

Management Discussion and Analysis

FINANCIAL REVIEW

For the year ended 31 December 2006, the Group recorded a turnover of approximately RMB125,386,040 (2005: RMB97,314,518), representing an increase of 28.8% as compared to that of last year. Of these, turnover derived from the sales of self-developed software was approximately RMB36,983,360 (2005: RMB33,054,203), representing an increase of 11.9%. Turnover derived from sales of third party software and hardware increased from approximately RMB60,427,720 in last year to approximately RMB73,299,551, representing an increase of 21.3%. Turnover derived from system integration, maintenance and other services was approximately RMB15,103,129 (2005: RMB3,832,595), representing an increase of 3.9 times.

Turnover increase in 2006 was mainly attributable to the increase in sales of third party software and hardware, as well as maintenance, training and other services, which amounted to RMB73,299,551 and RMB13,915,129 respectively, and represented increases of 21.3% and 5.6 times respectively.

The Group recorded a gross profit of RMB42,113,281 (2005: RMB35,982,864). The overall gross margin was decreased from approximately 37.0% of last year to approximately 33.6% of this year, mainly attributable to the decrease in gross margin in sales of third party software and hardware. Such decline was mainly due to the fact that the Group had reduced its selling price in order to secure ongoing contracts from clients which have adopted centralized procurement to enhance its operational efficiency and cost control.

The increase in administrative expenses by 50.5% from RMB13,299,940 of last year to RMB20,019,831 in this year mainly attributable to the issuance of share option under the share option scheme. Expense recognized from the share option scheme was RMB1,818,368. Total expenses related to the share-based payment, include both share option scheme and share incentive scheme, were RMB2,254,901 (2005: RMB1,268,354).

Profit attributable to shareholders was approximately RMB12,357,589 (2005: RMB9,255,522), representing an increase of 33.5% as compared to last year. Basic earnings per share were approximately RMB3.09 cents (2005: RMB2.31 cents).

The Board of Directors of the Company did not recommend to pay any final dividend for the year ended 31 December 2006 (2005: nil).



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BUSINESS REVIEW

Given the complete removal of the stumbling effects of system modes on the domestic launch of 3G following the designation of the domestic-made TD-SCDMA as the formal standard in the telecommunications industry by the Ministry of Information Industry, we believe that the release of 3G licenses by the PRC government is in the countdown stage. To capitalize on the opportunity offer by 3G, the Group is committed to R&D of 3G OSS-related products and nurturing talents since 2002. The Group is one of the few domestic OSS product and solution providers which is well-prepared in respect of R&D in 3G products. The Group is set to deliver a remarkable profit growth from the 3G business, enhance cooperative opportunities in this horizon, and develop new integrated network management products and total solutions.

Software management segment

The Group is planning to pass CMMI Level 4 assessment in the first half of 2007 and to become one of the six enterprises in the PRC having successfully passed the advanced level R&D process assessment, along side with such elite players like Wonders Information Co., Ltd. and Chinese Academy of Sciences' Institute of Software.

Software development

Under the mentoring of an internationally prestigious consultancy company, the Group has introduced iterative development, unified development, assemblies development technique to its project management and technological management practice. And the Group's efficiency in product research and development has been enhanced by raising project implementation into the Group's development administration process. Thus the risk of product research and development has been reduced.

Work implementation and management standard

After years of effort, the Group achieved remarkable improvement in Group's project management as well as in quality of human resources. During the year, the Group passed the highest level assessment from the Ministry of Information Industry on premium standard of computer information system integration and became one of the 108 PRC enterprises which attained the highest level in certification of computer information system integration.

CUSTOMER BASE

The Group's customers comprise four major telecommunications operators including China Mobile and China Telecom, 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 abroad to provide services to end users of telecommunications services.

In 2006, the Group began to provide services for network resources management and business orders processing system, service protection system as well as network resources allocation management system to a foreign telecommunications carrier. This represents a major step forward in its business pursuit in overseas market.

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 26 staff members.

In 2006, the Group established operational offices in Chengdu and Hefei as well as a customer technical services centre in Shenyang, thereby paving the way for full-scale expansion in sales network by the Group. At the same time, the Group also had service representatives residing locally at Shijiazhuang, Nanchang, Fuzhou, Taiyuan, Hangzhou and Lhasa, by which the sales and service network of the Group had become more comprehensive.

PRODUCT RESEARCH AND DEVELOPMENT

The Group had exerted greater effort in research and development on fundamental platform. It had built an assemblies development model based on information flow analysis, and had launched a successful trail run in a product line and solved the problem of data accuracy faced by the industry and its organizations, thereby laying foundation for future research and development of the Group. The Group's transmission network based on assemblies platform had passed the testing by China Mobile, which gave preliminary proof to the value of the assemblies platform.

In terms of software system framework and iterative development model, through the cooperation with a world renowned consultancy company, the Group had taken a solid step forward in laying a foundation for adapting the change in demand of the OSS domain and raising the standards for research and development management.

The Group launched a new version of transmission network system and completed the development and internal testing of the first version NGN OSS system in accordance with requirements of a project from a Hong Kong telecommunication operator. Further, commercial launch of the 3G-ready ISMP product in the PHS (personal handyphone system) segment had also taken place.

