MANAGEMENT DISCUSSION AND ANALYSIS

The Group's consolidated turnover for the year ended 31 December 2006 was approximately HK$377,433,000, representing an increase of approximately 51% when compared to 2005. Outsourcing software development work from the Group's existing Japanese customers and the provision of technical support services continued to grow in 2006. Turnover derived from outsourcing software development work after business tax increased by approximately 50% to approximately HK$349,857,000. The increase was mainly attributable to the growth in business volume from its two largest customers. Business growth momentum remained strong during the year. There was also a new Japanese customer became one of the five largest customers for the year. Turnover derived from technical support services increased by approximately 54% to approximately HK$27,576,000. Business from new customers as well as the enlarged service network coverage for its existing international technical support service business partner in China which mainly accounted for the increase.

There were 2,512 full time staff headcounts as at 31 December 2006, an addition of 742 or 42% from 1,770 at beginning of the year. 157 interns as at 31 December 2006 had not been included as full time staff, including which the total working force would reach 2,669. Turnover growth of 51% was higher than the headcount growth of 42%, mainly due to consolidation of full year results from Shensoft Shanghai representing approximately 9% of the total turnover.

Gross profit for the year increased to approximately HK$157,885,000, or 25% increase, when compared to the gross profit of HK$126,701,000 in 2005. The Group's gross profit margin was approximately 42% in 2006, dropped by about 8 percentage points when compared to the gross margin level at 50% in 2005. Weak Japanese Yen exchange rates accounted for approximately 2 percentage points drop in gross profit margin as a result of decrease in revenue while strong RMB exchange rates accounted for 1 percentage point drop in gross profit margin as a result of increase in costs. The remaining 5 percentage points drop in gross profit margin was due to the increase in manufacturing staff cost. The Group successfully controlled its average cost per engineer flat to that of 2005. However, headcount grew at a faster pace than turnover growth. Human resources remained a bottleneck to the industry. SinoCom relied on recruiting fresh graduate engineers to fill up the deficiency to a certain extent. However, they were inexperienced and sufficient training in advance is required before engagement to project, which reduced the overall productivity and efficiency. The Group is looking forward to running its own vocational education institute by lobbying the relevant PRC government authorities turning on green light to foreign enterprise in this area. Currently, the Group is subsidizing approximately 350 interns by paying them living allowances to lock up resources in order to preserve its expansion capacity.

Operating profit and net profit attributable to shareholders in 2006 increased by approximately 24% and 22% to HK$86,105,000 and HK$73,308,000 respectively. Operating margin and net profit margin in 2006 were approximately 23% and 19% respectively and the effective tax rate was approximately 14%. Net profit margin drop of 5 percentage points was attributable to the gross profit margin drop and reduced foreign exchange loss of approximately HK$10,684.000, or 2.8 percentage points of the net margin.

Liquidity and Financial Resources

Since inception, the Group has funded its operations through equity funding and cash from operation. The Group continued to maintain this strong cash generating capability for the year. During the year, the Group financed its operations and investing activities solely with internally generated cash flow. The bank loans of approximately HK$520,000 as at 31 December 2006 was borrowed by a subsidiary before it was acquired by the Group.

Share Capital

Neither the Company nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the period from the date of listing to 31 December 2006.

As at 31 December 2006, the number of shares in respect of which options had been granted and remained outstanding under the share option scheme of the Company was 56,184,000, representing approximately 5.12% of the shares of the Company in issue at that date.

Pledge of Assets

As at 31 December 2006, the Group had not pledged any of its assets.

Employees and Remuneration Policy

The Group had 2,512 full time staff as at 31 December 2006. Most of them are engineers located in China. Most of the 116 employees in Sinocom Japan were bridged system engineers worked at customers' locations in Japan. Their remuneration, promotion and salary review are assessed based on job responsibilities, work performance, professional experiences and the prevailing industry practice. The Group also offers project bonus and performance bonus to its staff. Project bonus is calculated by allowing a fixed amount per man-month of work completed in a project and distributed among staff engaged according to their respective contributions in the project. Performance bonus is calculated based on an evaluation of individual efforts and the financial performance of the Group. Adequate resources are preserved for regular Japanese language training, new I.T. knowledge training and business domain knowledge training for each project before commencement of a project. On the job training is also provided after a project commenced. The Group maintains social insurance schemes for retirement, unemployment, personal injury and hospitalization for all of its employees in China. A housing provident fund system has also been implemented for its employees in China. Staff in Japan are enrolled under the requisite pension fund and health scheme as required by Japanese law.

Foreign Exchange and Currency Risks

Since most of the Group's revenue was generated from software development outsourced from Japan in Japanese Yen while expenses were settled in RMB, any depreciation of Japanese Yen against RMB, will reduce the income of the Group and have an adverse impact on the profitability of the Group. The Group strategy was to convert Japanese Yen into RMB in order to build up a buffer when exchange rates were considered favourable by the management. The Group planned to expand its technical support business with revenue in RMB to partially diversify this risk.

Contingent Liabilities

On 14 March 2006, SinoCom Holdings (BVI) Limited ("SinoCom BVI"), a wholly-owned subsidiary of the Company, entered into a sale and purchase agreement (the "Agreement") with Mr. Jiang Xiufeng ("Jiang") pursuant to which SinoCom BVI has conditionally agreed to acquire from Jiang a 22% equity interest in Beijing Jbridge Information Technology Co., Ltd. ("Beijing Jbridge"), for a consideration of RMB6,600,000 (equivalent to HK$6,346,000) to be satisfied in cash. A deposit of RMB1,800,000 (equivalent to HK$1,792,000) was paid by SinoCom BVI to Jiang in relation to the acquisition. The completion of the acquisition was conditional upon satisfaction of certain precedent conditions which had not been fulfilled before the Agreement expired on 14 September 2006.

On 15 September 2006, SinoCom BVI informed Jiang to refund the deposit upon expiry and as provided in the Agreement. Jiang did not accept and applied an arbitration to the China International Economic and Trade Arbitration Commission against SinoCom BVI for specific performance of the Agreement in November 2006. Jiang requested SinoCom BVI to pay him the remaining acquisition consideration amounting to RMB4,800,000 (equivalent to HK$4,778,000) and legal costs and other expenses incurred amounting to approximately RMB600,000 (equivalent to HK$597,000).

In January 2007, SinoCom BVI counter-claimed Jiang for the deposits paid, related interest and legal costs incurred. The directors of the Company do not consider there will be an unfavourable judgement against SinoCom BVI in the arbitration and therefore no provision has been made for the deposit paid and the amounts claimed by Jiang in the consolidated financial statements. In the opinion of the directors of the Company, the deposit paid is recoverable in 2007 and accordingly classified under current assets.

Capital commitments

As at 31 December 2006, the Group had no material capital commitments.