NetDragon Websoft Inc.
網龍網絡有限公司

(incorporated in the Cayman Islands with limited liability)

Stock Code : 777

CONTENTS

CORPORATE INFORMATION

BOARD OF DIRECTORS

Executive Directors

Mr. Liu Dejian *(Chairman)*
Mr. Liu Luyuan *(Chief Executive Officer)*
Mr. Zheng Hui
Mr. Chen Hongzhan

Non-executive Directors

Mr. Lin Dongliang

Independent Non-executive Directors

Mr. Chao Guowei, Charles
Mr. Lee Kwan Hung
Mr. Liu Sai Keung, Thomas

COMPLIANCE OFFICER

Mr. Liu Luyuan

COMPANY SECRETARY

Ms. Tam Hon Shan, Celia, HKICPA, FCCA

QUALIFIED ACCOUNTANT

Ms. Tam Hon Shan, Celia, HKICPA, FCCA

AUDIT COMMITTEE

Mr. Chao Guowei, Charles *(Chairman of the Committee)*
Mr. Lee Kwan Hung
Mr. Liu Sai Keung, Thomas

REMUNERATION COMMITTEE

Mr. Lee Kwan Hung *(Chairman of the Committee)*
Mr. Chao Guowei, Charles
Mr. Liu Sai Keung, Thomas

NOMINATION COMMITTEE

Mr. Liu Sai Keung, Thomas *(Chairman of the Committee)*
Mr. Chao Guowei, Charles
Mr. Lee Kwan Hung

SHARE AWARD SCHEME COMMITTEE

Mr. Lee Kwan Hung *(Chairman of the Committee)*
Mr. Liu Sai Keung, Thomas
Ms. Tam Hon Shan, Celia
Mr. Wu Chak Man

AUTHORISED REPRESENTATIVES

Mr. Liu Luyuan
Ms. Tam Hon Shan, Celia

COMPLIANCE ADVISER

First Shanghai Capital Limited

LEGAL ADVISER

Sidley Austin

AUDITORS

Grant Thornton
Certified Public Accountants

PRINCIPAL BANKERS

Bank of Communications (Fuzhou Branch)
Bank of America (Branch of Diamond Bar, CA)
The Hong Kong & Shanghai Banking Corporation
(Nathan Road Branch)

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Tricor Investor Services Limited
26th Floor
Tesbury Centre
28 Queen's Road East
Wanchai
Hong Kong

ADVISOR ON RELATIONS WITH INVESTORS AND MEDIA

Porda International (Finance) PR Group

CORPORATE INFORMATION

STOCK INFORMATION

Listing Place:

Main Board of The Stock Exchange of Hong Kong Limited

Stock Code:

777

Listing Date:

24 June 2008

Stock Name:

NETDRAGON

REGISTERED OFFICE

Cricket Square
Hutchins Drive
P.O. Box 2681
Grand Cayman KY1-1111
Cayman Islands

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS IN HONG KONG

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77 Connaught Road Central
Central
Hong Kong

COMPANY WEBSITE

www.nd.com.cn

COMPANY PROFILE

NetDragon Websoft Inc. ("NetDragon" or the "Company"), together with its subsidiaries (collectively referred to as the "Group") was listed on the Growth Enterprise Market (the "GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 2 November 2007 under the stock code of "8288". On 24 June 2008, the Company's listing was successfully transferred to the Main Board (the "Main Board") of the Stock Exchange under a new stock code of "777". Also, the Group's stock became a constituent stock of the Morgan Stanley Capital International ("MSCI") China Index as from late May 2008.

The Group was established in 1999 and the then principal business was to provide Internet services. We are one of the leading online game developers and operators in the People's Republic of China (the "PRC"). We have successfully developed a range of MMORPGs catering to various types of players. We operate our online games under the free-to-play business model (the "FTP model") which encourages more players to experience our games. Under this model, our revenue is generated by selling virtual items.

We possess strong game development capabilities. Our integrated game development process comprising game design, programming, graphics and testing, enables us to control all the cost, quality and pace of development. With our strong online game development capability, we can launch new games in a timely and efficient manner to grasp business opportunities, upgrade our existing online games to prolong their life cycle, increase the Group's revenue and enhance the popularity of our online games.

To date, we have successfully launched and been operating various flagship online games with diversified themes, including Eudemons Online, Conquer Online, Zero Online, Tou Ming Zhuang Online, Heroes of Might and Magic Online, Way of the Five, Era of Faith and Monster & Me. We also provide multiple language versions for our selected online games, including English, French and Spanish versions. Currently, we have a number of online games in our development pipeline, including Tian Yuan, Disney Fantasy Online, Dungeon Keeper Online and CJ7 Online.

CONSOLIDATED INCOME STATEMENT

	For the year ended 31 December			
	2008	2007	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Revenue	**595,981**	645,214	122,061	35,119
Profit from operations	**262,180**	427,081	51,545	(30,921)
Loss on results of an associate	**(276)**	—	(2)	—
Profit before taxation	**261,904**	427,081	51,543	(30,921)
Taxation	**(22,635)**	(52,244)	(8,558)	1,721
Net profit attributable to the shareholders	**239,269**	374,837	42,985	(29,200)
Net profit attributable to equity holders of the Company	**239,381**	374,854	42,856	(29,171)

CONSOLIDATED BALANCE SHEET

	As at 31 December			
	2008	2007	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Non-current assets	**132,746**	66,572	27,412	24,214
Current assets	**1,387,664**	1,778,088	118,884	35,359
Current liabilities	**(66,599)**	(75,278)	(41,589)	(19,604)
Non-current liabilities	**—**	—	—	—
Minority interests	**—**	(112)	(129)	—
Equity attributable to equity holders of the Company	**1,453,811**	1,769,270	104,578	39,969

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CHAIRMAN'S STATEMENT

Dear shareholders,

On behalf of the board ("Board") of directors ("Directors"), I am pleased to present the annual report of NetDragon for the year ended 31 December 2008 following its successful transfer to the Main Board of the Stock Exchange on 24 June 2008.

The Group has been dedicated to improving our game development capabilities, expanding the range of online games as well as increasing profitability with the aim to enhance the shareholders' interest. The proceeds from listing on the GEM provide the necessary funds for future development of the Group. Such development includes strengthening our game development capabilities, enhancing the integrated operation model, enriching our product portfolio and extending life cycles of our online games, which will reinforce our competitive strength and our leading position in the industry.

With a clear vision to become the leading online game developer and operator of choice in the PRC, we are committed to present our customers with a wide range of innovative online games, to provide our people with a great working environment, and to generate high returns for our shareholders. I am pleased to report positive progress on our journey towards achieving this vision in 2008.

2008 was an important year for the Group's development with significant achievements made on various fronts. In February 2008, Forbes China named us one of the country's "Best Small and Medium-sized Enterprises 2008," and we became one of MSCI China Index's constituent stocks in late May 2008. We also won five "Golden Phoenix Awards" for 2008 at the China Game Industry Annual Conference. At this prestigious industry event, we were not only recognized as one of the "Top 10 Game Developers in China for 2008," but was also praised for our notable achievement in global marketing development and efforts made towards the "Award for Overseas Development of Chinese Domestic Games for 2008." In addition, our online game Eudemons Online was ranked among the "Top Ten Most Popular Domestic Online Games for 2008." All these achievements have strengthened our position both in the industry and the international capital market.

Despite the current uncertainties in the global economy triggered by the U.S. subprime crisis, the online gaming industry remains intact given its countercyclical nature, and is set to flourish with China's rapid Internet and broadband penetration in recent years and the wider range of games available in the market.

One of the key challenges we faced during the year was the re-emergence of "private servers" which adversely impacted our overall business operation. However, our senior management and staff swiftly implemented a series of defensive and counterattack measures to combat the issue. With support from both the Fujian and Fuzhou governments, encouraging success has been achieved on this front.

Our revenue amounted to approximately RMB596.0 million while profit attributable to the equity holders was approximately RMB239.4 million for the year ended 31 December 2008. Basic earnings per share amounted to approximately RMB44.49 cents. The Group is in a healthy financial position with a net cash position of approximately RMB1,305.1 million providing adequate sources of funding for further investment in our game development capabilities.

By operating in one of the most dynamic sectors of the economy, our games are the most critical to our success. By leveraging on our leading market position, we are continuously strengthening our game portfolio by focusing on our research and development capability as well as making improvements and upgrades in our existing games in a timely manner. We have been actively recruiting experienced game developers, developing game development software to replace manual operation and purchasing supplementary computers and software for game development. We believe that our strong game development platform will facilitate us in achieving a higher return.

Aside from allocating more resources towards our game development capabilities, we have also formed partnerships and cultural exchanges with leading enterprises and individuals in the creative industry in an effort to generate inspiration for new ideas.

CHAIRMAN'S STATEMENT

We have been working closely with Disney Online, Inc. (previously called "Buena Vista Internet Group"), to develop Disney Fantasy Online, a 2.5D MMORPG featuring certain Disney characters and intellectual property rights, and have partnered with Electronic Arts Inc ("EA"), an internationally renowned game developer, to develop Dungeon Keeper Online, the Group's first 3D MMORPG, based on the famous Dungeon Keeper™ line of games.

In addition, we are extremely pleased that Mr. Stephen Chow Sing-Chi will be involved to promote our signature online game Way of the Five in 2009. The market has been anticipating Way of the Five for some time. In 2008, it was chosen as one of "Top 10 Most Anticipated Online Games" at the Golden Plume Awards, the "Oscar" awards of China gaming industry.

In overseas market development, we have extended our foothold in Thailand, Vietnam and Taiwan by entering into cooperation and/or licensing agreements with online operators in the respective markets during the year under review. To further strengthen our presence elsewhere, we will continue to enhance our overseas distribution channels and identify strategic partnership opportunities in overseas markets in the future.

Our earlier investments have enabled us to build strong positions in the online game industry in the PRC and overseas. Looking forward, we will continue to lay the foundations for long-term success and create value in a challenging business environment. With a range of new and fun online games in the pipeline, I am confident the Group will continue to make progress and achieve sustainable growth in the future.

DIVIDENDS

As a token of appreciation for the support from the shareholders of the Company, the Board proposed to distribute final dividend of HKD0.11 per share for the financial year ended 31 December 2008 after taking into account of financial positions, cash flows, operation and capital requirements and future development needs of the Company. The Board believes that our stable financial conditions and cash flows can fund our future development. We will spend every effort to bring satisfactory rewards to our investors.

APPRECIATION

Creativity and innovative thinking are crucial ingredients to the creative process and the online gaming industry. In this regard, our employees are undoubtedly the Group's most valuable asset, and I would like to take this opportunity to express my sincere gratitude to all of them for their efforts, dedication and commitment throughout the year. I would also like to extend my heartfelt thanks to our shareholders and business partners for their continuous support and trust in the Group.

Liu Dejian
Chairman

Hong Kong, 12 March 2009

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—— 超智能的遊戲伴侶
懶人專用


Q版花花世界，就要你开心
互動社區生活功能
—— 豐富多彩的社群互動
智勇雙絕的戰鬥模式
—— 鬥智鬥法不鬥金
內外雙修的養成系統
—— 渡劫成仙任逍遙
前所未有的DIY寵物
—— 寵物養成全進化
花樣百出的副職技能
—— 調皮搗蛋的幽默人生
周星馳先生

MANAGEMENT DISCUSSION AND ANALYSIS

(1) INDUSTRY REVIEW

China is today one of the most well-positioned and fastest growing Internet economies in the world with a net user population that reached 253 million in 2008, according to the China Internet Network Information Centre ("CNNIC"). Despite this remarkable size, the Internet penetration rate in China stood at only 22.6%* by the end of 2008, compared to 73%* in Korea and 74%* in Japan. This suggests that the Internet's potential in China still has ample room for growth, given a strong user base as well as increasing utilisation rates. Ultimately the online gaming industry will emerge as one of the major beneficiaries.

Due to the vast potential of the online gaming industry in China, market competition remained intense in 2008. Dominated by a number of established industry leaders, China's online gaming sector continued to fragment with a significant number of game developers and operators entering the market. While this trend is expected to continue, industry consolidation is likely to occur over the longer term, which will favor those industry leaders that are well-managed and financially sufficient to gain market share and enlarge the scale of their business and user base.

Online security is an industry-wide issue concerning online game operators in China. During the past year, illegal or private server activities re-emerged in the online game sector. Private servers are vehicles by which unauthorized individuals illegally operate and offer online games to the general public at a discounted price. This kind of activity not only constitutes infringement of intellectual property rights, but also cripples the operations of the original game developers, which upset the continuity of their online games. A host of counter measures have been introduced by online game developers along with the Chinese government's support to eliminate the problem, which has resulted in great success.

* *Source: China Internet Network Information Centre*

(2) FINANCIAL REVIEW

Revenue

Our total revenue for the year ended 31 December 2008 was approximately RMB596.0 million, representing a decrease of approximately 7.6% as compared to approximately RMB645.2 million for the year ended 31 December 2007. However, the revenue of the Group for the three months ended 31 December 2008 amounted to approximately RMB136.5 million, maintaining at a steady level when compared with the three months ended 30 September 2008 of approximately RMB136.6 million, but representing a decrease of approximately 28.9% as compared with that of approximately RMB191.9 million for the same period in last year.

The following table sets out the breakdown of peak concurrent users ("PCU") and average concurrent users ("ACU") for our online games for periods indicated below *(note)*:

	For the three months ended				
	31 December 2008	**30 September 2008**	**30 June 2008**	**31 March 2008**	31 December 2007
PCU	**591,000**	**544,000**	**697,000**	**669,000**	787,000
ACU	**317,000**	**311,000**	**355,000**	**313,000**	407,000

Note: Online games include Conquer Online, Eudemons Online, Zero Online, Tou Ming Zhuang Online, Heroes of Might and Magic Online and other games.

The PCU for online games was approximately 591,000 for the three months ended 31 December 2008, representing an increase of approximately 8.6% from the three months ended 30 September 2008 but representing a decrease of approximately 24.9% from the three months ended 31 December 2007.

We also recorded an ACU for online games of approximately 317,000 for the three months ended 31 December 2008, it also represented a decrease of approximately 22.1% from the three months ended 31 December 2007 but representing an increase of approximately 1.9% from the three months ended 30 September 2008. The increase of concurrent users for the three months ended 31 December 2008 was mainly a reflection of an increase in Eudemons Online users, due in part to our successful fight against private server activities in coordination with Fujian and Fuzhou governments during the fourth quarter of 2008.

The following table sets out the breakdown of geographical revenue for periods indicated below:

	For the period from 1 January 2007 to 30 June 2007		For the period from 1 July 2007 to 31 December 2007		**For the period from 1 January 2008 to 30 June 2008**		**For the period from 1 July 2008 to 31 December 2008**	
	RMB'000	% of total revenue	RMB'000	% of total revenue	**RMB'000**	**% of total revenue**	**RMB'000**	**% of total revenue**
The PRC	208,747	79.8	315,905	82.4	**251,719**	**78.0**	**194,631**	**71.3**
Overseas	53,002	20.2	67,560	17.6	**71,178**	**22.0**	**78,453**	**28.7**
Total	261,749	100.0	383,465	100.0	**322,897**	**100.0**	**273,084**	**100.0**

Our Group's online game revenue analysed by geographical segments is based on the location where services are provided. The revenue derived from the PRC for the year ended 31 December 2008 was approximately RMB446.4 million, representing a decrease of approximately 14.9% as compared to approximately RMB524.6 million for the corresponding period in last year. However, the revenue derived from overseas markets for the year ended 31 December 2008 amounted to approximately RMB149.6 million, representing an increase of approximately 24.1% as compared with that of approximately RMB120.6 million for the same period in last year. The increase in revenue derived from overseas markets was mainly due to (i) the launch of the different languages of the online games of the Group, where we have launched the traditional Chinese version for Eudemons Online and Zero Online in Hong Kong, Taiwan and Macau (in association with our business partners in the respective markets) in the second half of 2008; and (ii) the launch of Indonesian version for Eudemons Online in Indonesia with the cooperation of business partners; and (iii) the overall increase of revenue derived from English version of Conquer Online operated by the Group itself.

Gross profit

Our gross profit was approximately RMB527.9 million with a gross profit margin of approximately 88.6% respectively for the year end 31 December 2008 as compared with approximately RMB608.4 million and 94.3% respectively for the year ended 31 December 2007. The decrease in gross profit and the percentage of gross profit margin were mainly due to the decrease in the player usage as demonstrated by the decrease in revenue derived for the year ended 31 December 2008 as compared with the year ended 31 December 2007 and the increase in leasing and expenses and depreciation of servers as a result of the increase number of servers owned by us as compared with the year ended 31 December 2007.

Other revenue and gains

Our other revenue and gains primarily consist of advertising income, government grants, interest income, fair value gain on financial instruments and other revenue and gains.

Other revenue and gains for the year ended 31 December 2008 increased by approximately 1,042.7% to approximately RMB95.1 million as compared with the year ended 31 December 2007. The increase in other revenue and gains was mainly attributable to (i) the net increase in the fair value of the foreign currency forward contract of approximately RMB32.2 million was recognised; (ii) the increase in interest income earned from net proceeds of the international placing in connection with the listing of the Company's shares on the GEM of the Stock Exchange; (iii) the increase in the contribution of advertising income; and (iv) the increase in the government grants of approximately RMB24.6 million. The government grants were mainly granted to NetDragon (Fujian) and TQ Digital by 福州技術經濟局財政局 and 福建省財政廳 amounting to RMB19.4 million and RMB2.0 million respectively.

Selling and marketing expenses

Our selling and marketing expenses primarily consist of staff costs, advertising and promotion expenses and other selling and marketing expenses.

Selling and marketing expenses for the year ended 31 December 2008 increased by approximately 28.1% to approximately RMB103.6 million as compared with the year ended 31 December 2007. The increase in the amount of selling and marketing expenses was mainly attributable to our continued advertising and promotion expenses for Conquer Online, Eudemons Online, Zero Online, Tou Ming Zhuang Online and Heroes of Might and Magic Online. In accordance with the terms of agreement with China Film Group Corporation and Ubisoft Entertainment SA ("Ubisoft"), respectively, the Group has to provide marketing support for promoting the collaboration of Tou Ming Zhuang Online and Heroes of Might and Magic Online. Besides, the Group has continued to increase the marketing and promotional activities of its self-developed game Way of the Five in late 2008, which has been officially launched in March 2009. In addition, the Group also actively participates in the game industry events and / or exhibitions including the China Digital Entertainment Expo and Conference ("ChinaJoy") and The 6th China International Web Culture Expo during the year of 2008.

Further, the increase in the amount of selling and marketing expenses was also caused by the increase in staff costs relating to the use of various defensive and counter-attack measures in an attempt to resolve and reduce the negative impact to our online games franchisee caused by the commonly known industry problem, "private servers". We have recruited experienced staff to keep checking, preventing and attacking the private servers activities. After incurring the above expenditures, the Company has started to obtain a better results in the revenue contribution from its flagship online game, Eudemons Online. The proportion of selling and marketing expenses to the total revenue for each of the year ended 31 December 2007 and 2008 was approximately 12.5% and 17.4%, respectively.

Administrative expenses

Our administrative expenses primarily consist of staff costs, depreciation, travel and entertainment expenses and other administrative expenses.

Administrative expenses increased by approximately 124.9% to approximately RMB112.7 million for the year ended 31 December 2008 as compared with the year ended 31 December 2007, as a result of the continuous expansions of our online game business. The increase of administrative expenses for the year ended 31 Decemer 2008 was mainly attributable to (i) the significant increase of our business development needs including cooperation with different business partners such as China Film Group Corporation, Disney Online, Inc. and EA; (ii) our overall expansion of the Group, including launching multi-language versions of online games during the year under review; and (iii) the exchange loss resulted from the appreciation of Renminbi ("RMB") against US dollars ("USD") and Hong Kong dollars ("HKD") for the year ended 31 December 2008. The proportion of administrative expenses to total revenue for the each of the year ended 31 December 2007 and 2008 was approximately 7.8% and 18.9%, respectively.

Development costs

Our development costs primarily consist of staff cost and other development-related expenses.

Development costs increased by approximately 141.1% to approximately RMB89.8 million for the year ended 31 December 2008 as compared with the year ended 31 December 2007. The increase in development costs was mainly due to expansion of our development team in line with the development of new online games including cooperation with difference business partners mentioned in the above administrative expenses and the increase in compensation for our employees. The number of staff in our development team increased from 412 as at 31 December 2007 to 1,465 as at 31 December 2008. We also increased the compensation in order to provide a competitive and attractive increment in the basic salary. The increase in the amount of development costs was also caused by the continued increase in staff costs for addressing and resolving the issues of private servers as mentioned in the selling and marketing expenses and co-operation with outsider service company for design and development.

