-end holidays also contributed to the increased usage by our users. We continued to implement the measures that we began in early 2006 to enhance account security, reduce account theft and reduce unauthenticated usage of stolen accounts, through means such as QQ Security Doctor, an anti-Trojan and anti-virus software. As a result, the number of both “spam” advertising messages and complaints of stolen accounts decreased throughout 2006. In order to reduce the effect of these measures on normal usage, we have refined restrictions on registration to prevent authentic applications from being rejected. Certain measures, however, such as increased levels of authentication before services and products may be used and restrictions on giving virtual items to third persons as gifts negatively impacted our revenues. Although these measures reduced our active user accounts and affected monetization on our platforms, we believe the measures will be conducive to the healthy growth of our IM platform in the future.





The decrease in fee-based Internet value-added services registered subscriptions reflects the fact that subscriptions for fee-based entertainment-related services in the third quarter are often positively affected by summer school holidays. Fee-based mobile and telecommunications value-added services registered subscriptions decreased at year end as we implemented a “clean-up” of delinquent customer accounts. Both fee-based Internet value-added services registered subscriptions and fee-based mobile and telecommunications value-added services registered subscriptions were also negatively affected as we accelerated the cancellation of delinquent customer accounts starting in the fourth quarter of 2006.

FINANCIAL PERFORMANCE HIGHLIGHTS

Fourth Quarter of 2006

Our unaudited consolidated revenues for the fourth quarter of 2006 were RMB713.2 million, an increase of 66.1% over the same period in 2005 and a decrease of 3.2% from the third quarter of 2006.

Revenues from our Internet value-added services for the fourth quarter of 2006 were RMB436.5 million, an increase of 65.9% over the same period in 2005 and a decrease of 10.9% from the third quarter of 2006.

Revenues from our mobile and telecommunications value-added services for the fourth quarter of 2006 were RMB193.1 million, an increase of 54.0% over the same period in 2005 and an increase of 16.8% from the third quarter of 2006.

Revenues from online advertising for the fourth quarter of 2006 were RMB81.5 million, an increase of 116.4% over the same period in 2005 and an increase of 1.4% from the third quarter of 2006.

Cost of revenues for the fourth quarter of 2006 were RMB233.7 million, an increase of 66.7% over the same period in 2005 and an increase of 12.0% from the third quarter of 2006.

Other gains, net for the fourth quarter of 2006 were RMB18.4 million, a decrease of 39.0% over the same period in 2005 and a decrease of 16.3% from the third quarter of 2006.

Selling and marketing expenses for the fourth quarter of 2006 were RMB73.4 million, an increase of 18.4% over the same period in 2005 and an increase of 12.6% from the third quarter of 2006.





General and administrative expenses for the fourth quarter of 2006 were RMB180.2 million, an increase of 60.4% over the same period in 2005 and an increase of 14.4% from the third quarter of 2006.

Operating profit for the fourth quarter of 2006 was RMB244.2 million, representing an increase of 68.5% over the same period in 2005 and a decrease of 25.4% quarter on quarter. As a percentage of revenues, operating profit accounted for 34.2% for the fourth quarter of 2006, compared to 33.8% for the same period of 2005 and 44.4% for the third quarter of 2006.

Profit for the fourth quarter of 2006 was RMB263.6 million, representing an increase of 113.1% over the same period in 2005 and a decrease of 6.7% from the third quarter of 2006. As a percentage of revenues, profit for the period accounted for 37.0% for the fourth quarter of 2006, compared to 28.8% for the same period of 2005 and 38.3% for the third quarter of 2006.



Year Ended 31 December 2006

Our consolidated revenues for the year ended 31 December 2006 were RMB2,800.4 million, an increase of 96.3% from the year ended 31 December 2005.

Revenues from our Internet value-added services for the year ended 31 December 2006 were RMB1,825.3 million, an increase of 132.0% from the year ended 31 December 2005.

Revenues from our mobile and telecommunications value-added services for the year ended 31 December 2006 were RMB700.1 million, an increase of 35.3% from the year ended 31 December 2005.

Revenues from online advertising for the year ended 31 December 2006 were RMB266.7 million, an increase of 136.4% from the year ended 31 December 2005.

Cost of revenues for the year ended 31 December 2006 were RMB817.1 million, an increase of 73.9% from the year ended 31 December 2005.

Other gains, net for the year ended 31 December 2006 were RMB83.2 million, an increase of 13.7% from the year ended 31 December 2005.