INTERNAL REFORM AND MANAGEMENT

The Group continued the implementation of reform with product lines as the core of operation. It had regrouped its products into 8 product lines and optimally structured functions such as business planning, solution, product research and development, human resources into each of these product lines, thereby enabling the offer of product line-oriented end-to-end service to customers. On the other hand, the Group had retained the 5 functions: base assemblies research and development, purchase, finance, quality control and corporate information, and consolidated them into 2 main business supporting units.

At the same time, the Group had set up a unified engineering service department on the basis of consolidating the engineering service for the 8 product lines, thereby establishing an on-site service system covering the whole nation.



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To complement the above reform measures, the Group had also strengthened the reporting, supervision and examination functions, formulated underlying policies and enhanced the monitor capability of product lines.

The Group envisages to pass the assessment of CMMI Level IV in the first half of 2007 and become the sixth PRC software company having passed the advanced level assessment on sophistication of software development process.

AWARDS AND HONOURS

At present, the Group had acquired 56 software copyright certificates and 24 software product registration certificates. There is one product currently under the process of review for invention patent and four products having submitted patent applications and passed preliminary review.

In 2006, the Group was admitted by Zhongguancun Science Park as a 'Patent Generator' (專利引擎) experimenting enterprise.

In November 2006, the Group received from the Ministry of Information Industry the certificate of premium standard of computer information system integration.

In December 2006, the "Technological Innovation on Large Scale Mobile Network Management System" project in collaboration with China Mobile and BOCO Inter-Telecom was awarded the Prize of Significant Technological Invention in Information Industries.

OUTLOOK

- Following a well-defined 3G policy in the PRC, the full development of the 3G network of major telecommunications operators in China will begin from 2007. After numerous years of huge investments, the Group had on three product lines established diversified technological accumulation, product reserves and market operation from element and network management, OSS, to 3G-oriented business platform. The Group has deeply involved in the formulation of the required standard of network management and interface and related synchronic testing. The Group is well prepared for the coming of 3G era. It is anticipated that simultaneous development of 3G network construction and network management system will bring a broad market outlook to the Group.
- The research and application of NGN technology fulfils the demand of future network integration and business integration, and with the aim of multi-network integration, provides flexible user interface and business distribution, and will become the real future network development direction. NGN technology has already become the focus of major operators in future network development, and hence, NGN contains enormous commercial benefits. At the same time, development and operations of many businesses of NGN will be based on the needs of the end users. These businesses will become the earning drivers for major operators. Therefore, NGN fulfils the needs of telecommunications development, and will become the milestone in the history of telecommunications development. The Group will, from now on and in the long-

term future, continue with its development as well as seek cooperation with reputable multinational telecommunications conglomerates, in order to strive for greater breakthrough in research and development as well as market promotion of these product lines.

- On the side of fundamental product research and development, the Group will continue to move toward the Service-oriented Architecture (SOA) with CMBD, MDA and iterative development as the core. This will enable the Group, through integrated application of base assemblies, to realize application development that satisfies the needs of operators in swift and flexible planning and also supports upper level business-oriented development.
- As to integrated service management platform (ISMP) business, after 3 consecutive years of investment, the Group believe it can secure certain market share in 2007. In this regard, business format of the Group will gradually transform from back stage support to coverage of both back stage support and front-end operation, production and maintenance. This will pave the way technologically as well as commercially for further and closer strategic cooperation with operators.
- As to development of element management products, the Group will command timely launches of new generation of business maintenance and activation products in conjunction with broadband business development plan of fixed line operators. With new broadband businesses such as IPTV and WiMAX continue to grow, the Group expects substantial business potential in this segment.

LIQUIDITY AND FINANCIAL RESOURCES

The Group generally finances its operations with internally generated cash flows and the bank balance.

As at 31 December 2006, the Group had bank balances and cash of approximately RMB9,975,850 and bank deposits of approximately RMB55,685,220 as compared to the bank balances and cash of approximately RMB73,523,366 as at 31 December 2005.

As at 31 December 2006, the Group did not have any long-term debts while its shareholders' funds amounted to approximately RMB136,635,553. In this regard, the Group holds a net cash position with nil gearing ratio (net debt to shareholders' funds) as at 31 December 2006.

The Group's net current assets totalled approximately RMB107,043,272 as at 31 December 2006, against approximately RMB93,337,881 as at the end of the previous financial year.



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GEARING RATIO

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CAPITAL STRUCTURE

For the year ended 31 December 2006, except for the repurchase of 5,000,000 ordinary shares, there was no change in the capital structure and issued share capital of the Group.

SIGNIFICANT INVESTMENT

As at 31 December 2006, the Group did not have any significant investments.

FOREIGN EXCHANGE EXPOSURE

Substantially all of the business transactions of the Group are denominated in Renminbi and Hong Kong dollars. The Group adopts a conservative financial policy. As at 31 December 2006, the Group did not have any bank liabilities, interest or currency swaps or other financial derivatives for hedging purpose. Therefore, the Group is not exposed to any material interest and exchange risks.

CHARGES ON GROUP ASSETS

As at 31 December 2006, the Group did not have any charges on its assets.

CONTINGENT LIABILITY

As at 31 December 2006, the Group did not have any significant contingent liabilities.

EMPLOYEE INFORMATION

As at 31 December 2006, the Group has 385 employees (2005: 315). Among them 334 were research and development staff members, accounted for 86.8% of total employees. 92% of our R&D staff members hold undergraduate or above academic qualification. Total staff costs being charged to profit for the year, including the Directors' emoluments, amounted to approximately RMB29,828,933 (2005: approximately RMB18,638,315). 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.