Other operating expenses

Our other operating expenses primarily consist of professional fee related to the listing, business tax related to intercompany transactions which the business tax for online game revenue is deducted from the online revenue directly, fair value loss on financial assets and other operating expenses.

Other operating expenses for the year ended 31 December 2008 increased by approximately 155.7% to approximately RMB54.7 million as compared with the year ended 31 December 2007. The increase in other operating expenses was attributable by the offsetting of (i) the net increase in the fair value of the 1-year USD denominated consecutive digital note ("USD Note") and 1-year AUD denominated credit-linked note ("AUD Note") of approximately RMB35.2 million and (ii) the decrease in business tax related to intercompany transactions due to the approved non-taxable cooperation revenue being paid by NetDragon (Fujian) to TQ Digital during the year of 2008. The increase in the fair value of the USD Note and AUD Note for the year and cumulated changes of RMB35.2 million was solely attributable to the changes in market conditions that give rise to market risk.

Income tax expenses

The profit before tax for the year ended 31 December 2008 dropped by approximately 38.7% as compared with the year ended 31 December 2007. We also recorded a decrease in the income tax expenses for the year ended 31 December 2008 of approximately 56.7% to approximately RMB22.6 million as compared with the year ended 31 December 2007. The decrease in income tax expenses was mainly due to (i) the tax refund of approximately RMB9.7 million approved by the 福建省福州市經濟技術開發區地方稅務局（「開發區地方稅務局」）in September 2008. The tax refund was related to the overpayment of income tax of NetDragon (Fujian) for the year ended 31 December 2007. The overpayment of income tax was related to an expense allowed by 開發區地方稅務局 for deduction recently; and (ii) based on 中華人民共和國國務院（企業所得稅法實施條例）TQ Digital is entitled to the tax benefit on the technology transfer income followed by 50% tax reduction for the year 2008.

Profit attributable to the equity holders of the Company

Profit attributable to the equity holders of the Company for the year end 31 December 2008 was approximately RMB239.4 million, representing a decrease of approximately RMB135.5 million as compared with approximately RMB374.9 million for the year ended 31 December 2007. However, the unaudited profit attributable to equity holders of the Company for the three months ended 31 December 2008 amounted to approximately RMB73.2 million, representing an increase of approximately 43.8% as compared with that of approximately RMB50.9 million for the three months ended 30 September 2008.

(3) BUSINESS REVIEW

As a leading innovator in the rapidly evolving interactive media industry, the Group continues to execute a strategy of strengthening its core game development and operating capabilities in order to tap market opportunities that the online gaming industry has both in the PRC and abroad.

Launch of new games

During the year under review, the Group sought to expand its product offerings by continuing to develop additional online games internally.

Heroes of Might and Magic Online

Launched in the second quarter of 2008, Heroes of Might and Magic Online is a 2.5D MMORPG. It was developed based on the well-known PC game Heroes of Might and Magic, licensed to the Company by Ubisoft. The game is targeted on the existing “Heroes of Might and Magic” PC players worldwide who tend to prefer strategy games. Leveraging this increasing market attention and popularity among online game players, Heroes of Might and Magic Online is expected to become another flagship title for the Group in the years to come.

Way of the Five

The Group has launched a self-developed cartoon-version of the turn-based online game Way of the Five in March 2009. This game has also received a number of industry awards, including the “Top Ten Most Popular Online Games for 2008” on the “Tencent Online Game Award List for 2008” and the “Top 10 Most Anticipated Online Games” at the Golden Plume Awards.

The Group also announced a co-operative arrangement with Mr. Stephen Chow Sing-Chi to promote the game.

Development and licensing of existing games

To help maximise the lifespan of its online games, the Group has continued to launch timely upgrades by offering a variety of customised virtual items and tasks to players in order to enhance the in-game features of its existing units. During the year under review, the Group launched upgrades for Conquer Online, Eudemons Online, Zero Online and Tou Ming Zhuang Online on a weekly basis which helped to sustain interest in the game among online players. The Group has also continued to launch expansion packs that offer additional in-game items and premium features to bolster the popularity of its online games. New Dynasty ("An Ren Wei Ji") was one of the major expansion packs launched at the end of last year for Conquer Online. Chinese and English language versions of the New Dynasty for Conquer Online were also launched in November and December 2008 respectively.

With an aim to further expand its business into overseas markets, the Group has licensed its own in-house developed online games in various countries where market opportunities are emerging. The flagship online games in different languages were launched to attract a larger user base worldwide. As a pioneer in the development of online gaming products, the Group has successfully entered markets where six different languages are spoken, including English, French and Spanish. The Group launched a traditional Chinese version of Eudemons Online and Zero Online in Hong Kong, Taiwan and Macau through collaborations with local business partners. Eudemons Online has also been translated into English and Portuguese versions as well, which had been launched in both the European and American markets. Zero Online was launched in Hong Kong and Macau market in the traditional Chinese version and the English version of this game began commercial operations in the United States of America (the "USA") in 2007. We have also began the operations of Eudemons Online and Zero Online in Thailand in Thai Version in 2008.

Games in the pipeline

The Group believes that strengthening its core competencies and creative design capability will facilitate the successful development of new online games. The Group also looked for opportunities to develop online games based on popular third party intellectual property. In 2008, the Group entered into cooperation with Disney Online, Inc., to develop Disney Fantasy Online which is expected to be launched in early 2009. It has become the most anticipated online game among players who are expecting a totally unique gaming experience.

During the year under review, the Group also made further inroads into the development of MMORPG. To this end, the Group entered into a cooperative agreement with EA for the development of its first 3D MMORPG Dungeon Keeper Online. The partnership with this internationally renowned game developer is proof of the Group's capabilities in game operations and development as well as a reflection of its market reputation.

Enhancement of R&D capabilities

As of 31 December 2008, the Group had increased its overall staff headcount to a total of 2,426, of which 1,465 are members of the development team. This was done in order to expand and diversify game offerings, while extending the market reach of its product portfolio and to further leverage the inherent advantages of vertical integration as a top developer and operator of online games. The Group's game development team blends the finest in programming, design and graphics expertise. This type of development will support our frequent game upgrades and updates to accommodate the latest player preferences and satisfy emerging market trends.

Corporate Milestones and Awards in 2008

Year 2008

	Corporate Milestones / Recognitions	Products Milestones / Awards
Jan	• TQ Digital was named "Top 10 Game Developers in China for 2007" by China Game Publisher Association ("CGPA") and General Administration of Press and Publication ("GAPP") • TQ Digital was named "The Research and Development Center for Software Technology in Fujian" by Fujian Information Industry Department • NetDragon (Fujian) was received the "Top 10 Game Operators of China for 2007", "Award for Overseas Development of Chinese Domestic Games for 2007" and "Outstanding Game Marketing Corporation" by CGPA and GAPP • NetDragon (Fujian) was named "Top 10 enterprises for the Software Industry in Fujian Province for 2007" by Fujian Information Industry Department and Fujian Provincial Bureau of statistics • NetDragon (Fujian) was named "Top 10 Game Developers in China for 2007" by QQ.com • NetDragon was ranked as one of the "200 Best Rising Enterprises of China for 2008" by Forbes China	• Heroes of Might and Magic Online was named amed "Most Anticipated Online Game for 2008" by CGPA and GAPP • Eudemons Online was awarded the "Most Popular Online Game for 2007", "Best MMORPG for 2007" and "Best Originality Award for 2007" by QQ.com • Way of the Five, Heroes of Might and Magic Online and Tou Ming Zhuang Online were awarded the "Most Anticipated Online Games for 2008" by QQ.com • Way of the Five was recognised as the "Excellent Online Game for juniors" by the Ministry of Culture, the PRC
Mar		• Traditional Chinese version of Eudemons Online was officially launched in Taiwan market
Apr	• NetDragon partnered with Industrial and Commercial Bank of China (ICBC) to issue the first "Peony NetDragon Credit Card" in China	• Traditional Chinese version of Zero Online was officially launched in Taiwan market • A new expansion pack "The Wings of the Ruler" for Eudemons Online was launched
May	• NetDragon became a constituent stock of MSCI China Index	• The new online game – Heroes of Might and Magic Online was officially launched

Year 2008

	Corporate Milestones / Recognitions	Products Milestones / Awards
Jun	• NetDragon successfully transferred to the Main Board of the Stock Exchange (stock code: 777)	
Sep	• NetDragon (Fujian) received the 2008 "China Internet Contribution Award for Self-Discipline" by Internet Society of China	
Oct	• NetDragon won "Economic Contribution Award" in the 6th China International Digital Content Expo Organised by the Ministry of Culture, the PRC	• Eudemons Online and Way of the Five were named among the "Top 10 Most Favourite Online Games" and "Top 10 Most Anticipated Online Games" respectively at the 2008 ChinaJoy Golden Plume Awards • A new expansion pack "Core Storm" for Zero Online was launched
Nov	• A delegation of committee leaders from the central government visited NetDragon's Fujian headquarters • NetDragon (Fujian) was named "The Best Cooperation Partner for E-Business of China Construction Bank, Fujian Branch" by China Construction Bank, Fujian Branch	• A new Chinese language expansion pack "An Ren Wei Ji" for Conquer Online was launched
Dec	• NetDragon held a press conference in Shanghai to announce the cooperative agreement with Disney Online, Inc. to develop the new online game – Disney Fantasy Online • NetDragon formed partnership with EA to develop a 3D MMORPG Dungeon Keeper Online	• A new English language expansion pack "New Dynasty" for Conquer Online was launched

Year 2009

	Corporate Milestones / Recognitions	Products Milestones / Awards
Jan	• NetDragon received Golden Phoenix Awards in the China Game Industry Annual Conference 2008 including: — "Top 10 Game Developers in China for 2008" — "Award for Overseas Development of Chinese Domestic Games for 2008" — "China Game Industry Annual Conference Special Award for 2008" — "China Game Industry Caring Company Award for 2008"	• Eudemons Online was named among the "Top 10 Most Popular Domestic Online Games for 2008" in the China Game Industry Annual Conference 2008 • Eudemons Online and Way of the Five were named "Top 10 Most Popular Online Games for 2008" in the Tencent Online Game Award List for 2008 • Tian Yuan was named among the "Top 10 Most Anticipated Online Game for 2008" in the Tencent Online Game Award List for 2008
	• NetDragon won the 2008 "National Outstanding Award for Internet Cultural Enterprise" conferred by the Ministry of Culture, the PRC	• Launched a new expansion pack "Divine Path" for Eudemons Online
Feb	• NetDragon was ranked as one of the "200 Best Rising Enterprises of China for 2009" by Forbes China • NetDragon licensed Zero Online in Vietnam through a partnership with Saigon Telecommunication and Technologies Corp	• Launched a new expansion pack "Expanding Horizons" for Zero Online

Notably, the Group was successfully listed on the Main Board of the Stock Exchange on 24 June 2008 under a new stock code of "777". This successful Main Board listing marks a key milestone in the development of NetDragon, which also recognises the Group's performance reflected in its overall remarkable growth in business. NetDragon became one of the constituent stocks of MSCI China Index in May 2008, which further bolstered the position of the Group on the international capital market.

One of the key challenges the Group faced during the year was the re-emergence of "private servers", which have adversely impacted overall business operations. Unauthorised individuals have illegally operated the Group's online games, especially the Eudemons Online franchise on private servers. These private server activities directly compete with the Group's operations, which has given rise to a decline in both con-currency levels and revenue generated from online games operations. During the year under review, the Group swiftly implemented a series of defensive and counter-attack measures to combat this issue. With support from both the Fujian and Fuzhou governments, the Group successfully defeated a number of private servers operating Eudemons Online nationwide.

(4) LIQUIDITY AND CAPITAL RESOURCES

For the year ended 31 December 2008, we had term deposits with initial term of over three months, cash on hand and at bank deposits of approximately RMB960.1 million as compared with approximately RMB1,700.1 million for the year ended 31 December 2007.

For the year ended 31 December 2008, the Group had cash deposited with an online payment service providers of approximately RMB1.4 million as compared with approximately RMB1.3 million for the year ended 31 December 2007.

For the year ended 31 December 2008, the Group had net current assets of approximately RMB1,321.1 million as compared with approximately RMB1,702.8 million for the year ended 31 December 2007.

(5) GEARING RATIO

As we did not have any interest bearing bank loans, our gearing ratio was zero as at 31 December 2008 and 31 December 2007.

(6) CAPITAL STRUCTURE

As at 31 December 2008, the Group's total equity amounted to approximately RMB1,453.8 million (2007: RMB1,769.4 million). Net current assets of the Group amounted to approximately RMB1,321.1 million (2007: RMB1,702.8 million).

(7) USE OF PROCEEDS FROM PLACING

As at 31 December 2008, the Group used approximately HKD149.5 million of net proceeds raised from the placing of the company's shares on GEM. Details of comparison between proposed applications and actual applications of net proceeds raised are set out in the section of "Report of the Directors" under the paragraph "Comparison of business objectives and actual business progress".

(8) FOREIGN CURRENCY RISKS

Our present operations are carried out in the PRC and USA. All our receipts and payments in relation to the operations are principally denominated in RMB and USD. In this respect, our Directors consider there is no significant currency mismatch in our operational cashflows and we are not exposed to any significant foreign currency exchange risk in our operation.

Most of the subsidiaries' functional currencies are RMB since majority of the revenues of the Group are derived from the operations in the PRC. RMB is not freely convertible into other foreign currencies and conversion of RMB into foreign currencies is subject to rules and regulation of foreign exchange control promulgated by the PRC Government. The Group also has operations in Hong Kong and USA and the business transactions conducted there during the year were mainly denominated and settled in HKD and USD, which are the functional currencies of the relevant subsidiaries. The exposure in exchange rate risks mainly arises from fluctuations in foreign currencies against the functional currency of the relevant Group entities. The Group currently does not have hedging policy in respect of the foreign currency risk. However, management monitors the related foreign currency risk exposure closely and will consider hedging significant foreign currency risk exposure should the need arises.

(9) CREDIT RISKS

Credit risk arises from term deposits with initial term of over three months, cash and cash equivalents, trade receivables, other receivables, loan receivables, amounts due from related parties, financial assets at fair value through profit or loss (please refer to note 24 of the Notes to the financial statements) and derivative financial instrument (please refer to note 25 of the Notes to the financial statements). As at 31 December 2008, the carrying amount of the above financial assets represents the Group's maximum exposure on credit risk.

Credit risk on trade receivables, other receivables, loan receivables and amounts due from related parties is minimised as the Group performs ongoing credit evaluation on the financial condition of its debtors and tightly monitors the ageing of the receivable balances. Follow up action is taken in case of overdue balances. In addition, management reviews the recoverable amount of the receivables individually or collectively at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts.

Credit risk on term deposits with initial term of over three months, cash and cash equivalents, financial assets at fair value through profit or loss and derivative financial instrument are mitigated as counterparties are banks or financial institutions with high credit ratings or reputable online payment service providers. With reference to the current economic situation, the Group will closely monitor the credit ratings for banks or financial institutions relating to the financial assets owned by the Group. In order to minimise the credit risk of the Group, we have diversified the financial assets in different banks or financial institutions and make sure the Company is in a healthy financial position which can provide adequate sources of funding as the Group's working capital.

(10) PROSPECTS AND OUTLOOK

Looking into 2009, the Group plans to further enhance its core game development capabilities, streamline its integrated model of operation, strengthen marketing efforts and channel management, expand its product mix and extend the life span of its online games in order to enhance the Group's revenue base.

The Group will continue to invest in the development of new and creative online games to attract and retain larger player bases. It also intends to develop new MMORPGs to expand its game portfolio. Currently, the Group has a number of online games in the pipeline, these include:

Tian Yuan

Tian Yuan is a 2.5D MMORPG with legendary ancient oriental settings. This game features a mythical world full of historical flavour, combining the most fashionable online gaming concept with glamorous Chinese fairy tales. This game is expected to be launched in first half of 2009.

Disney Fantasy Online

The Group signed a content development and distribution agreement with Disney Online, Inc. in January 2008. Based upon this agreement, the Group expects to develop a 2.5D MMORPG, which will feature certain Disney characters and intellectual property rights — such as a pre-determined selection of characters from amongst the Disney pantheon of animated characters as well as the thematic worlds in which such characters were set — as part of the game's non-player characters and virtual environments. The game is expected to be officially launched in early 2009.

Dungeon Keeper Online

The Group entered into licensing agreement with EA to develop the Group's first 3D MMORPG based on EA's Dungeon Keeper™ line of games. The Group also obtained the exclusive license to operate and distribute Dungeon Keeper Online throughout the Greater China region, including Hong Kong, Taiwan and Macau. Dungeon Keeper™ is a PC strategy game in which the players attempts to build and manage a dungeon or lair while protecting it from computer-controlled 'hero' characters intent on stealing the users' accumulated treasures and killing various monsters. The game was released by EA in 1997 which has gained positive market reaction and accumulated a sizable of player base. Dungeon Keeper Online is expected to be officially launched in 2010.

CJ7 Online

The Company had signed a content development and distribution agreement with Shanghai Baihai Information Technology Co., Ltd in developing and distributing a new online game namely CJ7 Online. CJ7 Online is being developed based on the theme, contents and characters of the same named movie "CJ7" and the Group has the right to distribute the game in the PRC.

Aside from developing more new game titles, the Group will also continue to focus on updating its existing MMORPGs. This will help provide weekly and quarterly updates for its existing games to include such features as new virtual items and tasks. The Group will also further strengthen its online security and employ defensive measures to prevent the emergence of private servers while reducing any potential negative impact.

The Group is striving to further expand its player base by working with local game operators to selectively offer its in-house developed online games to other markets. It will continue to pursue myriad opportunities to create online games based upon popular third-party intellectual property.

The Group believes that rapid and high-quality game development is critical to its success. It will continue to invest in, and significantly expand its game development capabilities through the recruitment of experienced, top quality game developers and designers. These updates will improve its games' appeal and help maintain their marketability.

Furthermore, the Group will engineer its game development automation software to replace certain manual and repetitive tasks, which should lead to improved efficiency in the game development process. Additional computers and software will be purchased to accelerate game development procedures. In addition, the Group has also invited professionals from different industries and professions to lead technical training sessions for the game development team to strengthen their development and design capabilities. With a modified and enhanced game development platform and professional game development team, the Group will be able to lay a solid foundation to rapidly and frequently develop and introduce new online games and updates to its existing games.

CORPORATE CULTURE AND SOCIAL RESPONSIBILITIES

CORPORATE CULTURE

NetDragon is an ambitious company with unique corporate culture which emphasises the importance of teamwork. After years of operation, NetDragon has established its own corporate culture. "Learning", "Innovation", "Sincerity" and "Happiness" are the elements of our corporate culture valued by each employee of NetDragon. With an ultimate goal of achieving sustainable growth driven by creativity and innovative ideas, NetDragon established the Department of Innovation Management in October 2008. It has formulated a set of innovation management guideline and theory as well as rewarding scheme to advocate creativity within the Group.

Developed based on the NetDragon's history and its principals of product innovation over the past, the new Innovation Theory consists of five major procedures:

1. Collection and discussion of new and innovative ideas (草船借「見」)
2. Seeking recommendations from professionals (拋「專」引玉)
3. Setting up programmes to carry out the ideas (創新「結」龍)
4. Introduction of reward scheme for creative ideas (開「新」有獎)
5. Share the results of the ideas (開「心」分享)

Facing the ever-changing market challenges and opportunities, NetDragon evolves continuously based on the two principles of "Human Resource Development" and "Provide Happy Experience to Customers". NetDragon creates a "wonderland" full of joy to be shared by our staff, customers and partners.

"Learning"

"Learning" can improve the competitiveness of NetDragon. Learning is beneficial to personal lifelong pursuits and is essential to an organisation's sustainable development. Learning can also enhance the value of staff and the competitiveness of the Group, which lends to the development of both the staff and the Group.

"Innovation"

Innovation is one of the element of NetDragon's corporate culture. In the Internet era, we pursue excellence and we yearn for excellent accomplishments through innovations.

"Sincerity"

Sincerity is a basic value shared among the members of NetDragon. Sincerity is necessary in virtual world. NetDragon appreciates frankness. We care about "What is right" instead of "Who is right". We share the sense of belonging.

"Happiness"

Happiness is our basic value. Creative industry aims to produce happiness. People yearn for happiness which is one of the desired outcome for personal communication. Happiness in NetDragon comes from sense of growth by learning, sense of accomplishments by innovation and sense of belonging through sincere relationship among all staff of NetDragon.

"Learning", "Innovation" and "Sincerity" evolve from "Happiness" which in return create happiness. We believe that enjoyable games can only be developed in happy working environment. Happiness is passed to players, the network community as well as the real world.

CORPORATE SOCIAL RESPONSIBILITIES

As one of the leading online game developers and operators in China, NetDragon prides itself on being widely recognized as a responsible corporate citizen. We aim to develop and market creative and innovative online gaming products while at the same time maintaining our deep commitment to the well-being of the community and our employees.