Selling and marketing expenses for the year ended 31 December 2006 were RMB293.2 million, an increase of 48.4% from the year ended 31 December 2005.

General and administrative expenses for the year ended 31 December 2006 were RMB610.0 million, an increase of 75.5% from the year ended 31 December 2005.

Operating profit for the year ended 31 December 2006 was RMB1,163.3 million, representing an increase of 140.2% over the year ended 31 December 2005. As a percentage of revenues, operating profit accounted for 41.5% for the year ended 31 December 2006, compared to 34.0% for the year ended 31 December 2005.

Profit for the year ended 31 December 2006 was RMB1,063.8 million, representing an increase of 119.2% from the year ended 31 December 2005. As a percentage of revenues, profit for the period accounted for 38.0% for the year ended 31 December 2006, compared to 34.0% for the year ended 31 December 2005.





Fourth Quarter of 2006 Compared to Third Quarter of 2006

The following table sets forth the comparative figures for the fourth quarter of 2006 and the third quarter of 2006:

	Unaudited	
	Three months ended	
	31 December	30 September
	2006	2006
	<i>(RMB in thousands)</i>	
Revenues	713,225	736,930
Cost of revenues	(233,697)	(208,637)
Gross profit	479,528	528,293
Other gains, net	18,360	21,942
Selling and marketing expenses	(73,430)	(65,231)
General and administrative expenses	(180,229)	(157,546)
Operating profit	244,229	327,458
Finance costs, net	(14,206)	(15,696)
Profit before income tax	230,023	311,762
Income tax benefit/(expenses)	33,600	(29,174)
Profit for the period	263,623	282,588

Revenues. Revenues decreased by 3.2% to RMB713.2 million for the fourth quarter of 2006 from RMB736.9 million for the third quarter of 2006. The following table sets forth our revenues by line of business for the fourth quarter of 2006 and the third quarter of 2006:

	Three months ended			
	31 December 2006		30 September 2006	
	Amount	% of total revenues	Amount	% of total revenues
	<i>(RMB in thousands, except percentages)</i>			
Internet value-added services	436,527	61.2%	490,018	66.5%
Mobile and telecommunications value-added services	193,075	27.1%	165,258	22.4%
Online advertising	81,525	11.4%	80,417	10.9%
Others	2,098	0.3%	1,237	0.2%
Total revenues	713,225	100.0%	736,930	100.0%





Revenues from our Internet value-added services decreased by 10.9% to RMB436.5 million for the fourth quarter of 2006 from RMB490.0 million for the third quarter of 2006. Revenues from our online entertainment-related value-added services, such as our online identity and community business and online games, decreased due to seasonal factors as the impact of the school summer holidays that affected the third quarter did not continue in the fourth quarter. A special one-time event, a vote for “Super Girls” using our QQ and QQ Live platforms in partnership with Hunan Satellite TV, also contributed to the higher third quarter results. In addition, we implemented measures to enhance the security of users’ virtual items, which particularly affected revenues from QQ Show and QQ Game in the fourth quarter. We also implemented a system upgrade with respect to QQ Game to improve system performance and user experience, and to provide more effective support for in-game avatars and in-game advertising, which affected certain monetization of the game portal in the fourth quarter. The decrease was somewhat offset by growth in revenues from Premium QQ.

Revenues from our mobile and telecommunications value-added services increased by 16.8% to RMB193.1 million for the fourth quarter of 2006 from RMB165.3 million for the third quarter of 2006. This increase reflected increases in revenues from our communication-based SMS, mobile voice value-added services and 2.5G services. China Mobile had implemented policy changes for wireless value-added services on its Monternet platform in the third quarter, involving giving new subscribers free one-month trial periods and reminding subscribers of fees and cancellation procedures, which had a negative effect on our revenues. In September and continuing in the fourth quarter, China Mobile discontinued its one-month trial period policy for SMS services. The discontinuing of such policy by China Mobile had a positive impact on our revenues and allowed us to offer enhanced services and products by increasing our promotional activity during the fourth quarter. The increase in revenues was partially offset by decreased revenues from content-based SMS services. In December, we entered into a partnership with China Mobile to develop a platform tentatively named “Fetion QQ” that will enable interconnection between China Mobile’s Fetion handset users and our QQ subscribers, which is expected to be introduced in the middle of 2007.

Revenues from online advertising increased by 1.4% to RMB81.5 million for the fourth quarter of 2006 from RMB80.4 million for the third quarter of 2006. We were able to achieve growth in online advertising in the fourth quarter compared to a seasonally strong third quarter. The increase was mainly attributable to increased in-game advertising revenues. The increase was partially offset by a decrease in advertising revenues from our web portal due to seasonal factors.