The Group has been actively engaged in a number of charitable events over the past year, including some of which were initiated by our own. The Group established the NetDragon Charity Committee in Fuzhou headquarter in June 2008 to carry out community and charity work. In 2008, the committee organized many events such as: blood donation, clothing donations as well as visits to elderly and orphan centres to offer support and care to the communities in which we operate. In addition, the Group donated a total of RMB3 million in cash and goods to aid the victims and support the recovery work, following the disastrous Sichuan earthquake in May 2008.

The Group is committed to promoting a healthy Internet culture and supports social morality within China's online gaming industry. The Group continued to implement various measures including enforcement of anti-addiction systems in online games in accordance with relevant industry standards. Moreover, it has launched a "Green Internet Access Programme for Youths" to facilitate a better understanding of Internet culture among young people. The Group also advocates protection of intellectual property and continuously strives to promote healthy expansion and development within the Internet and online gaming sector in China.

In order to cultivate a spirit of business and entrepreneurship among young people, the Group established the "Fujian NetDragon Youth Business Foundation" to provide free training programmes as well as marketing and promotional support to help young people start their own business ventures. In addition, in recognition of the Group's continuous efforts to foster harmonious economic and social development in China, NetDragon (Fujian) received the 2008 "China Internet Contribution Award for Self-Discipline" from the Internet Society of China, as well as winning the "2008 National Outstanding Award for Internet Cultural Enterprise" sponsored by Ministry of Culture, the PRC.

STAFF RELATIONSHIPS AND WELFARE

HUMAN RESOURCES

The Group considers human resource talent as our most valuable asset and vital to our overall business development. In order to expand and diversify its game offerings, extend the reach of its products in existing and new markets and further leverage the inherent advantages of vertical integration as a developer and operator of online games, the Group has increased its overall staff headcount to a total of 2,426 as at 31 December 2008. This compares with a total of 788 as of 31 December 2007.The Group has engaged a leading international management consultancy firm which helped the Group to define new strategies in human resources planning as well as organizational restructuring in order to optimise internal management within the Group. A set of new policies related to recruitment planning, staff remuneration, staff motivation and inter-departmental cooperation was introduced to encourage better allocation of human resources and further enhance staff welfare.

During the year under review, the Group had recruited talented graduates to enlarge its development team from a total of 22 universities in 11 major cities in the PRC, including Beijing, Shanghai, Shenyang, Wuhan, Chongqing, Tianjin, Hangzhou, Fuzhou, Xiamen, etc, .

To attract and retain talented employees, we have adopted the following strategies:

Training

The Group provides various in-house training programmes for staff of all levels and functions. New recruits receive orientation training to learn the four pillars of corporate culture at NetDragon – "Learning", "Innovation", "Sincerity" and "Happiness" with the aim of providing them with the most enjoyable work experience and help them join the NetDragon family in the fastest and easiest way. The Group also provides regular on-the-job training by organising courses that are well received by the staff. Professionals from different industries and professions lead training programmes, including management, marketing, human resources management and organisational behavior to enhance the managerial skills and professional standards of its workforce.

Training System

Staff training is crucial to the Group's human resources management and development. The Group's training center is called NetDragon University. Founded in 2007, NetDragon University is the first university established by an enterprise in the domestic online games industry. As the base for training talents for the strategic development of the Group, the university so far has four colleges and a development group, namely Games College, Business College, New Employees College, Growth College and E-Learning Development Group respectively, which provide our staff a wide variety of tailored training programs with features.

- Games College: the base for training talents at all levels in the online games industry
- Business College: the hub for training veterinarian management of the Group
- New Employees College: the cradle for instilling corporate culture and for the growth of new employees
- Growth College: Mind opening, team building and nurturing a happy working environment
- E-Learning Development Group: the best platform for training management staff

Working Environment

We provide all our staff with a friendly and enjoyable work environment which is spacious and offers diversified staff facilities, including a 24-hour canteen, activities rooms, swimming pool and fitness centre. Such pleasant work place not only improves the sense of belonging among our staff, but also helps enhance their efficiency and creativity. We also provide extra care to our staff by supplying healthy beverages on a daily basis as well as organising various staff activities like the 9.1 Revelry Festival, Sports Day and New Year Gala.

DIRECTORS AND SENIOR MANAGEMENT

EXECUTIVE DIRECTORS

Liu Dejian, aged 37, Chairman, Executive Director

Mr. Liu led us to become one of the PRC's leading online game development companies. He is mainly responsible for our overall business strategic development and is the chief game designer of our game development team. Mr. Liu leads the game development team on the design of our online game products. He formulates our development policy and contributes to our growth as a competitive online game developer and operator. Apart from his management and leadership, Mr. Liu constantly holds training seminars to further enhance the development of our human resources. Prior to starting NetDragon (Fujian), Mr. Liu graduated with a Bachelor's degree of Science in Chemistry from University of Kansas in the USA in 1995. He had been the vice-president of Beso Biological Research Centre, Inc. ("Beso") from 1995 to 2005. He was also the vice-president of Fuzhou Yangzhenhua 851 Bio-Engineering Research Inc. ("Fuzhou 851") from 1995 to 2000 and then promoted to be the president since 2001. Mr. Liu was first introduced to the technology of Internet during his study in the USA when he established a website for marketing of softwares. Anticipating that Internet would have a good development opportunity in the PRC, he founded NetDragon (Fujian) in 1999 when he came back to the PRC. He was awarded as Most Influential Person within the Online Game Industry in China for 2007（2007年度中國遊產業最具影響力人物）in the Chinese Game Industry Annual Conference 2007 in January 2008. He was appointed as vice-chairman of Fujian Province Association of Youth Entrepreneur in April 2006. He also obtained Fujian Youth Entrepreneur Achievement Award in April 2005, Go Tone Fujian IT Industry Top 10 Outstanding Youth in May 2005 and Certificate of Fujian Entrepreneurial Tutor of the Chinese Youth Business International Programme in June 2005. Mr. Liu is a brother of Liu Luyuan and a cousin of Zheng Hui.

Liu Luyuan, aged 35, Executive Director, Chief Executive Officer and one of the authorised representatives of the Company

Mr. Liu has over 10 years of experience in management and administration of technical institutions. Mr. Liu is mainly responsible for the overall management of the Group. Mr. Liu established the project management department and introduced the game project management system to ensure the standard of our games are in compliance with the standards. Mr. Liu is also responsible for the coordination with the governmental departments, media and the other external parties, under which he has built up our good reputation over years. Prior to joining us in 1999, Mr. Liu was the technical engineer of the information technology system project in Fujian Tumour Hospital and the section officer of the mechanic management system project in Fujian Provincial Health Bureau from 1997 to 1999. He was awarded as Online Game Pioneer in China for 2007（2007年度中國遊戲產業新銳人物）in Chinese Game Industry Annual Conference 2007 in January 2008. Mr. Liu graduated with a Bachelor's degree in Electronic and Mechanical Engineering from the University of Electronic Science and Technology in Chengdu in 1997. Mr. Liu is a brother of Liu Dejian and a cousin of Zheng Hui.

Zheng Hui, aged 40, Executive Director

Mr. Zheng is our Director responsible for the overall management and administration of the Group. Mr. Zheng manages our administrative department and provides supporting resources to our operation. Mr. Zheng also coordinates, supervises and manages the duties of our various departments. Mr. Zheng has more than 20 years of management and administration experience. He is one of the founding shareholders and has been appointed as the senior executive manager in NetDragon (Fujian) since 1999. Mr. Zheng is also the legal representative and executive director of Shanghai Tiankun Digital Technology Ltd ("NetDragon (Shanghai)") since 2004. Before founding NetDragon (Fujian) in 1999, Mr. Zheng worked in Beso and Fuzhou 851 from 1992 to 1999. He obtained a graduation certificate from the Continuing Education Institute of Beijing Normal University in 2000. Zheng Hui is the cousin of Liu Dejian and Liu Luyuan.

Chen Hongzhan, aged 36, Executive Director, Vice President, Chief Technology Officer

Mr. Chen is our chief technology officer. He worked as a game developer before joining the Group in 2001. The technical team led by Mr. Chen is responsible for the development procedure of our games and the technical supports to the production of our games. His technical supports and experience have raised the efficiency and quality of our game development department. He is an experienced online game developer with over 10 years of experience in the management of game development. He is mainly responsible for game development of our Company. Mr. Chen established his own online game studio from 1996 to 1998. Before joining us in 2001, Mr. Chen worked as the project manager in Chongqing Dazhong Software Company from 1998 to 2000 and a director in the online game department in Beijing Beijibing Technology Development Company Limited from 2000 to 2001. Mr. Chen graduated with a Bachelor's degree in Mechanical-Electrical Integration from the Beijing University of Aeronautics and Astronautics in 1995.

NON-EXECUTIVE DIRECTOR

Lin Dongliang, aged 46, Non-executive Director

Mr. Lin graduated with a Master's degree in Engineering Management in 1988 from Tsinghua University. He joined IDG Technology Venture Investment Inc. as its vice president in 1994, and has served as a general partner of IDG Technology Venture Investment since 1999. He has over 14 years of experience in venture investment. He was nominated by the IDG Group to the Board and was appointed as a non-executive Director on 15 December 2004. Since July 2002, Mr. Lin has been a non-executive director of Superdata Software Holdings Limited, a company previously listed on GEM from 6 June 2003 to 18 May 2006 upon its withdrawal.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Chao Guowei, Charles, aged 43, Independent non-executive Director

Mr. Chao was appointed as an independent non-executive Director on 15 October 2007. Mr. Chao is also the chairman of the audit committee, a member of our remuneration committee and nomination committee. Mr. Chao is the chief executive officer and director of SINA Corporation, a publicly listed company in Nasdaq. He has served as an experienced audit manager in PricewaterhouseCoopers LLP to provide audit and business consulting services for companies in Silicon Valley, California. He joined SINA Corporation as a vice president of finance in 1999 and has served as its co-chief operating officer, president and chief financial officer before his current position as the chief executive officer. He is a certified public accountant and a member of the American Institute of Certified Public Accountants. Mr. Chao is also a director of Focus Media Holding Limited, a publicly listed company in Nasdaq, and E-House (China) Holdings Limited, a company listed on the New York Stock Exchange. Mr. Chao graduated with a Master's degree in Professional Accounting from the University of Texas at Austin in 1993, a Master's degree in Journalism from the University of Oklahoma in 1991 and a Bachelor's degree in Journalism from the Fudan University in 1988.

DIRECTORS AND SENIOR MANAGEMENT

Lee Kwan Hung, aged 43, Independent non-executive Director

Mr. Lee was appointed an independent non-executive Director on 15 October 2007. He is a partner of Woo, Kwan, Lee & Lo and the chief representative of Woo, Kwan, Lee & Lo's Beijing Office. Mr. Lee received his LL.B (Honours) degree and Postgraduate Certificate in Laws from the University of Hong Kong in 1988 and 1989 respectively. He was then admitted as a solicitor in Hong Kong in 1991 and in England and Wales in 1997. Mr. Lee is currently a non-executive director of GST Holdings Limited and an independent non-executive director of GZI REIT Asset Management Limited (being the manager of GZI Real Estate Investment Trust) and Embry Holdings Limited, the shares of these companies are listed on the Stock Exchange. From 1 February 2000 to 31 December 2008. Mr. Lee was also a non-executive director of Mirabell International Holdings Limited, whose listing status on the Stock Exchange was withdrawn on 22 September 2008. Besides, Mr. Lee had been an independent non-executive director of China Mining Resources Group Limited (formerly known as Innomaxx Biotechnology Group Limited) from 31 May 2005 to 7 February 2007, whose shares are listed on the Stock Exchange. Save as disclosed, in the three years preceding the Latest Practicable Date, Mr. Lee did not hold any directorship in other listed public companies or any major appointments.

Liu Sai Keung, Thomas, aged 36, Independent non-executive Director

Mr. Liu is the managing director of strategic investments of GroupM China. He was appointed as an independent non-executive Director in 15 October 2007. Mr. Liu is also the chairman of our nomination committee, a member of our audit committee and remuneration committee. He graduated with a MBA degree from The Anderson School at the University of California, Los Angeles, and a Bachelor's degree in Business Administration and a Master's degree in Finance from The Chinese University of Hong Kong in 1995 and 1999, respectively. He worked in Swire Pacific Limited from 1995 to 1999 and left as the marketing manager of its motor division. Prior to joining GroupM China in 2007, he served as a director in the Beijing office of Tom Online Limited, and a manager in the business development department of Tom Group Limited from 2003 to 2004. He has also served as an associate in the Investment Banking division of the New York office of Lehman Brothers Inc. and as a vice-president of Star Group China.

SENIOR MANAGEMENT

Wu Chak Man, aged 37, Vice President, Chief Financial Officer, General Manager of NetDragon (Shanghai)

After joining us in January 2004, Mr. Wu has been responsible for sales and marketing in the PRC, the overseas business development and the operations in the USA. He is currently responsible for our corporate finance and financial management matters. Mr. Wu graduated with a Bachelor's degree in Economics from the University of California, Berkeley in 1994, and a Master's degree in business administration from Duke University in 2004. He has over 10 years of experience in business and management experience. He was the vice-president in the marketing of Beso from 1995 to 1999. From 2000 to 2002, he was the Chief Operating Officer of Octant Communications Inc.

Wu Jialiang, aged 32, Vice President, Director of TQ Digital and NetDragon (Fujian)

He graduated with a Bachelor's degree in Applied Mathematics from the University of Fuzhou in 1999. He has over 10 years of experience in system management, server operation and anti-hacking. After joining us in 1999, he is responsible for the maintenance of game servers to ensure the timely application and implementation of advanced network technology. Mr. Wu has been the responsible officer in our technical department, value-added business department and VIP management centre.

Rhee Kwanwoo, James, aged 41, Vice President, Corporate Development

Mr. Rhee joined us in June 2008 and is responsible for investor relations and strategic planning of the Group. Before joining us, Mr. Rhee was an equities analyst with Bear Stearns in Hong Kong and Dresdner Kleinwort Benson in Seoul, and had previously served as an attorney for corporations in Seoul and Singapore. He graduated with a Bachelor's degree in East Asian Studies from Wesleyan University in 1989 and a Juris Doctorate from The University of Connecticut School of Law in 1995. He is a Chartered Financial Analyst and is admitted to practice law in the state of New York.

QUALIFIED ACCOUNTANT AND COMPANY SECRETARY

Tam Hon Shan, Celia, aged 36, Financial Controller, Company Secretary, Qualified Accountant and one of the authorised representatives of the Company.

Ms. Tam joined us in April 2007 and is responsible for the financial and accounting management and secretarial affairs of the Company. She graduated with a Bachelor's degree in business accounting from the University of Lincolnshire and Humberside in 2000. She is a member of Association of Chartered Certified Accountants and Hong Kong Institute of Certified Public Accountants. She has over 10 years of experience in accounting and finance field.

REPORT OF THE DIRECTORS

The Directors have pleasure in presenting the annual report and the audited financial statements of the Group for the year ended 31 December 2008.

PRINCIPAL ACTIVITIES

The Company was incorporated in the Cayman Islands as an exempted company with limited liability on 29 July 2004 and is an investment holding company. Its shares were listed on the Main Board of the Stock Exchange on 24 June 2008.

The Group is principally engaged in online game development, including game design, programming and graphics, and online game operation.

Details of the principal activities of the Company's subsidiaries are set out in note 20 of Notes to the Financial Statements.

RESULTS AND APPROPRIATIONS

The results of the Group and appropriations of the Company for the year ended 31 December 2008 are set out in the Consolidated Income Statement on page 69.

The interim dividend of HKD 0.1 per share amounting to approximately HKD47,496,000 for the six months ended 30 June 2008 had been approved by the Directors at the Board meeting and was subsequently paid on 16 September 2008.

The Directors now recommend the payment of a final dividend of HKD0.11 per share. The final dividend is expected to be payable on or around 22 April 2009 to shareholders on the register of members of the Company on 16 April 2009, amounting to approximately HKD58,142,795.

PROPERTY, PLANT AND EQUIPMENT

During the year, the Group acquired buildings situated outside Hong Kong at a cost of approximately RMB2,081,000, motor vehicles at a cost of approximately RMB1,727,000 and computer equipment at a cost of approximately RMB53,697,000.

Details of these and other movements in the property, plant and equipment of the Group during the year set out in note 16 of Notes to the Financial Statements.

SHARE CAPITAL

Details of movements of the Company's issued share capital are set out in note 29 of Notes to the Financial Statements.

RESERVES

Movements in the reserves of the Company and of the Group during the year are set out in note 31 of Notes to the Financial Statements and the Consolidated Statement of Changes in Equity respectively.

DISTRIBUTABLE RESERVES OF THE COMPANY

As at 31 December 2008, the Company's reserves available for distribution to shareholders were approximately RMB52,117,000 (2007: RMB216,474,000), which comprises the dividend reserve of approximately RMB51,275,000 (2007: RMB216,093,000) and retained profit of approximately RMB842,000 (2007: RMB381,000) of the Company.

MAJOR CUSTOMERS AND SUPPLIERS

The aggregate turnover attributable to the Group's five largest customers accounted for 5.9% of the Group's total turnover for the year. The aggregate purchases attributable to the Group's five largest suppliers and the Group's largest supplier accounted for 88.5% and 37.2% respectively of the Group's total purchase for the year.

None of the Directors, their associates, or shareholders (which to the knowledge of the Directors owned more than 5% of the Company's share capital) had any beneficial interest in the Group's five largest suppliers and customers during the year.

DIRECTORS AND DIRECTORS' SERVICE CONTRACTS

The Directors of the Company during the year were as follows:

Executive Directors:

Mr. Liu Dejian *(Chairman)*
Mr. Liu Luyuan *(Chief Executive Officer)*
Mr. Zheng Hui
Mr. Chen Hongzhan

Non-executive Directors:

Mr. Lin Dongliang
Mr. Zhu Xinkun (retired on 28 April 2008)

Independent non-executive Directors:

Mr. Chao Guowei, Charles *(Note 1, 2, 3, 5)*
Mr. Lee Kwan Hung *(Note 1, 3, 4, 5, 7, 8)*
Mr. Liu Sai Keung, Thomas *(Note 1, 3, 5, 6, 7)*

Notes:

1. Member of Audit Committee
2. Chairman of Audit Committee
3. Member of Remuneration Committee
4. Chairman of Remuneration Committee
5. Member of Nomination Committee
6. Chairman of Nomination Committee
7. Member of Share Award Scheme Committee
8. Chairman of Share Award Scheme Committee

DIRECTORS AND DIRECTORS' SERVICE CONTRACTS (Cont'd)

Each of the executive Directors has entered into a service contract with the Company and each of the non-executive and independent non-executive Directors has entered into an appointment letter with the Company, all for an initial term of three years commenced on 24 June 2008 and renewable automatically for successive terms of one year each commencing from the day next after the expiry of the then current term unless and until terminated in accordance with the terms of the service contract or by either party thereto giving to the other not less than three months' prior written notice. Each of the executive Directors will receive a salary which is subject to annual review at the discretion of the Board.

The salary payable to the each of the Directors may, subject to shareholders' approval in general meeting, be revised by the Board each year as result of which the above rates may or may not be increased but, in any event, any increase shall not exceed 25% of the annual salary paid to the Director in the previous year.

Each of the executive Directors may also be entitled to a bonus payment in such amount as shall be determined by the Board in its absolute discretion provided that the aggregate sum of such bonus payments in any financial year shall, unless the Board shall determine otherwise, not exceed 1% of the audited consolidated net profit of the Company after taxation but before extraordinary items in the relevant financial year.

In accordance with the article of association of the Company, Zheng Hui,Lin Dongliang and Lee Kwan Hung will retire by rotation at the forthcoming annual general meeting ("AGM"). Zheng Hui, Lin Dongliang and Lee Kwan Hung, being eligible, will offer themselves for re-election at the forthcoming AGM of the Company. None of the Directors proposed for re-election has a service contract with the Company or any of its subsidiaries which is not determinable by the Company within one year without payment of compensation (other than statutory compensation).

The Company has received annual confirmations of independence from Mr. Chao Guowei, Charles, Mr. Lee Kwan Hung and Mr. Liu Sai Keung, Thomas and considers them to be independent.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

The listing of the Company was successfully transferred to the Main Board of the Stock Exchange on 24 June 2008. As at 31 December 2008, the interests and short positions of the Directors and chief executive of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chaper 571 of the Laws of Hong Kong) ("SFO"), which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under provisions of the SFO), or which were recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO, or which were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") set out in Appendix 10 to the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"), to be notified to the Company and the Stock Exchange are as follows:

Name of Director	Name of company	Capacity and nature of interests	Number of shares held or amount of registered capital contributed *(Note 1)*	Approximate percentage of shareholding
Liu Dejian *(Note 2)*	The Company	Through controlled corporations	280,634,540 (L)	53.09%
Liu Dejian *(Note 3)*	NetDragon (Fujian)	Beneficial owner	RMB9,886,000 (L)	98.86%
Liu Dejian *(Note 3)*	NetDragon (Shanghai)	Beneficial owner and through a controlled corporation	RMB1,000,000 (L)	100.00%
Liu Luyuan *(Note 2)*	The Company	Through controlled corporations	280,634,540 (L)	53.09%
Liu Luyuan *(Note 3)*	NetDragon (Fujian)	Beneficial owner	RMB9,886,000 (L)	98.86%
Liu Luyuan *(Note 3)*	NetDragon (Shanghai)	Beneficial owner and through a controlled corporation	RMB1,000,000 (L)	100.00%
Zheng Hui *(Note 2)*	The Company	Through controlled corporations	280,634,540 (L)	53.09%
Zheng Hui *(Note 3)*	NetDragon (Fujian)	Beneficial owner	RMB9,886,000 (L)	98.86%
Zheng Hui *(Note 3)*	NetDragon (Shanghai)	Beneficial owner and through a controlled corporation	RMB1,000,000 (L)	100.00%
Chen Hongzhan *(Note 4)*	The Company	Through a controlled corporation	13,900,000 (L)	2.63%
Chao Guowei, Charles	The Company	Beneficial owner	49,255 (L)	0.01%
Lee Kwan Hung	The Company	Beneficial owner	49,255 (L)	0.01%
Liu Sai Keung, Thomas	The Company	Beneficial owner	49,255 (L)	0.01%

Notes:

1. The letter "L" denotes the shareholder's long position in the share capital of the relevant member of the Group.

2. Liu Dejian is interested in 95.40% of the issued share capital of DJM Holding Ltd., which in turn is interested in 35.01% of the issued share capital of the Company.

   Liu Luyuan is interested in 100.00% of the issued share capital of Richmedia Holdings Limited, which in turn is interested in 4.98% of the issued share capital of the Company.

   Zheng Hui is interested in 4.60% and 100.00%, respectively, of the issued share capital of DJM Holding Ltd. and Fitter Property Inc., which in turn is interested in 35.01% and 6.72%, respectively, of the issued share capital of the Company. Zheng Hui owns the voting rights in respect of all the issued shares of Flowson Company Limited. Flowson Company Limited is interested in 100.00% of the issued share capital of Eagle World International Inc., which in turn is interested in 6.38% of the issued share capital of the Company.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES (Cont'd)

Notes: (Cont'd)

Liu Dejian is a brother of Liu Luyuan and a cousin of Zheng Hui who have agreed to act in concert to acquire interests in the shares in the Company. All of Liu Dejian, Liu Luyuan and Zheng Hui are deemed to be interested in 53.09% of the issued share capital of the Company through their direct and deemed shareholding in all of DJM Holding Ltd., Richmedia Holdings Limited, Fitter Property Inc. and Eagle World International Inc.

3. Liu Dejian, Liu Luyuan and Zheng Hui are interested in 96.05%, 2.11% and 0.70%, respectively, of the registered capital of NetDragon (Fujian), which in turn is interested in 99.00% of the registered capital of NetDragon (Shanghai). Zheng Hui is directly beneficially interested in 1.00% of the registered capital of NetDragon (Shanghai). Liu Dejian is a brother of Liu Luyuan and a cousin of Zheng Hui who have agreed to act in concert to acquire interests in the registered capital of NetDragon (Fujian). All of Liu Dejian, Liu Luyuan and Zheng Hui are deemed to be interested in 98.86% of the registered capital of NetDragon (Fujian) and the entire registered capital of NetDragon (Shanghai) through their deemed and direct shareholding in NetDragon (Fujian) and deemed and direct shareholding in NetDragon (Shanghai).

4. Chen Hongzhan is interested in 99.00% of the issued share capital of Cristionna Holdings Limited, which in turn is interested in 2.63% of the issued share capital of the Company. Chen Hongzhan is deemed to be interested in 2.63% of the issued share capital of the Company through his shareholding in Cristionna Holdings Limited.

Save as disclosed above, to the best knowledge of the Directors, as at 31 December 2008, none of the Directors and chief executive of the Company had any interest and short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO), or which were recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO, or which were required, pursuant to the Model Code, to be notified to the Company and the Stock Exchange.

DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

Save as disclosed under the paragraph headed "CONNECTED TRANSACTIONS" stated in this report and note 32 of the Notes to the Financial Statements, no contracts of significance in relation to the Company's business, to which the Company was a party and in which a Director had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND OTHER PERSONS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

The listing of the Company was transferred to the Main Board of the Stock Exchange on 24 June 2008. So far as is known to the Directors, as at 31 December 2008, the following persons (other than a Director or chief executive of the Company) had, or were deemed or taken to have interests or short positions in the shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or which were recorded in the register required to be kept by the Company under Section 336 of the SFO, or who were directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group are as follows:

Name	**Name of Group member**	**Capacity and nature of interests**	**Number of ordinary shares held or amount of registered capital contributed** *(Note 1)*	**Approximate percentage of shareholding**
DJM Holding Ltd.	The Company	Beneficial owner	185,078,100 (L)	35.01%
Fitter Property Inc.	The Company	Beneficial owner	35,498,720 (L)	6.72%
Eagle World International Inc. *(Note 2)*	The Company	Beneficial owner	33,712,920 (L)	6.38%
Flowson Company Limited *(Note 2)*	The Company	Through a controlled corporation	33,712,920 (L)	6.38%
IDG Group *(Note 3)*	The Company	Beneficial owner and through controlled corporations	78,333,320 (L)	14.83%
NetDragon (Fujian)	NetDragon (Shanghai)	Beneficial owner	RMB990,000 (L)	99.00%

Notes:

1. The letter "L" denotes the shareholder's long position in the share capital of the relevant member of the Group.

2. Eagle World International Inc. is an investment holding company incorporated on 7 May 2007 in the British Virgin Islands ("BVI") with limited liability and is owned as to 100.00% by Flowson Company Limited. Flowson Company Limited is deemed to be interested in 6.38% of the issued share capital of the Company through its shareholding in Eagle World International Inc.

SUBSTANTIAL SHAREHOLDERS' INTERESTS AND OTHER PERSONS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES (Cont'd)

Notes: (Cont'd)

3. The IDG Group is comprised of four limited partnerships, namely IDG Technology Venture Investments, L.P., IDG-Accel China Growth Fund L.P., IDG-Accel China Growth Fund-A L.P. and IDG-Accel China Investors L.P., being interested in approximately 2.06%, 9.84%, 2.01% and 0.92%, respectively, in the Company who are deemed to be acting in concert to acquire interests in the Company, and their respective controlling entities. The controlling structure of each of the above partnerships are as follows:

    a) IDG Technology Venture Investments, L.P. is controlled by its sole general partner, IDG Technology Venture Investments, LLC, which in turn is controlled by its managing members, Zhou Quan and Patrick J. McGovern.

    b) IDG-Accel China Growth Fund L.P. and IDG-Accel China Growth Fund-A L.P. are controlled by their sole general partner, IDG-Accel China Growth Fund Associates L.P., which in turn is controlled by its sole general partner, IDG-Accel China Growth Fund GP Associates Ltd. IDG-Accel China Growth Fund GP Associates Ltd. is held as to 35.00% by each of Zhou Quan and Patrick J. McGovern.

    c) IDG-Accel China Investors L.P. is controlled by its sole general partner, IDG-Accel China Investor Associates Ltd., which in turn is held as to 100.00% by James W. Breyer.

Save as disclosed above, the Directors are not aware of any persons (other than a Director or chief executive of the Company) who had, or were deemed or taken to have interests or short positions in the shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO, or which were recorded in the register required to be kept by the Company under Section 336 of the SFO, or who were directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group as at 31 December 2008.

CONNECTED TRANSACTIONS

STRUCTURE CONTRACTS

Cooperation Framework Agreement

With a view to offer further protection to the interests of the Company and the shareholders as a whole by means of contractual arrangements, TQ Digital and NetDragon (Fujian) and its equity holders entered into the structure contracts (together with the contracts entered into between NetDragon (Fujian) and Fujian TQ Online Interactive Inc. ("TQ Online") as set out below, "Structure Contracts"), which superseded the cooperation arrangements between TQ Digital and NetDragon (Fujian) effective from 1 January 2007.

In view of the new enterprise income tax law adopted by the National People's Congress of the PRC on 16 March 2007, a wholly foreign owned enterprise, TQ Online, has been set up to gradually substitute TQ Digital in our operation. TQ Online has entered into the Structure Contracts with NetDragon (Fujian) on 16 May 2008. As TQ Digital is and will still be the party operating the existing versions of the Group's online games, all Structure Contracts entered into between TQ Digital and NetDragon (Fujian) will not be replaced by the Structure Contracts entered into between TQ Online and NetDragon (Fujian).

Under the Structure Contracts, NetDragon (Fujian) is responsible to collect the revenue generated from the operation of the games. Through the Structure Contracts, we are able to recognize and receive the economic benefits of the business and operations of NetDragon (Fujian). The Structure Contracts enable TQ Digital and TQ Online to control over and to acquire the equity interests in and/or assets of NetDragon (Fujian) when permitted by the relevant PRC laws and regulations.

On 15 October 2007, TQ Digital and NetDragon (Fujian) entered into a cooperation framework agreement (the "Cooperation Framework Agreement") pursuant to which TQ Digital and NetDragon (Fujian) agreed to cooperate in the provision of services relating to the online game development for and the operation of the online game business of NetDragon (Fujian). The Cooperation Framework Agreement and the terms of reference of the management committee (the "Management Committee") laid down the principles that the Management Committee shall have right to determine the amount of license and service fees payable by NetDragon (Fujian) with reference to the amount of expenditure incurred by NetDragon (Fujian) in the conduct of its business and operations and its working capital requirements, including the guiding principles that (i) NetDragon (Fujian) shall pay the maximum amount of fees to TQ Digital without incurring any loss for each financial year; and (ii) the net asset value of NetDragon (Fujian) shall not exceed its net asset value as at 31 December 2006, being approximately RMB15,000,000. Further details of Management Committee are set out in the section of "Corporate Governance Report" under the paragraphs of "Management Committee". This principle will ensure that all of the net profit after tax of NetDragon (Fujian) in each financial year shall be paid to TQ Digital as service or license fees, and will give flexibility to the Management Committee to implement the Structure Contracts and its underlying principles more effectively in response to constantly changing PRC laws and regulation.

On 16 May 2008, TQ Online and NetDragon (Fujian) entered into another corporation framework agreement with the same terms as the original Cooperation Framework Agreement, save as to the date, duration and the substitution of TQ Digital by TQ Online. The term of such cooperation framework agreement is 10 years commenced from 16 May 2008 and ending on 15 May 2018, and automatically renewable for successive 10-year terms provided that TQ Online does not issue any notice of termination one month before the termination date.

As a result of the Structure Contracts, TQ Digital and TQ Online are able to control NetDragon (Fujian) and NetDragon (Shanghai), and accordingly, they are regarded as our subsidiaries and their results are to be consolidated into our financial statements. Since NetDragon (Fujian) and NetDragon (Shanghai) were under the common control of the same group of persons before and after our formation, the results and financial positions of NetDragon (Fujian) and NetDragon (Shanghai) are combined into our financial statements using merger accounting as if NetDragon (Fujian) and NetDragon (Shanghai) were part of us since their respective date of establishment or since the date when they first came under the common control.

CONNECTED TRANSACTIONS (Cont'd)

STRUCTURE CONTRACTS (Cont'd)

Cooperation Framework Agreement (Cont'd)

In accordance with the terms of the Cooperation Framework Agreements, TQ Digital and TQ Online (where relevant) entered into (1) cooperation and license agreements in respect of online games; (2) online games software development service agreements; and (3) technical support service agreements with NetDragon (Fujian), for the purpose of license, development of online games and provision of technical services to NetDragon (Fujian). Details of the agreements are set out below:

Date of agreement signed	Name of agreement	Summary of agreement	Terms of agreement
15-10-2007 and 20-11-2007	Cooperation and license agreements in respect of online games	TQ Digital will license online game softwares to NetDragon (Fujian) for use in PRC	• 10 years commenced (01-01-2007 to 31-12-2016) • Consideration for an initial license fee and a per annum license fee determined as a percentage of NetDragon (Fujian)'s annual gross revenues
15-10-2007	Online game software development service agreement	TQ Digital will provide online software development service to NetDragon (Fujian)	• 10 years commenced (01-01-2007 to 31-12-2016) • Consideration of a service fee
15-10-2007	Technical support service agreement	TQ Digital would provide technical support services to NetDragon (Fujian)	• 10 years commenced (01-01-2007 to 31-12-2016) • Consideration of a per annum services fee determined as a percentage of NetDragon (Fujian)'s annual gross revenues
16-05-2008	Online game software Development service Agreement	TQ Online will provide online software development service to NetDragon (Fujian)	• 10 years commenced (16-05-2008 to 15-05-2018) • Consideration of a service fee
16-05-2008	Technical support service agreement	TQ Online would provide technical support services to NetDragon (Fujian)	• 10 years commenced (16-05-2008 to 15-05-2018) • Consideration of a per annum services fee determined as a percentage of NetDragon (Fujian)'s annual gross revenues

Equity Interest Pledge Agreement

On 28 September 2007, TQ Digital, NetDragon (Fujian) and all equity holders of NetDragon (Fujian) entered into an equity interest pledge agreement, pursuant to which all such equity holders granted to TQ Digital a continuing first priority security interests over their respective equity interests in the registered capital of NetDragon (Fujian), representing all of the equity interest in its registered capital, for the purpose of securing the performance of the contractual obligations by NetDragon (Fujian)'s equity holders under the Structure Contracts.

CONNECTED TRANSACTIONS (Cont'd)

STRUCTURE CONTRACTS (Cont'd)

Agreement for the Exclusive Right to Acquire Equity Interest and Assets

On 15 October 2007, TQ Digital, NetDragon (Fujian) and all of the equity holders of NetDragon (Fujian) entered into an agreement for the exclusive right to acquire equity interest and assets, pursuant to which NetDragon (Fujian) and all its equity holders granted to TQ Digital or its designee (a) a right to acquire part or all of the equity interest in the registered capital of NetDragon (Fujian); and (b) a right to acquire part or all of the assets of NetDragon (Fujian) from the equity holders of NetDragon (Fujian) as and when permitted by the relevant PRC laws and regulations. The amount of consideration payable by TQ Digital to the equity holders of NetDragon (Fujian) shall be a nominal amount or the lowest possible amount permissible under the applicable PRC law. If the minimum amount of consideration stipulated under the relevant PRC laws and regulations is higher than the nominal amount at the time of exercise of the acquisition right, Liu Dejian, Liu Luyuan and Zheng Hui had jointly, severally and irrevocably undertaken to reimburse the Company or its subsidiaries of any amount in excess of the nominal amount.

Equity Holders' Voting Rights Proxy Agreement

On 15 October 2007, all equity holders of NetDragon (Fujian) entered into an equity holders' voting rights proxy agreement (the "Proxy Agreement") with TQ Digital and NetDragon (Fujian), pursuant to which all equity holders of NetDragon (Fujian) have irrevocably authorised TQ Digital or a nominee designated by TQ Digital (which will likely be a director of TQ Digital) to exercise all their voting rights in NetDragon (Fujian). The term of the Proxy Agreement shall continue indefinitely for so long as NetDragon (Fujian) subsists in order to secure our control over NetDragon (Fujian).

Other Contracts

In addition to the Structure Contracts, a service agreement (the "Original Service Agreement") which took effect on 1 July, 2007, was entered into by and between NetDragon Websoft Inc. ("NetDragon (USA)") and NetDragon (Shanghai) pursuant to which NetDragon (Shanghai) will provide various services to NetDragon (USA) in exchange for a flat fee calculated based on the number of servers running certain non-Chinese language games. The Original Service Agreement was terminated by the parties thereto on 31 October 2008 for internal restructuring purpose. On 1 November 2008, NetDragon (Shanghai) entered into another service agreement (the "Existing Service Agreement") with NetDragon Websoft (Hong Kong) Limited ("NetDragon (Hong Kong)") with the similar terms as and in substitution of the Original Service Agreement. Pursuant to the Existing Service Agreement, NetDragon (Shanghai) will: (1) provide email correspondence to answer inquiries from customers including payment and password related issues; (2) handle customer complaints regarding hacked accounts and assist such customers in resolving their concerns; and (3) monitor the status of certain servers and perform server maintenance when needed. The term of the Existing Service Agreement is five years.

The Directors expect that there may be other contracts, such as service agreement and/or cooperation and license agreement, to be entered from time to time (together with the Original Service Agreement and the Existing Service Agreement, the "Other Contracts") between the Company and its subsidiaries on the one hand and NetDragon (Fujian) or NetDragon (Shanghai) on the other after NetDragon (Shanghai) has obtained the requisite licenses for providing Internet content and operating online games. Save as the Original Service Agreement and the Existing Service Agreement, as at 31 December 2008, no Other Contract has been entered into.

CONNECTED TRANSACTIONS (Cont'd)

STRUCTURE CONTRACTS (Cont'd)

Waiver from the Stock Exchange and Annual Review

As Liu Dejian, Liu Luyuan and Zheng Hui, being the executive Directors and the controlling shareholders of the Company, are interested in an aggregate of 98.86% in NetDragon (Fujian), NetDragon (Fujian) and NetDragon (Shanghai), being a subsidiary of NetDragon (Fujian), are technically associates of Liu Dejian, Liu Luyuan and Zheng Hui, and therefore connected persons of the Company. Transactions between the Company, NetDragon Websoft Inc. ("NetDragon (BVI)"), TQ Digital, TQ Online, NetDragon (Hong Kong) or NetDragon (USA) (all being wholly-owned subsidiaries of the Company) on one hand and NetDragon (Fujian) or NetDragon (Shanghai) on the other hand, including the Structure Contracts and the Other Contracts, would technically constitute connected transactions under the Listing Rules. The Stock Exchange has granted a specifc waiver to the Company from strict compliance with the connected transactions requirement of Chapter 14A of the Listing Rules in respect of the Structure Contracts and the Other Contracts.

The Company's independent non-executive Directors have reviewed the Structure Contracts and the Other Contracts and confirm that the relevant transactions carried out during the year ended 31 December 2008 have been entered into in accordance with the relevant provisions of the Structure Contracts and the Other Contracts, have been operated so as to allow the economic interest generated by NetDragon (Fujian) and NetDragon (Shanghai) to be flowed to TQ Digital and the Existing Service Agreement was entered into on terms that are fair and reasonable so far as the Company is concerned and in the interests of the shareholders of the Company as a whole.

The Company's auditor has carried out review procedures on the transactions carried out pursuant to the Structure Contracts during the year under review and has provided a letter dated 27 February 2009 to the Board, with a copy to the Stock Exchange, confirming that:

(i) The fees paid by NetDragon (Fujian) to TQ Digital are in accordance with the criteria and principles set out in the Structure Contracts for the purpose of ensuring the economic interest generated by NetDragon (Fujian) and NetDragon (Shanghai) is flowed to TQ Digital, which have been properly approved by the Management Committee;

(ii) The net asset value of NetDragon (Fujian) at 31 December 2008 did not exceed its net assest value as at 31 December 2006, being approximately RMB15,000,000; and

(iii) No dividends or other distributions have been made by NetDragon (Fujian) or NetDragon (Shanghai) (save as to NetDragon (Fujian)) to the holders of their equity interest.

The Company's auditors also performed annual review on the transactions under the Other Contracts during the period under review and has provided a letter dated 27 February 2009 to the Board, with a copy to the Stock Exchange, confirming that the fees paid to NetDragon (Shanghai) by NetDragon (USA) and NetDragon (Hong Kong) are in accordance with the criteria and principles set out in the Other Contracts, which have been properly approved by the Management Committee.

During the year under review, there was no transaction between NetDragon (Fujian) or NetDragon (Shanghai) and TQ Online under the Structure Contracts.

NetDragon (Fujian) and NetDragon (Shanghai) have provided to the Company an undertaking that they will allow the Company and its auditors to have full access to relevant records of NetDragon (Fujian) and NetDragon (Shanghai) for the purpose of the Company's auditors review of the transactions referred to above.