Cost of revenues. Cost of revenues increased by 12.0% to RMB233.7 million for the fourth quarter of 2006 from RMB208.6 million for the third quarter of 2006. The increase principally reflected increased telecommunications operators' revenue share, bandwidth and server custody fees, sharing and subscription costs and staff costs as usage of our services increased and as we continued to build our business. As a percentage of revenues, cost of revenues increased to 32.8% for the fourth quarter of 2006 from 28.3% for the third quarter of 2006, as our revenue decreased and as revenues from our mobile and telecommunication services that generally have lower gross profit margins constituted a higher portion of our revenues. The following table sets forth our cost of revenues by line of business for the fourth quarter of 2006 and the third quarter of 2006:

	Three months ended			
	31 December 2006		30 September 2006	
	Amount	% of segment revenues	Amount	% of segment revenues
<i>(RMB in thousands, except percentages)</i>				
Internet value-added services	116,531	26.7%	109,168	22.3%
Mobile and telecommunications value-added services	81,513	42.2%	65,830	39.8%
Online advertising	28,737	35.2%	26,841	33.4%
Others	6,916	329.6%	6,798	549.6%
Total cost of revenues	<u>233,697</u>		<u>208,637</u>	

Cost of revenues for our Internet value-added services increased by 6.7% to RMB116.5 million for the fourth quarter of 2006 from RMB109.2 million for the third quarter of 2006. The increase reflected higher expenses associated with our bandwidth capacity and servers as usage increased and as we supported more bandwidth intensive services, such as Qzone. Sharing costs also increased as we paid greater amounts of licensing fees due to increased revenue from our licensed game R2Beat.

Cost of revenues for our mobile and telecommunications value-added services increased by 23.8% to RMB81.5 million for the fourth quarter of 2006 from RMB65.8 million for the third quarter of 2006. The increase reflected increased telecommunications operators' revenue share, mainly corresponding to the increased business volume of our mobile and telecommunications value-added services, and increased sharing and subscription costs relating to our content services.

Cost of revenues for our online advertising increased by 7.1% to RMB28.7 million for the fourth quarter of 2006 from RMB26.8 million for the third quarter of 2006. The increase mainly reflected higher expenses associated with our bandwidth capacity and servers as the scale of our advertising business grew, and, in particular, as we introduced new advertisements on our QQ Live platform during the quarter that resulted in greater broadband use.





Other gains, net. Other gains during the reported periods reflected primarily the interest income generated from bank deposits and other interest-earning financial assets and fair value gains on financial instruments. Financial subsidies received from the government, often at the end or start of the year, are also reflected in other gains. We recorded other gains of RMB18.4 million for the fourth quarter of 2006 compared to RMB21.9 million for the third quarter of 2006. The decrease mainly reflected a donation of RMB20.0 million to the Tencent Charity Fund. We formed the Tencent Charity Fund in the fourth quarter to support charitable initiatives in China. We believe that, as a good corporate citizen, we should contribute to the development of a better society in China. In addition, we want to encourage our employees to participate in charity and volunteer work and build a strong and constructive corporate culture. We are committed to supporting the Tencent Charity Fund through additional donations and by encouraging our employees to participate actively in the future. The decrease was mostly offset by increased interest income from our interest-earning financial assets and higher financial subsidies from the local government, mainly related to the promotion of high-tech research and new software products. In the fourth quarter of 2006, we received subsidies of RMB15.2 million, compared to no subsidy received in the third quarter.

Selling and marketing expenses. Selling and marketing expenses increased by 12.6% to RMB73.4 million for the fourth quarter of 2006 from RMB65.2 million for the third quarter of 2006. The increase reflected our increased efforts to promote our mobile value-added services and products after China Mobile relaxed its policy of giving new subscribers free one-month trial periods for SMS services which had negatively impacted our mobile and telecommunications value-added services in the third quarter of 2006. In addition, we have focused on improving our advertising sales capability by enhancing our training program and hiring high caliber professionals. We have also stepped up our selling efforts by developing advertising agency channels and increasing our promotions to new customers. Greater expenses incurred in connection with branding on our portal also contributed to the increase in selling and marketing expenses. As a percentage of revenues, selling and marketing expenses increased to 10.3% in the fourth quarter of 2006 from 8.9% in the third quarter of 2006.