CONNECTED TRANSACTIONS (Cont'd)

CONTINUING CONNECTED TRANSACTIONS

As disclosed in the listing document of the Company dated 27 May 2008 (the "Listing Document"), the Group has entered into the following continuing connected transactions (the "Transactions") as defined under the Listing Rules and waiver was granted by the Stock Exchange to comply with the announcement requirement as required under Rule 14A.47 of the Listing Rules:

On 15 October 2007, TQ Digital and NetDragon (Fujian) have entered into an agreement (the "New Service Agreement") for provision of repair and maintenance of computer system service and after-sales service with Fuzhou Tianliang Network Technology Company Limited ("Fuzhou Tianliang") pursuant to which, at the direction of TQ Digital, Fuzhou Tianliang agreed to provide to NetDragon (Fujian) computer system repair and maintenance service and after-sales service for online game customers on normal commercial terms which are no less favorable than those available from independent third parties. The term of the New Service Agreement is for two and a half years commenced from 1 July 2007 to 31 December 2009. The computer system repair and maintenance service mainly includes the routine system checking and maintenance and technical diagnosis and repair of system hardware, operating systems, database and application software which are vital to the operations of NetDragon (Fujian) as it ensures the smooth operation and upkeep of the computer systems on which the online games software are being run. On the other hand, the after-sales service mainly includes the provision of customer hotline services and assistance in responding to customers' enquiries and complaints in online forums and correspondences which are essential for customer management to enhance customer loyalty.

Fuzhou Tianliang is a limited company established in the PRC, which is owned as to 30% and 30% by Chen Hongzhan, an executive Director, and Zheng Hui, an executive Director, respectively and Fuzhou Tianliang is therefore our connected person under the Listing Rules. The above related transactions are also disclosed in note 32 of the Notes to the Financial Statements as related party transactions of the Group.

The independent non-executive Directors of the Company have reviewed the Transaction conducted during the year and confirmed that the Transactions:

(i) have been entered into in the ordinary and usual course of the business of the Group;

(ii) have been entered into either on normal commercial terms or, if there are no sufficient comparable transactions to judge whether they are on normal commercial terms, on terms no less favourable to the Group than those available to or from independent third parties;

(iii) have been entered into in accordance with the New Service Agreement on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole; and

(iv) have not exceeded the annual cap for the year ended 31 December 2008 as disclosed in the Listing Document.

The Company's auditor has carried out review procedures on the Transactions and has provided a letter dated 27 February 2009 to the Board, with a copy to the Stock Exchange, confirming that the Transactions:

(i) have been approved by the board of directors;

(ii) have been entered into in accordance with the terms of the agreements governing the Transactions and the Transactions have been entered into on normal commercial terms in the normal course of business of the Group; and

(iii) have not exceeded the annual cap for the year ended 31 December 2008 as disclosed in the wavier granted by the Stock Exchange.

REPORT OF THE DIRECTORS

BOARD PRACTICES AND PROCEDURES

In the opinion of the Directors, the Company has complied with the requirements of board practices and procedures of Rules 5.34 to 5.45 of the GEM Listing Rules before 24 June 2008 and the Code of Best Practice as set out in Appendix 14 to the Listing Rules from 24 June 2008 to the end of the year.

PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's Articles of Association or the laws in the Cayman Islands which would oblige the Company to offer new shares on a pro rata basis to existing shareholders of the Company.

COMPETITION AND CONFLICT OF INTEREST

Save as disclosed in the Listing Document, none of the Director or any of their respective associates, as defined in the Listing Rules, has interest in any business that competes or may compete, either directly or indirectly, with the businesses of the Group, or has any other conflict of interests with the Group as at 31 December 2008 and as at the date of this report.

POST BALANCE SHEET EVENTS

There is no post balance sheet events after the year ended 31 December 2008.

PURCHASE, SALE OR REDEMPTION OF SECURITIES

During the year, the Company repurchased a total of 27,520,500 shares on the Stock Exchange at an aggregate consideration of HKD246,077,531.66 before expenses.

Details of the share repurchase are as follows:

Month of purchase	**Number of ordinary shares repurchased**	**Price per share**		**Aggregate consideration paid**
		Highest	**Lowest**	
		HKD	*HKD*	*HKD*
January 2008	4,159,500	13.50	12.40	54,823,486.66
February 2008	11,699,000	13.00	11.04	138,561,450.00
September 2008	9,370,500	5.42	3.97	46,907,500.00
November 2008	1,995,000	2.63	2.33	4,988,660.00
December 2008	296,500	2.75	2.54	796,435.00

The repurchased shares were cancelled on delivery of the share certificates during the year except 296,500 shares were cancelled on 5 January 2009. The nominal value of the cancelled shares was transferred to the capital redemption reserve and the relevant aggregate consideration was paid out from the Company's retained profits.

Except as disclosed above, neither the Company nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the year.

COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS

The following is a summary of comparison of the Company's actual business progress with its business objectives as set out in the prospectus of the Company dated 23 October 2007 (the "Prospectus") for the period from 1 January 2008 to 31 December 2008.

For the period from 1 January 2008 to 30 June 2008

	Business objectives as stated in the Prospectus	Actual business progress for the period
Further strengthen our core game development capabilities	• We will recruit additional experienced game developers to cope with our game development.	• We have recruited more than 300 game developers to join our game development team.
	• We intend to set up a 3D graphic centre in Shanghai to upgrade and enhance the features of our existing and newly developed online games and recruit fresh graduates from universities and experienced 3D graphic artists to enhance our artist team and to facilitate the development of our 3D technology in order to expand our online game portfolio.	• We have set up a 3D graphic department with 6 staff in Shanghai for the six months ended 30 June 2008. The 3D graphic staff includes an experienced expertise, the (i) 3D Art Director, who has extensive online game development experience; and (ii) several experienced artists. We are going to move to a more spacious office in the coming future in order to further expand the 3D graphic department.
	• We intend to invite professionals to organise trainings and seminars for our internal training programmes.	• We invited professionals from different industries and professors to conduct training sessions and seminars for our employees.
	• We will continue to upgrade our computers and game development software.	• We have purchased new computers and softwares and replaced old computer hardwares and accessories required for our game development.
	• We will continue to standardise our game development process to improve efficiency.	• We have developed some game development software to replace some manual operation which improved the efficiency on our game development process.

COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

	For the period from 1 January 2008 to 30 June 2008	
	Business objectives as stated in the Prospectus	**Actual business progress for the period**
Further enhance our integrated operation model	• We will integrate our customer information system and ERP system.	• We have started to integrate our customer information system and ERP system and performing several test run.
	• Our team will use the study result on customer Information system to form marketing strategies.	• Our team has used the study result on customer information system to form marketing strategies such as making advertisement in the movies.
Enrich our product portfolio and extend our game life cycles	• We will launch the Chinese versions of Tian Yuan (previously named as Piao Miao Online) and Heroes of Might and Magic Online.	• The Chinese version of Heroes of Might and Magic Online was launched in late May 2008. We will conduct the closed and open beta testing of the Chinese version of Tian Yuan (previously named as Piao Miao Online) in the fourth quarter of 2008 and first quarter of 2009, respectively.
	• We will rollout upgraded versions of Eudemons Online, Zero Online and Way of the Five (previously named as Happiness Q).	• We rollout upgraded versions of Eudemons Online and Zero Online but not for Way of the Five (previously named as Happiness Q)
	• We will customise Way of the Five (previously named as Happiness Q) and Tian Yuan (previously named as Piao Miao Online) into the English version.	• We will customize Way of the Five (previously named as Happiness Q) into English version in early 2009 after the official launch of the Chinese version. We plan to customize Tian Yuan (previously named as Piao Miao Online) into English version after conducting the open beta testing of the Chinese version in the first quarter of 2009.

COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

For the period from 1 January 2008 to 30 June 2008

	Business objectives as stated in the Prospectus	Actual business progress for the period
	• We will customise Zero Online into other language versions.	• We have conducted the closed beta testing of the Spanish and Traditional Chinese versions of Zero Online in first half of 2008, respectively. We will conduct the open beta testing for both languages versions of Zero Online in second half of 2008.
	• We will recruit additional experienced staff to operate our games	• We have recruited more than 200 additional experienced employees to join our marketing team.
Expand our business through acquisition or cooperation with external parties	• We intend to acquire PRC or overseas medium size game development studios and game operators specialising in MMORPGs.	• We were negotiating with several potential PRC medium size game development studios and game operators specializing in MMORPGs to evaluate merger and acquisition possibilities.
	• We intend to establish cooperation partnership with PRC or overseas medium to large size well-known Internet portals.	• We have signed a content development and distribution agreement with Disney Online, Inc. in January 2008 and expect to release Disney Fantasy Online by early 2009. In Disney Fantasy Online, players live in a Disney-themed central world and can interact with selected Disney characters.
	• We will evaluate other merger and acquisition opportunities that complement or benefit our business strategies.	• Our business development team has continued to evaluate acquisition and merger activities that complement or benefit our business strategies.

COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

	For the period from 1 January 2008 to 30 June 2008	
	Business objectives as stated in the Prospectus	**Actual business progress for the period**
Strengthen our corporate image and promote our games	• We will continue to engage marketing consultants to formulate marketing strategies to promote our corporate image and our games.	• We continued to engage Effort Ogilvy (Fujian) Advertising Co. Ltd to formulate marketing strategies to promote our games.
	• We will continue the cooperation with well-known Internet portals for game promotion and corporate image advertisement.	• We have engaged well-known Internet portals such as those operated by SINA, Baidu and Tencent for corporate image advertisement and game promotion.
	• We will continue to participate in game industry events.	• We were participating in the 2007 China Game Industry Conference in January 2008 and received several awards in the conference as well.
	• We will engage a number of advertising agents to place advertisements on various media, including newspapers and magazines.	• We have engaged a number of advertising agents to place advertisements in various media.

COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

	For the period from 1 July 2008 to 31 December 2008	
	Business objectives as stated in the Prospectus	**Actual business progress for the period**
Further strengthen our core game development capabilities	• We will expand our development team for more game designers and graphic artists, to cope with our new game development.	• We have recruited more than 650 game developers to join our game development team.
	• We intend to work closely with universities and game development academics by sponsoring competitions and offering scholarships for students.	• The Group has actively maintained close cooperation with Faculty Of Software, Fujian Normal University and Mathematics and Computer Science College of Fuzhou University, and has participated in and initiated pre-employment traning programmes through commencement of pre-employment tranings and using the Group's training materials as the teaching contents of the elective courses or practice courses in the fourth year of colleges. Meanwhile, the Group maintain connection with game development academics such as Shanghai Bosi Game Academy and Shanghai Game Academy, thereby providing graduates with opportunities for practice and employment.
	• We will offer more training programmes and seminars to enhance our developers' skills.	• The Group has irregulary invited experts and professors to run training programmes and seminars for the Group's employees and management, including inviting professors from Fujian Normal University Acedemy of Fine Arts to run internal training programmes for staff of the resourses center; and inviting tutors for master students and associate professors of Management College of Fuzhou University etc. to run internal training programmes for the management.

COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

For the period from 1 July 2008 to 31 December 2008

	Business objectives as stated in the Prospectus	**Actual business progress for the period**
	• We will continue to upgrade our computers and game development software.	• We have purchased new computers and softwares and replaced old computer hardwares and accessories required for our game development.
Further enhance our integrated operation model	• We will integrate our accounting system and distribution and payment system.	• We have started to integrate our accounting system and distribution and payment system and performing several test run.
	• We will test and fine-tune the integration of customer information system and ERP system and provide trainings on the integrated systems to our staff.	• We have started to integrate our customer information system and ERP system and performing several test run.
Enrich our product portfolio and extend our game life cycles	• We will launch two new online games.	• We have postponed the launching of the new online games and propose to launch Way of the Five (previously named as Happiness Q) and Tian Yuan (previously named as Piao Miao Online) on the first half of 2009.
	• We will rollout upgraded versions of Conquer Online, Eudemons Online, Zero Online, Way of the Five (previously named as Happiness Q), Tian Yuan (previously named as Piao Miao Online) and Heroes of Might and Magic Online.	• We rollout upgraded version of Conquer Online named “Twin Talismans” on August 2008. We also rollout the new Chinese expansion pack “An Ren Wei Ji” and the new English expansion pack “New Dynasty” for Conquer Online. We have launched the upgraded version of Eudemons Online, Zero Online and Heroes of Might and Magic Online. We did not launch Way of the Five (previously named as Happiness Q) and Tian Yuan (previously named as Piao Miao Online) on 2008, therefore no upgraded versions for the two games are launched.

COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

	For the period from 1 July 2008 to 31 December 2008	
	Business objectives as stated in the Prospectus	**Actual business progress for the period**
	• We will customise Way of the Five (previously named as Happiness Q), Tian Yuan (previously named as Piao Miao Online) and Heroes of Might and Magic Online into different languages.	• We have postponed the launching of the new online games Way of the Five (previously named as Happiness Q) and Tian Yuan (previously named as Piao Miao Online), and did not release other languages of Hero of Might and Magic Online too.
	• We will recruit additional experienced staff to operate our games.	• We have recruited more than 100 additional experienced employees to join our team.
Expand our business through acquisition or cooperation with external parties	• We intend to acquire PRC or overseas medium size game development studios and game operators specialising in MMORPGs.	• We have formed cooperative agreements with overseas game development studios specialized in developing MMORPGs. We were negotiating with several potential PRC medium size game development studios and game operators specializing in MMORPGs to evaluate merger and acquisition possibilities.
	• We intend to establish cooperation partnership with PRC or overseas medium to large size well-known Internet portals.	• We have signed a cooperative agreement with EA for the development of its first 3D MMORPG Dungeon Keeper Online. We have signed a content development and distribution agreement with Shanghai Baihai Information Technology Co., Ltd in developing and distributing a new online game namely CJ7 Online.
	• We will evaluate other merger and acquisition opportunities that complement or benefit our business strategies.	• Our business development team has continued to evaluate acquisition and merger activities that complement or benefit our business strategies.

COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

For the period from 1 July 2008 to 31 December 2008

	Business objectives as stated in the Prospectus	Actual business progress for the period
Strengthen our corporate image and promote our games	• We will continue to engage marketing consultants to formulate marketing strategies to promote our corporate image and our games.	• We continued to engage Effort Ogilvy (Fujian) Advertising Co. Ltd to formulate marketing strategies to promote our games.
	• We will continue the cooperation with well-known Internet portals for game promotion and corporate image advertisement.	• We have engaged well-known Internet portals for game promotion and corporate image advertisement.
	• We will continue to participate in game industry events.	• The Group is aggressively participated in the game industry events and activities, such as (i) the 6th China International Digital Content Expo organised by the Ministry of Culture in October 2008; and (ii) China Digital Entertainment Expo and Conference in October 2008
	• We will engage a number of advertising agents to place advertisements on various media, including newspapers and magazines.	• We have engaged a number of advertising agents to place advertisement in various media.
	• We will engage an international public relationship firm to promote our corporate image in the online game industry.	• The Group will continue to seek cooperation with different international public relation companies to enhance the Group's profile in the online games industry.

COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

Comparison between proposed applications and actual applications of net proceeds raised from the placing of the Company's shares on GEM

Business Objectives	**For the period from 1 January 2008 to 30 June 2008** **Proposed applications as set out in the Prospectus** *HKD million*	 **Actual amount of proceeds used** *HKD million*
Further strengthen our core game development capabilities	29.4	23.7
Further enhance our integrated operation model	1.5	—
Enrich our product portfolio and extend our game life cycles	10.3	6.2
Expand our business through acquisition or cooperation with external parties	63.2	—
Strengthen our corporate image and promote our games	27.4	15.1
Working capital	14.2	14.2
Total	146.0	59.2

Business Objectives	**For the period from 1 July 2008 to 31 December 2008** **Proposed applications as set out in the Prospectus** *HKD million*	**Proposed applications as set out in the announcement for the change in use of proceeds on 22 October 2008** *HKD million*	**Actual amount of proceeds used** *HKD million*
Further strengthen our core game development capabilities	8.4	8.4	22.2
Further enhance our integrated operation model	1.3	1.3	3.4
Enrich our product portfolio and extend our game life cycles	11.3	11.3	1.8
Expand our business through acquisition or cooperation with external parties	83.7	24.5	30.1
Strengthen our corporate image and promote our games	29.9	29.9	27.0
Working capital	17.3	162.6	5.8
Total	151.9	238.0	90.3

PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of the Directors as at the latest practicable date prior to the issue of this report, the Company has maintained the prescribed public float under the Listing Rules.

SHARE OPTION SCHEME

Pursuant to the resolution of all the shareholders of the Company dated 12 June 2008, the Company adopted a share option scheme (the "Main Board Share Option Scheme") to replace the then existing share option scheme. During the year under review, no option had been granted under the Main Board Share Option Scheme.

DIRECTORS' RIGHTS TO ACQUIRE SHARES OR DEBENTURES

Apart from the Main Board Share Option Scheme disclosed above and set out in note 30 of Notes to the Financial Statements, at no time during the year was the Company, its holding company or any of its subsidiaries and fellow subsidiaries a party to any arrangement to enable the Directors, their respective spouse or minor children to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or in any other body corporate.

SHARE AWARD SCHEME

The Company adopted a share award scheme (the "Share Award Scheme") on 2 September 2008 (the "Adoption Date") in which selected employees (the "Selected Employee(s)") of the Group are entitled to participate. The purpose of the scheme is to recognise the contributions by certain employees of the Group and to provide them with incentives in order to retain them for the continual operation and development of the Group and to attract suitable personnel for further development of the Group. Unless early terminated by the Board, the Share Award Scheme shall be valid and effective for a term of ten years commencing on the Adoption Date. The Board shall not grant any further award of shares which would result in the nominal value of the shares awarded by the Board under the Share Award Scheme exceeding 10% of the issued Share capital of the Company from time to time. The maximum number of shares which may be awarded to a Selected Employee under the Share Award Scheme shall not exceed 1% of the issued share capital of the Company from time to time.

Pursuant to the rules of the Share Award Scheme, the Group has entered into a trust deed with Bank of Communications Trustee Limited (the "Trustee") in respect of the appointment of the Trustee for the purpose of the administration of the Share Award Scheme and holding the awarded shares before they are vested.

As at 31 December 2008, the Board awarded an aggregate amount of approximately HKD16,094,000 for the purchase of shares to a number of Selected Employees. For the year ended 31 December 2008, the Trustee purchased 3,174,000 shares and the total payout, including the related transaction costs, amounted to approximately HKD16,100,000. The shares so purchased have been allocated and awarded to the Selected Employees as set out below according to the rules of the Share Award Scheme.

SHARE AWARD SCHEME (Cont'd)

Reference Date	Name of Selected Employee	Awarded sum (HKD)	Number of shares purchased	Number of shares vested in 2008	Vesting Date	Transfer Date
25.09.2008	Chao Guowei, Charles	999,000.00	197,019	49,255	06.11.2008	15.12.2008
25.09.2008	Chen Hongzhan	999,000.00	197,019	—	—	—
25.09.2008	Lee Kwan Hung	999,000.00	197,019	49,255	06.11.2008	15.12.2008
25.09.2008	Liu Dejian	999,000.00	197,019	—	—	—
25.09.2008	Liu Luyuan	999,000.00	197,019	—	—	—
25.09.2008	Liu Sai Keung, Thomas	999,000.00	197,019	49,255	06.11.2008	15.12.2008
25.09.2008	Rhee Kwanwoo, James	3,030,000.00	597,566	149,392	06.11.2008	15.12.2008
25.09.2008	Tang Zhao Xi	2,020,000.00	398,377	—	—	—
25.09.2008	Wu Chak Man	2,020,000.00	398,377	79,675	06.11.2008	15.12.2008
25.09.2008	Wu Jialiang	3,030,000.00	597,566	—	—	—

Subject to the receipt by the Trustee of (i) transfer documents prescribed by the Trustee and duly signed by the Selected Employees within the period stipulated in the vesting notice issued by the Trustee to the Selected Employees; and (ii) a confirmation from the Company that all vesting conditions having been fulfilled, the awarded shares will be transferred to the Selected Employees at nil consideration upon vesting. As at 31 December 2008, details of the awarded shares under the Share Award Scheme were as follows:

		Number of shares					
Transfer Date	**Average price per share (HKD) *(note)***	**As at 1 January 2008**	**Awarded during the year of 2008**	**Vested during the year**	**Lapsed during the year**	**As at 31 December 2008**	**Vesting Period**
15.12.2008	5.07	—	1,587,000	376,832	—	1,210,168	06.11.2008 – 06.11.2012

Note:

These shares were purchased by the Trustee of the Share Award Scheme at an average price of HKD5.07 per share.

SHARE AWARD SCHEME (Cont'd)

As at 31 December 2008, details of the shares awarded to the senior management and independent non-executive Directors under the Share Award Scheme are as follows:

Name of Selected Employee	Position	Awarded Shares	Vesting date
Chao Guowei, Charles	Independent non-executive Director	49,255	6 Nov 2008
Lee Kwan Hung	Independent non-executive Director	49,255	6 Nov 2008
Liu Sai Keung, Thomas	Independent non-executive Director	49,255	6 Nov 2008
Rhee Kanwoo, James	Vice President, Corporate Development	149,392	6 Nov 2008
Wu Chak Man	Chief Financial Officer	79,675	6 Nov 2008

These shares were vested to the Selected Employees in recognition of their respective services and contribution to the Group during the year of 2008.