General and administrative expenses. General and administrative expenses increased by 14.4% to RMB180.2 million for the fourth quarter of 2006 from RMB157.5 million for the third quarter of 2006. The increase was partly due to the continuing expansion of our strategic research and development staff as we focused on developing and enhancing our various products and services, including IM functionalities, online games and web portals. Expenses relating to our office lease also increased for our planned business expansion. In addition, the net value-added tax relating to the sales of software among group companies, which we incurred in the fourth quarter but not in the third quarter, contributed to higher general and administrative expenses. As a percentage of revenues, general and administrative expenses increased to 25.3% in the fourth quarter of 2006 from 21.4% in the third quarter of 2006.

Finance costs, net. Finance costs represent foreign exchange loss and interest expenses arising from the discounting of “earn-out” consideration in connection with the acquisition of Joymax Development Ltd. (“Joymax Development”) and its subsidiaries (the “Joymax Group”) in January 2006. We recorded finance costs of RMB14.2 million for the fourth quarter of 2006 compared to RMB15.7 million for the third quarter of 2006. The decrease in finance costs recorded was mainly due to the adjustments made with respect to the purchase price payable relating to the acquisition of the Joymax Group. Under the terms of the acquisition agreement, we undertook to pay a portion of the purchase price under an “earn-out” arrangement based on the profit of a subsidiary of Joymax Development for the year ended/ending 31 December 2006 and 2007. As a result of reassessment of current and future profits, the estimated purchase price was adjusted downwards and, therefore, a reversal of interest expense with respect to the discounting of estimated purchase price was recorded. A significant portion of our cash and investments, consisting primarily of the proceeds from our initial public offering in 2004, are subject to the risk of the appreciation of Renminbi. We recorded foreign exchange loss of RMB14.2 million in the fourth quarter of 2006 and RMB13.7 million in the third quarter of 2006.



Income tax benefit/(expenses). We recorded an income tax benefit of RMB33.6 million for the fourth quarter of 2006 compared to income tax expenses of RMB29.2 million for the third quarter of 2006. The net tax credit mainly related to the recognition of deferred tax assets of RMB53.6 million in the fourth quarter of 2006 relating to sales of self-developed software and technologies among our group companies.

Profit for the period. As a result of the factors discussed above, profit for the period decreased by 6.7% to RMB263.6 million for the fourth quarter of 2006 from RMB282.6 million for the third quarter of 2006. Net margin was 37.0% for the fourth quarter of 2006 compared to 38.3% for the third quarter of 2006.

Year Ended 31 December 2006

The following table sets forth the comparative figures for the year ended 31 December 2006 and the year ended 31 December 2005:

	Audited	
	Year ended 31 December	
	2006	2005
	<i>(RMB in thousands)</i>	
Revenues	2,800,441	1,426,395
Cost of revenues	(817,062)	(469,869)
Gross profit	1,983,379	956,526
Other gains, net	83,195	73,145
Selling and marketing expenses	(293,247)	(197,627)
General and administrative expenses	(610,022)	(347,685)
Operating profit	1,163,305	484,359
Finance costs, net	(46,534)	(47,304)
Profit before income tax	1,116,771	437,055
Income tax (expenses)/benefit	(52,971)	48,307
Profit for the period	1,063,800	485,362





MANAGEMENT DISCUSSION AND ANALYSIS

Revenues. Revenues increased by 96.3% to RMB2,800.4 million for the year ended 31 December 2006 from RMB1,426.4 million for the year ended 31 December 2005. The following table sets forth our revenues by line of business for the year ended 31 December 2006 and the year ended 31 December 2005:

	Year ended 31 December			
	2006		2005	
	Amount	% of total revenues	Amount	% of total revenues
<i>(RMB in thousands, except percentages)</i>				
Internet value-added services	1,825,343	65.2%	786,680	55.1%
Mobile and telecommunications value-added services	700,114	25.0%	517,265	36.3%
Online advertising	266,684	9.5%	112,826	7.9%
Others	8,300	0.3%	9,624	0.7%
Total revenues	<u>2,800,441</u>	<u>100.0%</u>	<u>1,426,395</u>	<u>100.0%</u>

Revenues from our Internet value-added services increased by 132.0% to RMB1,825.3 million for the year ended 31 December 2006 from RMB786.7 million for the year ended 31 December 2005. Revenues from our various online games and our online identity and community services increased as we continued to enhance our existing services such as our QQ game portal and QQ Show and built on the success of relatively new products such as QQ Fantasy, QQ Pet and Qzone. Revenues from Premium QQ also grew as we bundled other value-added services, including QQ Magic, E-cards, self-defined personal icons and QQ Ring into its service package in the second quarter of 2006.