AUDITORS

A resolution will be submitted in the forthcoming AGM of the Company to re-appoint Grant Thornton as auditors of the Company.

On behalf of the Board
Liu Dejian
Chairman

Hong Kong, 12 March 2009

The Directors believe that good corporate governance practices serve as an effective risk management for the Company and hence, the shareholders of the Company will benefit from the high standard of corporate governance.

Throughout the year, the Company has complied with the principles set out in the Code on Corporate Governance Practices (the "CG Code Provisions") in Appendix 14 to the Listing Rules.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has established its code of conduct regarding securities transaction by directors, senior management and relevant employees on terms no less exacting than the required standard indicated by the Model Code as set out in Appendix 10 to the Listing Rules. Having made specific enquiry of all Directors, the Directors, except Liu Dejian and Chen Hongzhan, have complied with the required standard set out in the Model Code during the period under review. Liu Dejian had late filing of Disclosure of Interests Notice with the Stock Exchange on 11 September 2008 reporting his increase in shareholding of the Company. Mr. Chen Hongzhan had late filing of Disclosure of Interests Notice with the Stock Exchange on 24 October 2008 reporting the increase in his shareholding of the Company. In order to ensure strict compliance with the Model Code by all Directors, a refreshment discussion on the detailed guildlines for dealing in the Company's securities has been held by end of 2008.

THE BOARD

The Board is composed of four executive Directors (including the Chairman and the Chief Executive Officer of the Company) and four non-executive Directors (of whom three are independent non-executive Directors), whose biographical details are set out in "Directors and Senior Management" section on pages 32 to 34. Save as disclosed herein, none of the members of the Board has any financial, business, family or other material relevant relationship to one another.

Each of the non-executive and independent non-executive Directors has entered into an appointment letter with the Company, all for an initial term of three years commenced on 24 June 2008 and renewable automatically for successive terms of one year each commencing from the day next after the expiry of the then current term unless and until terminated in accordance with the terms of the appointment letter or by either party thereto giving to the other not less than three months' prior written notice.

THE BOARD (Cont'd)

Duties of the Board including delegation to management

The Board is responsible for overall strategic formulation and performance monitoring of the Group. It delegates day-to-day operations of the Company to the committees and senior management within the control and authority framework set by the Board. In addition, the Board has also delegated various responsibilities to the audit committee, the remuneration committee, the nomination committee and the share award scheme committee. Further details of these committees are set out in this report.

Duties of the Board include:

(i) ensuring, maintaining and overseeing the internal control systems of the Group;

(ii) setting the objectives of management of the Group;

(iii) monitoring the performance of management of the Group;

(iv) ensuring that a framework of prudent and effective controls is in place to enable risks to be assessed and managed; and

(v) overseeing the management of NetDragon's relationships with stakeholders, such as, shareholders, customers, the community, interest groups, employees and others who have a legitimate interest in the responsible conduct of the Group's business.

During the year, the Board held 10 meetings and the attendance of each of the Directors at Board and committee meetings held in 2008 is set out below:

Directors	Full Board	Audit Committee	Remuneration Committee	Nomination Committee	Share Award Scheme Committee
Executive Directors					
Liu Dejian *(Chairman)*	10/10	N/A	N/A	N/A	N/A
Liu Luyuan *(Chief Executive Officer)*	10/10	N/A	N/A	N/A	N/A
Zheng Hui	10/10	N/A	N/A	N/A	N/A
Chen Hongzhan	10/10	N/A	N/A	N/A	N/A
Non-executive Directors					
Lin Dongliang	10/10	N/A	N/A	N/A	N/A
Zhu Xinkun (retired on 28 April 2008)	1/1	N/A	N/A	N/A	N/A
Independent non-executive Directors					
Chao Guowei, Charles	10/10	4/4	2/2	1/1	N/A
Lee Kwan Hung	10/10	4/4	2/2	1/1	1/1
Liu Sai Keung, Thomas	10/10	4/4	2/2	1/1	1/1

Board and committee minutes are recorded in appropriate detail and are kept by the Company Secretary. Draft minutes are circulated to Directors for comments within reasonable time after each meeting and the final version is open for Directors' inspection.

THE BOARD (Cont'd)

The Directors are entitled, upon reasonable request, to seek independent professional advice in appropriate circumstances, at the Company's expenses. The Board shall resolve to provide separate appropriate independent professional advice to the Directors to assist the relevant Directors to discharge their duties.

In full compliance with Rule 3.10 of the Listing Rules, the Company has appointed three independent non-executive Directors, at least one of whom has appropriate professional accounting qualifications.

In addition, the Company has received from each of the independent non-executive Directors an annual confirmation of their independence pursuant to Rule 3.13 of the Listing Rules. These Directors' independence have been verified.

DIRECTORS'S INTEREST IN CONTRACT

With reference to the Structure Contracts entered into between TQ Digital, TQ Online and NetDragon (Fujian), the executive Directors Liu Dejian, Liu Luyuan and Zheng Hui, are interested in an aggregate of 98.86% in NetDragon (Fujian). NetDragon (Shanghai), being a subsidiary of NetDragon (Fujian), is technically an associate of Liu Dejian, Liu Luyuan and Zheng Hui, and therefore connected persons of the Company. Transactions between the Company, NetDragon (BVI), TQ Digital, TQ Online, NetDragon (Hong Kong) or NetDragon (USA) (all being wholly-owned subsidiaries of the Company) on one hand and NetDragon (Fujian) or NetDragon (Shanghai) on the other hand, including the Structure Contracts and the Other Contracts would technically constitute connected transactions. Details for the Structure Contracts and the Other Contracts are set out in pages 43 to 46 in the section of "Report of the Directors" under the paragraphs of "Structure Contracts".

With reference to the continuing connected transactions, the executive Directors, Zheng Hui and Chen Hongzhan each owned 30% and 30% respectively in Fuzhou Tianliang. Details for the continuing connected transactions are set out in page 47 in the section of "Report of the Directors" under the paragraphs of "Continuing Connected Transactions".

Save as the above, none of the Directors is materially interested, either directly or indirectly, in any contract of significance of the Company during the year ended 31 December 2008 or as at the end of the year.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

The positions of the Chairman and the Chief Executive Officer are held by Mr. Liu Dejian and Mr. Liu Luyuan respectively.

In order to reinforce their respective independence, accountability and responsibility, the role of the Chairman is separated from that of the Chief Executive Officer. The Chairman provides leadership and is responsible for the effective functioning of the Board in accordance with good corporate governance practice and ensuring the effectiveness of the Board. With the support of the senior management, the Chairman is also responsible for ensuring that the Directors receive adequate, complete and reliable information in a timely manner and appropriate briefing on issues arising at Board meetings.

The Chief Executive Officer focuses on managing the Company and its subsidiaries, developing and implementing objectives, policies and strategies approved and delegated by the Board. The Chief Executive Officer is in charge of the Group's day-to-day management and operations and is also responsible for developing strategic plans and formulating the organisational structure, control systems and internal procedures and processes for the Board's approval.

AUDIT COMMITTEE

The Company established the audit committee on 15 October 2007 which has adopted written terms of reference in compliance with the CG Code Provision and has held four meetings during 2008. The primary duties of our audit committee are to review and supervise our financial reporting process and internal control systems.

The audit committee reviews the quarterly, interim and annual financial results of the Company. In addition, the audit committee also reviews and approves the pricing policy for the continued connected transactions with Fuzhou Tianliang.

Our audit committee comprises three independent non-executive Directors, namely Chao Guowei, Charles, Lee Kwan Hung and Liu Sai Keung, Thomas. Chao Guowei, Charles is the chairman of the audit committee.

The terms of reference of the audit committee are posted on the Company's website.

The Company's audited financial statement for the year ended 31 December 2008 have been reviewed by the audit committee. The audit committee is of the opinion that the preparation of such results complied with the applicable accounting standards and requirements and that adequate disclosures have been made.

REMUNERATION COMMITTEE

The Company established the remuneration committee on 15 October 2007 which considers and recommends to our Board the remuneration and other benefits paid by us to our Directors and senior management, and has held two meeting during 2008. The remuneration of all our Directors and senior management is subject to regular monitoring by the remuneration committee to ensure that levels of their remuneration and compensation are appropriate.

Our remuneration committee comprises three independent non-executive Directors, namely Chao Guowei, Charles, Lee Kwan Hung and Liu Sai Keung, Thomas. Lee Kwan Hung is the chairman of the remuneration committee.

The terms of reference of the remuneration committee are posted on the Company's website.

EMPLOYEE AND EMOLUMENT POLICY

The emolument policy of the employees of the Company is set up by the Board of Directors on the basis of their merit, qualifications and competence.

The emoluments of the Directors and senior management of the Company are recommended by the remuneration committee and are decided by the Board, as authorised by shareholders at the AGM, having regard to the Group's operating results, individual performance and comparable market statistics.

NOMINATION COMMITTEE

The Company established a nomination committee on 15 October 2007 which considers and recommends to our Board of Directors suitably qualified persons to become our Directors and is responsible for reviewing the structure, size and composition of our Board on a regular basis, and has held one meeting during 2008.

Our nomination committee comprises three independent non-executive Directors, namely Chao Guowei, Charles, Lee Kwan Hung and Liu Sai Keung, Thomas. Liu Sai Keung, Thomas is the chairman of the nomination committee.

The terms of reference of the nomination committee are posted on the Company's website.

MANAGEMENT COMMITTEE

The Company established the Management Committee pursuant to the Structure Contracts to oversee the business and operations of NetDragon (Fujian). Through its control over NetDragon (Fujian), the Management Committee is also able to oversee the business and operations of NetDragon (Shanghai), being the subsidiary of NetDragon (Fujian). The Management Committee comprises four members, of which each of TQ Digital and NetDragon (Fujian) is entitled to appoint two members from its respective board of directors. Other than by reason of retirement, resignation, incapability or death, a member of the Management Committee may only be removed by the party who originally appointed such member. As a general requirement, the members appointed by NetDragon (Fujian) must also be the equity holders of NetDragon (Fujian) as well as directors of TQ Digital. In the case where the number of members who concurrently act as a director of both TQ Digital and NetDragon (Fujian) is less than two, TQ Digital is entitled to appoint an additional member of the Management Committee. As such, under the Structure Contracts, the Management Committee is allowed to have a maximum of five members.

Currently, the Management Committee comprises Liu Dejian and Liu Luyuan who were appointed by NetDragon (Fujian), and Zheng Hui and Chen Hongzhan who were appointed by TQ Digital. The directors of NetDragon (Fujian) comprise Liu Dejian, Liu Luyuan, Zheng Hui, being executive Directors, Wu Jialiang, being a member of our senior management, and Lin Lizhi, being our general manager. Zheng Hui, an executive Director, is the only director of NetDragon (Shanghai). Further details of the above members are set out in the section headed "Directors and Senior Management" in this annual report.

SHARE AWARD SCHEME COMMITTEE

In recognition of the contribution of employees and to provide them with incentives in order to retain them for the continual operation and development of the Group and to attract suitable personnel for further development of the Group, the Company established a share award scheme committee on 2 September 2008 for the purpose of administration of the Share Award Scheme.

Our share award scheme committee comprises two independent non-executive Directors, namely Lee Kwan Hung and Liu Sai Keung, Thomas and two senior management, namely Wu Chak Man and Tam Hon Shan, Celia.

INTERNAL CONTROLS

The Board has overall responsibility for maintaining an effective internal control system of the Group. The Company has maintained a tailored governance structure with defined lines of responsibility and appropriate delegation of responsibility and authority to the senior management.

The Board has engaged an independent external professional firm to conduct an annual review of the effectiveness of its internal control systems covering all material controls, including financial, operational and compliance controls as well as risk management functions for the year under review.

AUDITORS' REMUNERATION

During the year under review, the remuneration paid to the Company's external auditors, is set out as follows:

	RMB'000
Audit services	1,090
Non-audit services	548
	1,638

The above non-audit services include professional advisory fees relating to the Main Board listing and internal control review.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Directors are responsible for overseeing the preparation of accounts of each financial period with a view to ensuring such accounts give a true and fair view of the state of affairs of the Group and of the results and cash flow for that period. In preparing the financial statements for the year ended 31 December 2008, the Directors have selected suitable accounting policies and have applied them consistently, adopted appropriate Hong Kong Financial Reporting Standards which are pertinent to its operations and relevant to the financial statements, made judgements and estimates that are prudent and reasonable, and have prepared the accounts on the going concern basis.

COMMUNICATIONS WITH SHAREHOLDERS AND INVESTORS

The management personnel responsible for investor relations held regular meetings with equity research analysts, fund managers and institutional shareholders and investors.

The market capitalization of the Company as at 31 December 2008 was approximately HKD1,532.86 million (entired issued share capital: 528,570,860 shares) at closing market price: (HKD2.9 per share). The public float is around 28%.

The forthcoming AGM will be held at Vinson Room, Pacific Place Conference Centre, Level 5, One Pacific Place, 88 Queensway, Hong Kong in Hong Kong on 21 April 2009 at 3:00 p.m..

Grant Thornton
均富

Member of Grant Thornton International Ltd

To the members of NetDragon Websoft Inc.
(incorporated in the Cayman Islands with limited liability)

We have audited the consolidated financial statements of NetDragon Websoft Inc. (the "Company") and its subsidiaries (collectively, the "Group") set out on pages 69 to 148, which comprise the consolidated and company balance sheets as at 31 December 2008, and the consolidated income statement and the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2008 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Grant Thornton
Certified Public Accountants
13/F Gloucester Tower
The Landmark
15 Queen's Road Central
Hong Kong

12 March 2009

CONSOLIDATED INCOME STATEMENT

For the year ended 31 December 2008

	Notes	2008	2007
		RMB'000	RMB'000
Revenue	8	595,981	645,214
Cost of revenue		(68,064)	(36,863)
Gross profit		527,917	608,351
Other revenue and gains	8	95,083	8,321
Selling and marketing expenses		(103,599)	(80,844)
Administrative expenses		(112,673)	(50,090)
Development costs		(89,823)	(37,253)
Other operating expenses		(54,725)	(21,404)
Operating profit		262,180	427,081
Share of results of an associate		(276)	—
Profit before income tax	9	261,904	427,081
Income tax expense	11	(22,635)	(52,244)
Profit for the year		239,269	374,837
Attributable to			
Equity holders of the Company	12	239,381	374,854
Minority interests		(112)	(17)
Profit for the year		239,269	374,837
Dividends	13	98,771	295,162
		RMB cents	RMB cents
Earnings per share	14		
– Basic		44.49	85.01
– Diluted		N/A	N/A

CONSOLIDATED BALANCE SHEET

As at 31 December 2008

	Notes	2008 RMB'000	2007 RMB'000
ASSETS AND LIABILITIES			
Non-current assets			
Property, plant and equipment	16	96,160	61,344
Land use rights	17	7,362	1,174
Deposit paid for acquisition of property, plant and equipment		7,357	—
Intangible assets	18	10,754	—
Interest in an associate	19	224	—
Available-for-sale financial asset	21	4,000	4,000
Loan receivables	22	6,835	—
Deferred tax assets	33	54	54
		132,746	66,572
Current assets			
Loan receivables	22	440	—
Trade and other receivables, prepayments and deposits	23	81,990	67,295
Financial assets at fair value through profit or loss	24	311,806	—
Derivative financial instrument	25	31,857	—
Amounts due from related parties	32(iii)	—	8,832
Tax recoverable		108	581
Term deposits with initial term of over three months	26	629,454	50,000
Cash and cash equivalents	27	332,009	1,651,380
		1,387,664	1,778,088

	Notes	2008 RMB'000	2007 RMB'000
Current liabilities			
Trade and other payables, accruals and deferred income	28	**53,677**	45,262
Amount due to a related party	32(iii)	**—**	76
Income tax payable		**12,922**	29,940
		66,599	75,278
Net current assets		**1,321,065**	1,702,810
Total assets less current liabilities/Net assets		**1,453,811**	1,769,382
EQUITY			
Share capital	29	**39,264**	41,219
Reserves	31	**1,414,547**	1,728,051
Equity attributable to equity holders of the Company		**1,453,811**	1,769,270
Minority interests		**—**	112
Total equity		**1,453,811**	1,769,382

BALANCE SHEET

As at 31 December 2008

	Note	2008 RMB'000	2007 RMB'000
ASSETS			
Non-current assets			
Interests in subsidiaries	20	518,159	167,871
Current assets			
Trade and other receivables, prepayments and deposits	23	1,008	5,428
Amounts due from subsidiaries	20	341,953	225,052
Financial assets at fair value through profit or loss	24	311,806	—
Derivative financial instrument	25	31,857	—
Cash and cash equivalents	27	33,965	1,317,532
		720,589	1,548,012
Current liabilities			
Trade and other payables, accruals and deferred income	28	873	7,402
Amounts due to subsidiaries	20	1,817	2,967
		2,690	10,369
Net current assets		717,899	1,537,643
Total assets less current liabilities/Net assets		1,236,058	1,705,514
EQUITY			
Share capital	29	39,264	41,219
Reserves	31(a)	1,196,794	1,664,295
Total equity		1,236,058	1,705,514

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2008

	Equity attributable to equity holders of the Company													
	Share capital RMB'000	Share premium RMB'000	Capital contribution RMB'000	Capital redemption reserve RMB'000	Capital reserve RMB'000 *(note 31(b)(ii))*	Statutory reserves RMB'000 *(note 31(b)(iii))*	Dividend reserve RMB'000	Treasury share reserve RMB'000 *(note 31(b)(iv))*	Employee share-based compensation reserve RMB'000 *(note 31(b)(v))*	Translation reserve RMB'000	Retained profits RMB'000	Total RMB'000	Minority interests RMB'000	Total equity RMB'000
At 1 January 2007	1,453	16,267	21,755	—	11,596	6,768	—	—	—	(10)	46,749	104,578	129	104,707
Exchange difference arising on translation of overseas operations and net expense recognised directly in equity	—	—	—	—	—	—	—	—	—	(10,797)	—	(10,797)	—	(10,797)
Profit for the year	—	—	—	—	—	—	—	—	—	—	374,854	374,854	(17)	374,837
Total recognised income and expense for the year	—	—	—	—	—	—	—	—	—	(10,797)	374,854	364,057	(17)	364,040
Issue of shares by a subsidiary *(note 31(b)(i))*	—	69,984	(21,755)	—	170	—	—	—	—	—	—	48,399	—	48,399
Issue of shares by the Company *(note 29(ii)&(iii))*	2,053	—	—	—	(1,820)	—	—	—	—	127	—	360	—	360
Dividend declared *(note 13)*	—	—	—	—	—	—	—	—	—	—	(79,069)	(79,069)	—	(79,069)
Issue of new shares by the Company upon listing *(note 29(vii))*	7,046	1,183,554	—	—	—	—	—	—	—	—	—	1,190,600	—	1,190,600
Issue of new shares by the Company upon capitalisation issue *(note 29(vi))*	29,481	(29,481)	—	—	—	—	—	—	—	—	—	—	—	—
Issue of new shares by the Company upon exercise of over-allotment option *(note 29(viii))*	1,194	200,559	—	—	—	—	—	—	—	—	—	201,753	—	201,753
Shares issue expenses	—	(59,839)	—	—	—	—	—	—	—	—	—	(59,839)	—	(59,839)
Repurchase and cancellation of shares *(note 29(ix))*	(8)	(1,561)	—	8	—	—	—	—	—	—	(8)	(1,569)	—	(1,569)
Proposed final dividend *(note 13)*	—	—	—	—	—	—	216,093	—	—	—	(216,093)	—	—	—
Appropriations	—	—	—	—	—	54,448	—	—	—	—	(54,448)	—	—	—
At 31 December 2007	41,219	1,379,483	—	8	9,946	61,216	216,093	—	—	(10,680)	71,985	1,769,270	112	1,769,382