Revenues from our mobile and telecommunications value-added services increased by 35.3% to RMB700.1 million for the year ended 31 December 2006 from RMB517.3 million for the year ended 31 December 2005. This increase mainly reflected an increase in revenues from our content-based SMS provided by the Joymax Group, which we acquired in January 2006, and from our mobile voice value-added services and 2.5G services as we increased promotion for WAP and IVR. The increase was partially offset by the negative impact on revenues of the policy changes for wireless value-added services on China Mobile's Monternet platform, including giving new subscribers free one-month trial periods and reminding subscribers of fees and cancellation procedures.

Revenues from online advertising increased by 136.4% to RMB266.7 million for the year ended 31 December 2006 from RMB112.8 million for the year ended 31 December 2005. The increase reflected our growing customer base and the growth in reach of and traffic on our online advertising platforms. In addition, we have been focusing on improving our advertising sales capability by enhancing our training program and hiring high caliber professionals. We have also stepped up our selling efforts by developing advertising agency channels and increasing our promotions to new customers.





Cost of revenues. Cost of revenues increased by 73.9% to RMB817.1 million for the year ended 31 December 2006 from RMB469.9 million for the year ended 31 December 2005. The increase principally reflected higher amounts of telecommunications operators' revenue share, increased bandwidth and server custody fees as we supported more bandwidth intensive services, increased sharing costs due to increases in revenues and enrichment of content and increased staff costs as we increased the number of employees to support our various services and products. As a percentage of revenues, cost of revenues decreased to 29.2% for 2006 from 32.9% for 2005. The following table sets forth our cost of revenues by line of business for the year ended 31 December 2006 and the year ended 31 December 2005:

	Year ended 31 December			
	2006	% of segment revenues	2005	% of segment revenues
	Amount		Amount	
	<i>(RMB in thousands, except percentages)</i>			
Internet value-added services	426,191	23.3%	231,480	29.4%
Mobile and telecommunications value-added services	272,558	38.9%	189,264	36.6%
Online advertising	93,940	35.2%	34,761	30.8%
Others	24,373	293.7%	14,364	149.3%
Total cost of revenues	<u>817,062</u>		<u>469,869</u>	

Cost of revenues for our Internet value-added services increased by 84.1% to RMB426.2 million for the year ended 31 December 2006 from RMB231.5 million for the year ended 31 December 2005. The increase mainly reflected higher expenses incurred to support more bandwidth intensive services, such as QQ Pet, Qzone and online games, increased telecommunications operators' revenue share, increased staff costs and increased hardware and equipment-related expenses to support our growing range of Internet value-added services. In addition, sharing and subscription costs associated with the offering of richer content services, such as our avatars, games and music, increased.

Cost of revenues for our mobile and telecommunications value-added services increased by 44.0% to RMB272.6 million for the year ended 31 December 2006 from RMB189.3 million for the year ended 31 December 2005. The increase was mainly due to increased telecommunications operators' revenue share, an increase in sharing and subscription costs as we enriched our content in an increasingly competitive market and an increase in staff costs as we increased the number of employees to support our various services and products and in anticipation of the introduction of 3G services in China. In addition, increased telecommunications operators' revenue share and other costs relating to the services of Joymax Group, which we acquired in late January 2006, contributed to the increase.

Cost of revenues for our online advertising increased by 170.2% to RMB93.9 million for the year ended 31 December 2006 from RMB34.8 million for the year ended 31 December 2005. The increase mainly reflected the higher amount of sales commissions paid to advertising agencies as the volume of our advertising contracts grew and as we increased our usage of advertising agencies to help develop business volume. In addition, we continued to incur increased bandwidth and server custody fees.





Other gains, net. We recorded other gains of RMB83.2 million for the year ended 31 December 2006 compared to RMB73.1 million for the year ended 31 December 2005. The increase mainly reflected additional interest income due to the increase in US dollar-denominated interest rates and higher financial subsidies from the local government, mainly related to the promotion of high-tech research and new software products. In the year ended 31 December 2006, we received subsidies of RMB15.2 million, compared to RMB9.8 million in the year ended 31 December 2005. The increase was partially offset by a donation of RMB20.0 million to the Tencent Charity Fund. We formed the Tencent Charity Fund in the fourth quarter of 2006 to support charitable initiatives in China. We believe that, as a good corporate citizen, we should contribute to the development of a better society in China. In addition, we want to encourage our employees to participate in charity and volunteer work and build a strong and constructive corporate culture. We are committed to supporting the Tencent Charity Fund through additional donations and by encouraging our employees to participate actively in the future.

Selling and marketing expenses. Selling and marketing expenses increased by 48.4% to RMB293.2 million for the year ended 31 December 2006 from RMB197.6 million for the year ended 31 December 2005. The increase principally reflected increased promotional and advertising activities, mainly in connection with the products of the Joymax Group. In addition, increased outsourcing expenses as we expanded our customer support activities and greater travel and entertainment costs as we continued marketing products and established new distribution channels contributed to the increase. As a percentage of revenues, selling and marketing expenses decreased to 10.5% in the year ended 31 December 2006 from 13.9% in the year ended 31 December 2005.

General and administrative expenses. General and administrative expenses increased by 75.5% to RMB610.0 million for the year ended 31 December 2006 from RMB347.7 million for the year ended 31 December 2005. The increase primarily reflected the increase in research and development costs as a result of an increase in the number of research and development staff and technical personnel developing new products and services to drive our future growth, including online games, IM functionalities and web portals. Staff costs also increased as a result of a higher number of staff employed to support our business expansion, together with the increase in office expenses and office rental. In addition, amortization cost attributable to intangible assets acquired in the acquisition of the Joymax Group contributed to the increase. As a percentage of revenues, general and administrative expenses decreased to 21.8% in the year ended 31 December 2006 from 24.4% in the year ended 31 December 2005.

Finance costs, net. Finance costs represent foreign exchange loss and interest expenses arising from the discounting of “earn-out” consideration in connection with the acquisition of the Joymax Group. We recorded finance costs of RMB46.5 million for the year ended 31 December 2006 compared to RMB47.3 million for the year ended 31 December 2005. The decrease in finance costs recorded was mainly due to the lower amount of foreign exchange losses relating to our U.S.-denominated cash and investments in connection with the appreciation of Renminbi, and was offset for the most part by interest expense arising from the discounting of purchase price payable relating to the acquisition of the Joymax Group in January 2006. A significant portion of our cash and investments, consisting primarily of the proceeds from our initial public offering in 2004, are subject to the risk of the appreciation of Renminbi. We recorded foreign exchange loss of RMB41.1 million in the year ended 31 December 2006 and RMB47.3 million in the year ended 31 December 2005.





Income tax benefit/(expenses). We recorded income tax expenses of RMB53.0 million for the year ended 31 December 2006 compared to an income tax benefit of RMB48.3 million for the year ended 31 December 2005. We had recognized deferred tax assets of RMB110.0 million in the year ended 31 December 2005, RMB88.6 million of which related to previously unrecognized deferred tax assets before 2005. We recognized deferred tax assets of RMB62.4 million in the year ended 31 December 2006.

Profit for the period. As a result of the factors discussed above, profit for the period increased by 119.2% to RMB1,063.8 million for the year ended 31 December 2006 from RMB485.4 million for the year ended 31 December 2005. Net margin was 38.0% for the year ended 31 December 2006 compared to 34.0% for the year ended 31 December 2005.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2006 and 30 September 2006, we had the following major financial resources in the form of cash and investments:

	Audited 31 December 2006	Unaudited 30 September 2006
	<i>(RMB in thousands)</i>	
Cash and cash equivalents	1,844,320	1,640,880
Term deposits with initial term of over three months	944,375	897,963
Financial assets held for trading	195,907	215,857
Held-to-maturity investments	234,261	237,261
Total	<u>3,218,863</u>	<u>2,991,961</u>

A large portion of our financial resources represents non-Renminbi denominated proceeds raised from our initial public offering in 2004, and is held in deposits and investments denominated in US dollars. As there are no cost-effective hedges against the appreciation of Renminbi, we have not used any means to hedge our exposure to foreign exchange risk. In addition, generally there is no effective manner to convert a significant amount of US dollars into Renminbi, which is not a freely exchangeable currency. Therefore, we may experience a loss as a result of any foreign currency exchange rate fluctuations in connection with our deposits and investments.

We had no interest-bearing borrowings as at 31 December 2006.

CAPITAL EXPENDITURES

In the year ended 31 December 2006, our capital expenditures consisted of additions to fixed assets, construction in progress, leasehold land and land use rights and intangible assets totalling RMB478.1 million. In the year ended 31 December 2005, our capital expenditures consisted of similar items totalling RMB302.0 million.