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2008

	Equity attributable to equity holders of the Company													
	Share capital RMB'000	Share premium RMB'000	Capital contribution RMB'000	Capital redemption reserve RMB'000	Capital reserve RMB'000 *(note 31(b)(ii))*	Statutory reserves RMB'000 *(note 31(b)(iii))*	Dividend reserve RMB'000	Treasury share reserve RMB'000 *(note 31(b)(iv))*	Employee share-based compensation reserve RMB'000 *(note 31(b)(v))*	Translation reserve RMB'000	Retained profits RMB'000	Total RMB'000	Minority interests RMB'000	Total equity RMB'000
At 1 January 2008	41,219	1,379,483	—	8	9,946	61,216	216,093	—	—	(10,680)	71,985	1,769,270	112	1,769,382
Exchange difference arising on translation of overseas operations and net expense recognised directly in equity	—	—	—	—	—	—	—	—	—	(45,027)	—	(45,027)	—	(45,027)
Profit for the year	—	—	—	—	—	—	—	—	—	—	239,381	239,381	(112)	239,269
Total recognised income and expense for the year	—	—	—	—	—	—	—	—	—	(45,027)	239,381	194,354	(112)	194,242
Interim dividend declared *(note 13)*	—	—	—	—	—	—	47,496	—	—	—	(47,496)	—	—	—
Dividend paid *(note 13)*	—	—	—	—	—	—	(263,589)	—	—	—	(9,057)	(272,646)	—	(272,646)
Purchase of treasury shares	—	—	—	—	—	—	—	(14,107)	—	—	—	(14,107)	—	(14,107)
Recognition of share-based payments *(note 30)*	—	—	—	—	—	—	—	—	1,014	—	—	1,014	—	1,014
Vested shares paid to employees	—	—	—	—	—	—	—	1,675	(1,014)	—	(661)	—	—	—
Repurchase and cancellation of shares *(note 29(x))*	(1,955)	(222,119)	—	1,955	—	—	—	—	—	—	(1,955)	(224,074)	—	(224,074)
Proposed final dividend *(note 13)*	—	—	—	—	—	—	51,275	—	—	—	(51,275)	—	—	—
Appropriations	—	—	—	—	—	36,476	—	—	—	—	(36,476)	—	—	—
At 31 December 2008	**39,264**	**1,157,364**	**—**	**1,963**	**9,946**	**97,692**	**51,275**	**(12,432)**	**—**	**(55,707)**	**164,446**	**1,453,811**	**—**	**1,453,811**

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2008

	2008 RMB'000	2007 RMB'000
Cash flows from operating activities		
Profit before income tax	261,904	427,081
Adjustments for:		
Share of results of an associate	276	—
Fair value loss/(gain) on financial assets at fair value through profit or loss	35,217	(106)
Fair value gain on derivative financial instrument	(32,231)	—
Interest income	(29,148)	(7,008)
Dividend income from available for sale financial assets	(176)	—
Amortisation of land use rights	103	5
Amortisation of intangible assets	3,378	—
Depreciation of property, plant and equipment	33,315	9,341
Equity-settled share-based payments	1,014	—
Loss on disposals of property, plant and equipment	175	20
Impairment on receivables	1,660	541
Foreign exchange differences	24,939	(8,171)
Operating profit before changes in working capital	300,426	421,703
Increase in trade and other receivables, prepayments and deposits	(4,375)	(27,314)
Decrease in amounts due from related parties	8,832	1,072
Increase in trade and other payables, accruals and deferred income	8,415	7,352
Decrease in amounts due to related parties	(76)	(649)
Cash generated from operations	313,222	402,164
Income tax paid	(39,153)	(25,692)
Net cash generated from operating activities	274,069	376,472

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31 December 2008

	2008	2007
	RMB'000	RMB'000
Cash flows from investing activities		
Interest received	12,336	6,840
Dividend income from available-for-sale financial asset	176	—
Increase in interest in an associate	(500)	—
Proceeds from disposals of property, plant and equipment	246	10
Proceeds from disposals of investment in trading securities	—	957
Increase in term deposits with initial term of over three months	(579,454)	(50,000)
Advance of loans to key management and staff	(7,450)	—
Repayment of loans from staff	175	—
Additions to land use rights	(6,291)	(1,179)
Additions to property, plant and equipment	(68,557)	(47,504)
Additions to intangible assets	(14,258)	—
Deposit paid for acquisition of property, plant and equipment	(7,357)	—
Additions to financial assets at fair value through profit or loss	(340,818)	—
Net cash used in investing activities	(1,011,752)	(90,876)
Cash flows from financing activities		
Proceeds from share issued by the Company	—	1,394,166
Proceeds from share issued by a subsidiary	—	48,399
Dividend paid *(note 13)*	(263,589)	(79,069)
Share issue expenses	—	(59,839)
Payment for repurchase of shares	(224,074)	(1,569)
Payment for purchase of treasury shares	(14,107)	—
Net cash (used in)/generated from financing activities	(501,770)	1,302,088
Net (decrease)/increase in cash and cash equivalents	(1,239,453)	1,587,684
Cash and cash equivalents at beginning of year	1,651,380	66,322
Effect of foreign exchange rate change	(79,918)	(2,626)
Cash and cash equivalents at end of year	332,009	1,651,380

1. GENERAL INFORMATION

NetDragon Websoft Inc. (the "Company") was incorporated in the Cayman Islands on 29 July 2004 as an exempted company with limited liability. The registered office of the Company is situated at Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY1-1111, Cayman Islands and its principal place of business is situated at 58 Hot Spring Branch Road, Fuzhou, Fujian, the People's Republic of China, except Hong Kong (the "PRC") .

The Company's shares have been listed on the Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 2 November 2007. On 12 June 2008, an extraordinary general meeting ("EGM") were held to approve, among others, the Company's voluntary withdrawal of listing on GEM and proposed listing on the Main Board of the Stock Exchange by way of introduction. The proposed withdrawal was passed by the shareholders at the EGM. Further details are set out in the announcement of the Company dated 12 June 2008.

The shares of the Company have been listed on the Main Board of the Stock Exchange since 24 June 2008.

The Company is an investment holding company. The Company and its subsidiaries (collectively, the "Group") are principally engaged in online game development, including game design, programming and graphics, and online game operation.

The operations of the Group were initially conducted through Fujian NetDragon Websoft Co., Ltd. ("NetDragon (Fujian)"), a limited liability company established in the PRC by certain shareholders of the Company on 25 May 1999. NetDragon (Fujian) is legally owned by the controlling shareholders of the Company who are PRC citizens.

The existing PRC law and regulations restrict foreign investment in businesses providing internet content and information services in the PRC, which included activities and services operated by NetDragon (Fujian). As a wholly-owned foreign enterprise, the Company's wholly owned subsidiary, Fujian TQ Digital Inc ("TQ Digital"), does not have the requisite licenses to provide internet content and information services in the PRC.

Accordingly, the Group operated pursuant to a cooperation arrangement between TQ Digital and NetDragon (Fujian) prior to 1 January 2007. Under such cooperation arrangement, TQ Digital was responsible for game software development and provision of the relevant technical services while NetDragon (Fujian) was responsible for the overall operation of the relevant games. In addition, each of TQ Digital and NetDragon (Fujian) was entitled to use the trademarks, copyrights and other intellectual property rights of the other party. Revenue generated from the operations of the games was collected by TQ Digital on behalf of NetDragon (Fujian). Pursuant to the cooperation arrangement, TQ Digital would then return 30% of the total revenue received to NetDragon (Fujian), representing the revenue attributable to the operations of the games, and retain the remaining 70% of the total revenue, representing the games license fee.

1. GENERAL INFORMATION (Cont'd)

In preparation for the listing on the Stock Exchange and with a view to offer further protection to the interests of the Company and the shareholders as a whole by means of contractual arrangements, TQ Digital and NetDragon (Fujian) and its equity holders entered into certain agreements (the "Structure Contracts"), which superseded the cooperation arrangements between TQ Digital and NetDragon (Fujian) effective from 1 January 2007. Under the Structure Contracts, the decision-making rights and operating and financing activities of NetDragon (Fujian) and its subsidiary, Shanghai Tiankun Digital Technology Limited ("NetDragon (Shanghai)"), are ultimately controlled by TQ Digital. TQ Digital is also entitled to substantially all of the operating profits generated by NetDragon (Fujian) and NetDragon (Shanghai) under these arrangements.

Despite the lack of shareholding in NetDragon (Fujian), the agreements entered into by TQ Digital and the equity holders of NetDragon (Fujian) confer TQ Digital the power and authority to exercise control over NetDragon (Fujian). Pursuant to the agreements:

- all the equity holders of NetDragon (Fujian) have granted irrevocable proxy to TQ Digital or a nominee designated by TQ Digital (which will likely be a director of TQ Digital) to exercise all their voting right in the capacity of shareholders of NetDragon (Fujian);
- the equity holders of NetDragon (Fujian) have agreed not to enter into any transaction that may materially affect the assets, liabilities, equity or operations of NetDragon (Fujian) without the prior written consent of TQ Digital;
- the equity holders of NetDragon (Fujian) have agreed not to transfer, sell, pledge, dispose of or create any encumbrance on their equity interest in NetDragon (Fujian) without the prior written consent of TQ Digital;
- NetDragon (Fujian) will not distribute any dividend; and
- the equity holders of NetDragon (Fujian) have pledged their equity interest in NetDragon (Fujian) to TQ Digital as a security against its payment obligations and other obligations and covenants under the Structure Contracts.

The Structure Contracts taken as a whole allow TQ Digital to govern the financial and operating policies of NetDragon (Fujian) and TQ Digital is able to obtain substantially all economic benefits from the activities conducted by NetDragon (Fujian). Accordingly, the directors of the Company regard NetDragon (Fujian) and NetDragon (Shanghai) as the subsidiaries of the Group as defined under Hong Kong Accounting Standard 27 "Consolidated and Separate Financial Statements" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA").

1. GENERAL INFORMATION (Cont'd)

Further details of the Group reorganisation prior to the listing of the Company's shares on the GEM of the Stock Exchange, including further details of the Structure Contracts, are disclosed in the Company's prospectus dated 23 October 2007.

In view of the new enterprise income tax adopted by the National People's Congress of the PRC on 16 March 2007, a wholly owned foreign enterprise, Fujian TQ Online Interactive Inc. ("TQ Online") has been established through Glory More Limited ("Glory More"), one of the wholly owned subsidiaries of NetDragon Websoft Inc. ("NetDragon (BVI)") and incorporated in Hong Kong, to gradually replace TQ Digital in the Group's operation in order to maximise the tax benefits to the Group under the new tax law. Consequentially, TQ Online has entered into the Structure Contracts with NetDragon (Fujian) on 16 May 2008 under which any new versions of the Group's existing games and new games will be operated by TQ Online and NetDragon (Fujian).

As the Company, NetDragon (BVI), TQ Digital, NetDragon Websoft Inc. ("NetDragon (USA)"), NetDragon (Fujian), NetDragon (Shanghai), NetDragon Websoft (Hong Kong) Limited ("NetDragon (HK)"), Glory More and TQ Online were ultimately controlled by the same group of parties before and after the formation of the Group and the control is not transitory, the financial statements are thereby prepared using the principles of merger accounting as set out in Accounting Guideline 5 "Merger Accounting for Common Control Combination" issued by the HKICPA.

2. ADOPTION OF NEW AND AMENDED HKFRSs

In the current year, the Group has applied for the first time the following new standards, amendments and interpretations (the "new HKFRSs") issued by the HKICPA, which are relevant to and effective for the Group's financial statements for the annual period beginning on 1 January 2008:

HK(IFRIC) – INT 11	HKFRS 2: Group and Treasury Share Transactions
HKAS 39 (Amendments)	Reclassification of Financial Assets

The new HKFRSs had no material impact on how the results and financial position for the current and prior periods have been prepared and presented. Accordingly, no prior period adjustment is required.

At the date of authorisation of these financial statements, the following new and amended HKFRSs have been published but are not yet effective, and have not been adopted early by the Group.

HKAS 1 (Revised)	Presentation of Financial Statements [1]
HKAS 23 (Revised)	Borrowing Costs [1]
HKAS 27 (Revised)	Consolidated and Separate Financial Statements [2]
HKAS 32, HKAS 39 & HKFRS 7 (Amendments)	Puttable Financial Instruments and Obligations Arising on Liquidation [1]
HKAS 39 (Amendment)	Eligible Hedged Items [2]
HKFRS 1 and HKAS 27 (Amendments)	Cost of an Investment in a Subsidiary, Jointly Controlled Entity or an Associate [1]
HKFRS 2 (Amendment)	Share-based Payment – Vesting Conditions and Cancellations [1]
HKFRS 3 (Revised)	Business Combinations [2]
HKFRS 8	Operating Segments [1]
HK(IFRIC) – INT 13	Customer Loyalty Programmes [3]
HK(IFRIC) – INT 15	Agreements for the Construction of Real Estate [1]
HK(IFRIC) – INT 16	Hedges of a Net Investment in a Foreign Operation [4]
HK(IFRIC) – INT 17	Distribution of Non-cash Assets to Owners [2]
HK(IFRIC) – INT 18	Transfers of Assets from Customers [5]
Various	Annual Improvements to HKFRS 2008 [6]

[1] Effective for annual periods beginning on or after 1 January 2009

[2] Effective for annual periods beginning on or after 1 July 2009

[3] Effective for annual periods beginning on or after 1 July 2008

[4] Effective for annual periods beginning on or after 1 October 2008

[5] Effective for transfers of assets from customers received on or after 1 July 2009

[6] Generally effective for annual periods beginning on or after 1 January 2009 unless otherwise stated in the specific HKFRS

2. ADOPTION OF NEW AND AMENDED HKFRSs (Cont'd)

The directors anticipate that all of these pronouncements will be adopted in the Group's accounting policy for the first period beginning after the effective date of the pronouncement.

Among these new standards and interpretations, HKAS 1 (Revised) Presentation of Financial Statements is expected to materially change the presentation of the Group's financial statements.

The amendment affects the presentation of owner changes in equity and introduces a statement of comprehensive income. Preparers will have the option of presenting items of income and expense and components of other comprehensive income either in a single statement of comprehensive income with subtotals or in two separate statements (a separate income statement followed by a statement of other comprehensive income). The management is in the process of making an assessment of what the impact of this amendment is expected to be in the period of initial application. So far it has concluded that the adoption of this amendment does not affect the financial position and results of the Group, but will give rise to additional disclosures.

In addition, HKFRS 8 Operating Segments may result in new or amended disclosures. The management is in the process of identifying reportable operating segments as defined in HKFRS 8.

The directors are currently assessing the impact of the other new or amended HKFRSs upon initial application. So far, the directors have preliminary concluded that the initial application of these HKFRSs is unlikely to have a significant impact on the Group's results and financial position.

3. CHANGE IN ACCOUNTING ESTIMATES

In previous year, computer and office equipment were depreciated at 19-20% per annum. With effect from 1 January 2008, computer and office equipment were depreciated at 19-31.67% per annum. Such change is mainly due to the change in management estimation to better reflect the useful life of computer and office equipment. This change in depreciation rate has increased the depreciation charge for the year by approximately RMB9,152,000.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

The financial statements on pages 69 to 148 of the Group have been prepared in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Interpretations issued by the HKICPA. The financial statements also comply with the applicable disclosure requirements of the Hong Kong Companies Ordinance and the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules").

The financial statements for the year ended 31 December 2008 were approved and issued by the board of directors on 12 March 2009.

The significant accounting policies that have been used in the preparation of these financial statements are summarised below. These policies have been consistently applied to all the years presented unless otherwise stated.

The financial statements have been prepared under the historical cost except for financial instruments classified as at fair value through profit or loss and derivative financial instrument which are stated at fair values. The measurement bases are fully described in the accounting policies below.

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries (note 4(c) below) made up to 31 December each year.

It should be noted that accounting estimates and assumptions have been used in preparing the consolidated financial statements. Although these estimates are based on management's best knowledge and judgement of current events and actions, actual results may ultimately differ from those estimates and assumptions. The areas where assumptions and estimates are significant to the financial statements or areas involving higher degree of judgement or complexity are set out in note 5 "Critical Accounting Estimates and Judgements".

(b) Merger accounting

The net assets of the combining entities or businesses are combined using the existing book values from the controlling parties' perspective. No amount is recognised as consideration for goodwill or excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost at the time of common control combination. The consolidated financial statements include the results of each of the combining entities or businesses from the date of incorporation/ establishment or since the date when the combining entities or businesses first came under the common control, where this is a shorter period, regardless of the date of the common control combination. All significant intra-group transactions, balances and unrealised gains on transactions have been eliminated on combination. Unrealised losses are also eliminated unless the transactions provide evidence of an impairment of the asset transferred.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(c) Subsidiaries

A subsidiary is an entity (including special purpose entity) over which the Group has power to govern its financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights, so as to obtain benefits from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Purchase method of accounting is used to account for the acquisition of subsidiaries by the Group, except for those acquisitions which qualify as a common control combination, which are accounted for using merger accounting as detailed in note 4(b).

All the material intra-group transactions, balances and unrealised gains on transactions between group companies are eliminated in preparing the consolidated financial statements. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

In the Company's balance sheet, the investment in subsidiary is stated at cost less provision for impairment losses, if any. The result of subsidiary is accounted for by the Company on the basis of dividends received and receivable.

Minority interest represents the portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned by the Group and are not the Group's financial liabilities.

Minority interests are presented in the consolidated balance sheet within equity, separately from the equity attributable to the equity holders of the Company. Profit or loss attributable to the minority interests are presented separately in the consolidated income statement as an allocation of the Group's results. Where losses applicable to the minority exceeds the minority interests in the subsidiary's equity, the excess and further losses applicable to the minority are allocated against the minority interest to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses. Otherwise, the losses are charged against the Group's interests. If the subsidiaries subsequently report profits, such profits are allocated to the minority interest only after the minority's share of losses previously absorbed by the Group has been recovered.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(d) Associates

An associate is an entity over which the Group is able to exercise significant influence, generally accompanying a shareholding of between 20% and 50% of the voting rights but which are neither subsidiaries nor investment in a joint venture. An investment in an associate is accounted for in the consolidated financial statements under the equity method of accounting and is initially recorded at cost and adjusted thereafter for the post-acquisition changes in the Group's share of the associate's net assets less any identified impairment losses, unless it is classified as held for sale. The consolidated income statement include the Group's share of the post-acquisition, post-tax results of the associate for the year.

(e) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment losses.

The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in future economic benefits expected to be obtained from the use of the item of property, plant and equipment, and where the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

Depreciation is calculated on a straight-line basis to write off the cost of each item of property, plant and equipment over its estimated useful life, after taking account of its estimated residual value. The principal annual rates used for this purpose is as follows:

Buildings	4.75%
Leasehold improvements	shorter of the lease terms and 20% - 33.33%
Computer and office equipment	19% - 31.67%
Motor vehicles	19% - 23.75%

Useful lives, residual values and depreciation methods are reviewed and adjusted, if appropriate, at each balance sheet date.

An item of property, plant and equipment is derecognised upon disposal or when no further economic benefits are expected to arise from the continued use of the item. Any gain or loss arising on derecognising the item (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the period the item is derecognised.

Construction in progress is stated at cost less any impairment losses, and is not depreciated. Construction in progress is reclassified to the appropriate category of property, plant and equipment or investment properties when completed and ready for use.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(f) Intangible assets

Intangible assets acquired separately are recognised initially at cost. After initial recognition, intangible assets with finite useful lives are carried at cost less accumulated amortisation and any accumulated impairment losses. Amortisation for intangible assets with finite useful lives is provided on straight-line basis over their estimated useful lives of 4 to 5 years.

(g) Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessee, rentals payable under the operating leases are charged to the income statement on the straight-line basis over the lease terms.

Payment for obtaining land use rights is considered as operating leases payment are initially stated at cost and subsequently charged to income statement over the period of the right using the straight-line method.

(h) Foreign currencies

Items included in the financial statements of each of the Group entities are measured using the currency of the primary economic environment in which the Group entity operates (i.e. the "functional currency"). The functional currency of the Company is Hong Kong dollars. The consolidated financial statements are presented in Renminbi ("RMB"), since the major subsidiaries of the Group are operating in a RMB environment and the functional currency of the major subsidiaries is RMB.

In preparing the financial statements of individual Group entity, transactions in currencies other than the Group entity's functional currency (i.e. foreign currency) are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are not translated.

For the purpose of preparing the consolidated financial statements, the assets and liabilities of the subsidiaries in which functional currency is not RMB are translated into RMB at the exchange rates ruling at the balance sheet date, and their income statements are translated into RMB at the weighted average exchanges rates for the year. Foreign exchange gains and losses arising thereon are dealt with in the translation reserve. Such translation differences are recognised in the income statement in the period in which the foreign operation is disposed of.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(i) Impairment of non-financial assets

Where an indication of impairment exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount.

An asset's recoverable amount is the higher of its fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Where the carrying amount of an asset/a cash-generating unit exceeds its recoverable amount, the asset/cash-generating unit is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset/cash-generating unit. An impairment loss is charged to the income statement in the period in which it arises.

A previously recognised impairment loss on non-financial assets other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset/cash-generating unit, provided the increased amount of the asset/cash-generating unit does not exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset/cash-generating unit in prior years. Such reversal is credited to the income statement in the period in which it arises.

(j) Financial assets

The Group's financial assets are classified into financial assets at fair value through profit or loss, available-for-sale financial assets and loans and receivables. Management determines the classification of its financial assets at initial recognition depending on the purpose for which the financial assets were acquired and where allowed and appropriate, re-evaluates this designation at the balance sheet date.

All financial assets are recognised when, and only when, the Group becomes a party to the contractual provisions of the instrument. All regular way purchases and sales of financial assets are recognised on trade date. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

Derecognition of financial assets occurs when the rights to receive cash flows from the investments expire or are transferred and substantially all of the risks and rewards of ownership have been transferred.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(j) Financial assets (Cont'd)

At each balance sheet date, financial assets are reviewed to assess whether there is objective evidence of impairment. If any such evidence exists, impairment loss is determined and recognised based on the classification of the financial asset.

(i) Financial assets at fair value through profit or loss

When a contract contains one or more embedded derivatives, the entire hybrid contact may be designated as a financial asset at fair value through profit or loss, except when the embedded derivative does not significantly modify the cash flows or it is clear that separation of the embedded derivative is prohibited.

Financial assets may be designated at initial recognition as at fair value through profit or loss if the following criteria are met:

— the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on different basis; or

— the assets are part of a group of financial assets which are managed and their performance is evaluated on a fair value basis, in accordance with a documented risk management strategy and information about the group of financial assets is provided internally on that basis to the key management personnel; or

— the financial asset contains an embedded derivative that would need to be separately recorded.

(ii) Loans and receivables

Loans and receivables including trade and other receivables, loan receivables, amounts due from related parties, term deposits with initial term of over three months and cash and cash equivalents are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Trade receivables are included in current assets. Other loans and receivables are included in current assets unless they are expected not to be realised within 12 months after the balance sheet date and in such case, they are classified as non-current assets in the balance sheet.

Loans and receivables are subsequently carried at amortised cost using the effective interest method, less any impairment losses. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction cost. Changes in value of loans and receivables through the amortisation process are recognised in the income statement.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(j) Financial assets (Cont'd)

(iii) Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are either designated or not classified in any other categories of financial assets. They are included in non-current assets unless management intends to dispose of the assets within 12 months from the balance sheet date.

After initial recognition, available-for-sale financial assets are measured at fair value. Gain or loss arising from changes in fair value excluding any dividend and interest income is recognised as a separate component of equity until they are disposed of or determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is removed from equity and recycled to the income statement.

For available-for-sale equity investment which fair value cannot be measured reliably because (1) the variability in the range of reasonable fair value estimates is significant for that investment and (2) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such investment is stated at cost less any impairment losses.

(k) Impairment of financial assets

At each balance sheet date, the Group assesses whether there is objective evidence that financial assets other than at fair value through profit or loss are impaired.

Objective evidence of impairment includes observable data that comes to the attention of the Group about one or more of the following loss events:

— significant financial difficulty of the debtor;

— a breach of contract, such as a default or delinquency in interest or principal payments;

— it becoming probable that the debtor will enter bankruptcy or other financial reorganisation;

— significant changes in the technological, market, economic or legal environment that have an adverse effect on the debtor; and

— a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(k) Impairment of financial assets (Cont'd)

If such evidence exists, the impairment loss is measured and recognised as follows:

(i) Loans and receivables

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The amount of impairment loss is recognised in the income statement of the period in which the impairment occurs. In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Group will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the loans and receivables is directly reduced by any identified amount of impairment with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

If, in subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed to the extent that it does not result in a carrying amount of the financial asset exceeding what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal is recognised in the income statement of the period in which the reversal occurs.

(ii) Available-for-sale financial assets measured at cost

If there is objective evidence that an impairment loss on an unquoted investment that is not carried at fair value has been incurred, the amount of impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed in subsequent period in which the reversal occurs.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(l) Derivative financial instrument

The derivative financial instrument represents the foreign currency forward contract which is initially recognised at fair value on the date on which a derivative contract is entered into and is subsequently re-measured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in fair value on derivative during the year that do not qualify for hedge accounting are taken directly to the income statement.

(m) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and at bank, demand deposits with banks and cash deposited with online payment service provider which can be readily withdrawn.

(n) Financial liabilities

Financial liabilities include trade and other payables and accruals as well as amounts due to related parties which are initially stated at fair value and subsequently carried at amortised cost using the effective interest method. Changes in value of financial liabilities through the amortisation process are recognised in the income statement.

(o) Provisions and contingent liabilities

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation. When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group, are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(p) Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Current tax assets and liabilities for the current year and prior periods are measured at the amounts expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised for all deductible temporary differences, unused tax losses available to be carried forward as well as other unused tax credits, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, the unused tax credits and the unused tax losses can be utilised.

Deferred tax assets and liabilities are not recognised if temporary differences arise from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction, affect neither the accounting profit nor taxable profit or loss.

Deferred tax liabilities in respect of taxable temporary differences associated with an investment in subsidiaries are not recognised where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profits will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax is calculated at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(q) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before the revenue is recognised:

(i) The Group sells pre-paid game cards to distributors and online game players. With the pre-paid game cards, online game players can credit their online game accounts with game points which can be used for the consumption of certain online games of the Group or for purchasing virtual products or premium features for the consumption of other online games of the Group which are free-to-play. The game users can also credit their online user accounts directly. Such income received is deferred and recorded as deferred income under current liabilities and would be recognised as revenue (i.e. online game revenue) upon the actual usage of the game points. Revenue recognised in respect of operating the online games is net of discounts, business tax and other related taxes and charges.

(ii) Licence fee income included in online game revenue, is recognised on an accrual basis in accordance with the substance of the relevant agreement. The income determined on a time basis is recognised on a straight-line basis over the period of the agreement.

(iii) Advertising income is recognised when the advertisements are published or broadcasted on the Group's online game and film advertisement. The advertising income is net of any discounts, business tax and other related taxes and charges.

(iv) Dividend is recognised when the right to receive payment is established.

(v) Grants from government are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as other revenue and presented as such over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

(vi) Interest income is recognised on a time-proportion basis using the effective interest method.

(r) Cost of revenue

Costs of revenue consist primarily of rental and maintenance fees of computer equipment and software, fees in respect of internet services, handling charges for online payment services, manufacturing costs for pre-paid game card, depreciation and amortisation, which are recognised in the income statement upon utilisation of the relevant services or when the relevant costs are incurred, as appropriate.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(s) Development costs

Expenditure incurred on projects to develop new products is charged to income statement as incurred unless the Group can demonstrate the technical feasibility of completing the projects so that the asset generated will be available for use or sale, its intention to complete the projects and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the project and the ability to measure reliably the expenditure during the development. In such case, development expenditure is capitalised and deferred as intangible asset, and is amortised over its estimated useful life.

(t) Employee benefits

(i) Pension obligations

In accordance with the rules and regulations in the PRC, the employees of the entities established in the PRC participate in defined contribution retirement benefits plans organised by regional governments. The regional governments undertake to assume the retirement benefit obligations of all existing and future retired employees payable under the plan described above. Contributions to these plans are expensed as incurred and other than these monthly contributions, the Group has no further obligation for the payment of retirement benefits of its employees. The assets of these plans are held separately from those of the Group in an independent fund managed by the PRC government.

The Group's contributions to the defined contribution retirement benefit plan are not reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions.

(ii) Share-based employee compensation

Share option scheme

The Group operates equity settled share-based compensation plans for remuneration of its employees.

All employee services rendered in exchange for the grant of any share-based compensation are measured at their fair values. These are indirectly determined by reference to the share options awarded. The value is appraised at the grant date and excludes the impact of any non-market vesting conditions.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(t) Employee benefits (Cont'd)

(ii) Share-based employee compensation (Cont'd)

Share option scheme (Cont'd)

All share-based compensation is recognised as expense in income statement with a corresponding credit to equity share option reserve, net of deferred tax where applicable. If vesting periods or other vesting conditions apply, the expense is recognised over the vesting period, based on the best available estimate of the number of share options expected to vest. Non-market vesting conditions are included in assumptions about the number of share options expected to become exercisable. Estimates are subsequently revised, if there is any indication that the number of share options expected to vest differs from previous estimates. No adjustment to expense recognised in prior periods is made if fewer share options ultimately are exercised than originally vested.

At the time when the share options are exercised, the amount previously recognised in share option reserve will be transferred to share premium. When the share options are forfeited or are still not exercised at the expiry date, the amount previously recognised in share option reserve will be transferred to retained profits.

Share award scheme

The Group operates a share award scheme which allows it to issue equity-settled share-based payments to selected employees. For the shares granted to the employees, the fair value of the employee services received in exchange for the grant of the shares is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the shares granted. At each balance sheet date, the Group revises its estimates of the number of shares that are expected to vest. It recognises the impact of the revision of original estimates, if any, in the income statement, with a corresponding adjustment to equity.

(u) Share capital

Ordinary shares and non-redeemable preferred shares with discretionary dividends are classified as equity. Any transaction costs associated with the issuing of shares are deducted from share premium to the extent they are incremental costs directly attributable to the equity transactions.

(v) Dividends

Dividends proposed by the directors of the group entities are classified as a separate allocation of retained profits within the equity section of the balance sheet, until they have been approved by the equity holders in a general meeting. When these dividends have been approved by the equity holders and declared, they are recognised as a liability.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(w) Related parties

A party is considered to be related to the Group if:

(i) the party, directly or indirectly through one or more intermediaries, (1) controls, is controlled by, or is under common control within, the Group; (2) has an interest in the Group that gives it significant influence over the Group; or (3) has joint control over the Group;

(ii) the party is an associate;

(iii) the party is a jointly controlled entity;

(iv) the party is a member of the key management personnel of the Group or its parent;

(v) the party is a close member of the family of any individual referred to in (i) or (iv);

(vi) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (iv) or (v); or

(vii) the party is a post-employment benefit plan for the benefit of the employees of the Group, or of any entity that is a related party of the Group.

(x) Treasury shares held for share award scheme

Where the shares of the Company are acquired under the share award scheme, the consideration paid, including any directly attributable incremental costs, is presented as “Treasury share reserve” and deducted from total equity.

5. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

In the process of applying the Group's accounting policies, which are described in note 4, management has made various estimates and judgements which are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Estimates and judgements are continually evaluated. The key source of estimating uncertainty and accounting judgements that result in significant risk of causing a material adjustment to the carrying amount of assets and liabilities in the next financial year or significantly affect the amounts recognised in the financial statements are discussed below:

(i) Online game revenue recognition

Online game revenue is recognised based on the actual consumption of the relevant game points. Income received in respect of unutilised game points including those arising from unactivated pre-paid game cards is recognised as deferred income. Online game income received is net of discounts given to certain distribution and payment channels. The amount of deferred income arising from unactivated pre-paid game cards is extracted from the accounting system of the Group. As to the amount of deferred income in respect of other unutilised game points, management's estimation is required in determining the average sales value of these unutilised game points as discounts given are different for different sales channels.

In assessing the amount of average sales value for the unutilised game points, management considers the discount rate applicable to each of the distribution and payment channels and the mix of income received via different distribution and payment channels. Based on these factors, management determines an average discount rate which gives rise to the best estimate of the discount given to those unutilised game points at year end. The average sales value of each game point is then determined by factoring the average discount rate to the face value of the game point. If the actual sales value of the unutilised game points differs from management's estimates, the amount of deferred income as well as online game revenue recognised would be affected.

(ii) Subsidiary

NetDragon (Fujian) and NetDragon (Shanghai) are accounted for as subsidiaries as a consequence of the Structure Contracts. Significant judgements have been exercised by the management in assessing and concluding that NetDragon (Fujian) and NetDragon (Shanghai) are subsidiaries of the Group. Details of the judgement made by the management are disclosed in note 1.

5. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Cont'd)

(iii) Useful lives of property, plant and equipment

The Group's management determines the estimated useful lives of the property, plant and equipment of the Group. This estimate is based on the historical experience of the actual useful lives of the relevant assets of similar nature and functions. The estimated useful lives could be different as a result of technical innovations which could affect the related depreciation charges included in income statement.

(iv) Impairment of receivables

The Group's management determines the provision for impairment of receivables. This estimate is based on the credit history of the customers and other debtors and the current market condition. Management will reassess the provision at each balance sheet date. The Group's estimates may be inaccurate and any changes in estimates would affect profit or loss in future years.

6. FINANCIAL RISK MANAGEMENT AND CAPITAL MANAGEMENT

6.1 Financial risk management

The Group is exposed to a variety of financial risk through its use of financial instruments in its ordinary course of operations and in its investment activities. The financial risks include market risk (including foreign currency risk, interest rate risk and price risk), credit risk and liquidity risk. The Group's overall risk management focuses on unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. Risk management is carried out by key management under the policies approved by the board of directors. The Group does not have written risk management policies. However, the board of directors meet regularly and cooperate closely with key management to identify and evaluate risks and to formulate strategies to manage financial risks.

(a) Market risk

(i) Foreign exchange risk

Most of the subsidiaries' functional currencies are RMB since majority of the revenues of the Group are derived from the operations in the PRC. RMB is not freely convertible into other foreign currencies and conversion of RMB into foreign currencies is subject to rules and regulation of foreign exchange control promulgated by the PRC Government. The Group also has operations in Hong Kong and the United States of America ("USA") and the business transactions conducted there during the year were mainly denominated and settled in Hong Kong dollars ("HKD") and US dollars ("USD"), which are the functional currencies of the relevant subsidiaries. The exposure in exchange rate risks mainly arises from fluctuations in foreign currencies against the functional currency of the relevant Group entities. The Group currently does not have hedging policy in respect of the foreign currency risk. However, management monitors the related foreign currency risk exposure closely and will consider hedging significant foreign currency risk exposure should the need arises.

The Group may also experience a loss as a result of any foreign currency exchange fluctuations in connection with its financial assets at fair value through profit or loss as mentioned in note 24. The Group has entered into a forward contract arrangement that minimise the foreign exchange risk as mentioned in note 25. Hence, the management considers that the foreign exchange risk encountered by the Group is currently not material.

6. FINANCIAL RISK MANAGEMENT AND CAPITAL MANAGEMENT (Cont'd)

6.1 Financial risk management (Cont'd)

(a) Market risk (Cont'd)

(i) Foreign exchange risk (Cont'd)

Based on the market conditions as at 31 December 2008, the Group determined that it is reasonably possible for RMB to strengthen/weaken by 5% against HKD and USD in the coming twelve months. If RMB had strengthened/weakened by 5% against HKD and USD with all other variables held constant, the Group's profit after tax and retained earnings would have changed mainly as a result of foreign exchange gains/losses on settlement of denominated dividend payable into HKD from a PRC subsidiary to the Company and settlement of outstanding foreign currency denominated monetary items. Details of the changes are as follows:

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Profit for the year increase/(decrease)				
– Strengthened 5%	**15,539**	11,041	**—**	—
– Weakened 5%	**(15,539)**	(11,041)	**—**	—

The changes in foreign exchange rates do not affect the Company's and the Group's other components of equity.

6. FINANCIAL RISK MANAGEMENT AND CAPITAL MANAGEMENT (Cont'd)

6.1 Financial risk management (Cont'd)

(a) Market risk (Cont'd)

(ii) Interest rate risk

The Group has no external borrowing. The Group is exposed to fair value interest rate risk through the impact of rate changes on interest-bearing financial assets, cash and cash equivalents (note 27), term deposits with initial terms of over three months (note 26) and financial assets at fair value through profit or loss (note 24). However, the Group's income and operating cash flows are substantially independent of changes in market interest rates. Management considers that the interest rate risk encountered by the Group is currently not significant.

Based on the market conditions as at 31 December 2008, the Group determined that it is reasonably possible for interest rates on term deposits with initial maturity of over three months (note 26) and cash and cash equivalents (note 27) to strengthen by 50 basis points and weaken by 10 basis points in the coming twelve months. If interest rates on term deposits with initial maturity of over three months and cash and cash equivalents had been 50 basis points higher/10 basis points lower with all other variables held constant, the profit after tax and retained earnings would have changed mainly as a result of higher/lower interest income on floating rate financial assets. Details of the changes are as follows:

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Profit for the year increase/(decrease)				
– 50 Basis points higher	**3,207**	8,506	**170**	6,588
– 10 Basis points lower	**(640)**	(1,701)	**(9)**	(1,318)

The change in interest rates does not affect the Company's and the Group's other components of equity.

6. FINANCIAL RISK MANAGEMENT AND CAPITAL MANAGEMENT (Cont'd)

6.1 Financial risk management (Cont'd)

(b) Credit risk

Credit risk arises from term deposits with initial term of over three months, cash and cash equivalents, trade receivables, other receivables, loan receivables, amounts due from related parties, financial assets at fair value through profit or loss and derivative financial instrument. The Group limits its exposure to credit risk by rigorously selecting the counterparties. The Group's exposure to credit risk is summarised as follows:

	2008	2007
	RMB'000	RMB'000
Term deposits with initial term of over three months	**629,454**	50,000
Cash and cash equivalents	**332,009**	1,651,380
Trade receivables	**9,500**	26,940
Other receivables	**24,624**	6,140
Loan receivables	**7,275**	—
Amounts due from related parties	**—**	8,832
Financial assets at fair value through profit or loss	**311,806**	—
Derivative financial instrument	**31,857**	—

The carrying amount of term deposits with initial term of over three months, cash and cash equivalents, trade receivables, other receivables, loan receivables, amounts due from related parties, financial assets at fair value through profit or loss and derivative financial instrument represent the Group's maximum exposure to credit risk.

Credit risk on term deposits with initial term of over three months, cash and cash equivalents, financial assets at fair value through profit or loss and derivative financial instrument are mitigated as counterparties are banks or financial institutions with high credit ratings or reputable online payment service provider. Credit risk on trade receivables, other receivables, loan receivables and amounts due from related parties is minimised as the Group performs ongoing credit evaluation on the financial condition of its debtors and tightly monitors the ageing of the receivable balances. Follow up action is taken in case of overdue balances. In addition, management reviews the recoverable amount of the receivables individually or collectively at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts.

None of the Group's financial assets are securitised by collateral or other credit enhancements.

6. FINANCIAL RISK MANAGEMENT AND CAPITAL MANAGEMENT (Cont'd)

6.1 Financial risk management (Cont'd)

(c) Liquidity risk

Management of the Group aims at maintaining sufficient level of cash and cash equivalents to finance the Group's operations and expected expansion. The Group's primary cash requirements include payments for operating expenses and additions or upgrades of property, plant and equipment and intangible assets. The Group finances its working capital requirements mainly by the funds generated from operations.

The Group's financial liabilities (including trade and other payables and accruals as well as amount due to a related party) will be settled within 12 months from the balance sheet date. The Group manages liquidity risk by forecasting the amount of cash required and monitoring the working capital of the Group to ensure that all liabilities due and known funding requirements could be met. Based on the assessment of the management, liquidity risk encountered by the Group is minimal.

6.2 Fair value estimation

The fair values of financial instruments traded in active markets are based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price. The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. The fair value of debt securities is determined using the method of estimated discount cash flows. The fair value of foreign currency forward contract is calculated by reference to market forward currency rates for contracts with similar maturity profiles. The fair value of long-term loan receivables is estimated by discounting the future cash flows at the current market interest rate of similar financial assets.

The carrying values of trade and other receivables, prepayments and deposits, loan receivables, financial assets at fair value through profit or loss, derivative financial instrument, amounts due from related parties, cash and cash equivalents, term deposits with initial term of over three months and trade and other payables, accruals and deferred income are assumed to approximate their fair values due to the short-term maturity of these balances.

6. FINANCIAL RISK MANAGEMENT AND CAPITAL MANAGEMENT (Cont'd)

6.3 Capital management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders, to maintain an optimal capital structure to reduce the cost of capital and to support the Group's stability and growth.

The Group actively and regularly reviews and manages its capital structure to ensure optimal capital structure and shareholder returns, taking into consideration the future capital requirements of the Group. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, issue new shares or return capital to shareholders.

Management regards total equity as capital. The amount of capital as at 31 December 2008 amounted to RMB1,453,811,000 (2007: RMB1,769,382,000), which the management considers as optimal having considered the projected capital expenditures and the projected strategic investment opportunities.

The details of the total equity of the Group as at 31 December 2008 and 2007 are as follows:

	2008 RMB'000	2007 RMB'000
Share capital	39,264	41,219
Reserves	1,414,547	1,728,051
Equity attributable to equity holders of the Company	1,453,811	1,769,270
Minority interests	—	112
Total equity	1,453,811	1,769,382

7. SEGMENT INFORMATION

Based on risks and returns, the directors of the Company consider that the primary reporting format of the Group is by business segment. The directors consider that there is only one business segment, being online game development and operation and marketing of those online games. Therefore no further information about business segment is presented.

Geographical segment is the secondary reporting format of the Group. In determining the Group's geographical segments, revenue is attributed to the segments based on the location where services are provided and assets and capital expenditure are attributed to the segments based on the location of the assets. Unallocated assets mainly comprise investment in an associate, available-for-sale financial asset, deferred tax assets, financial assets at fair value through profit or loss, derivative financial instrument, tax recoverable and amounts due from related parties.

The Group's revenue analysed by geographical markets during the year is presented below:

	2008 RMB'000	2007 RMB'000
PRC	446,350	524,652
USA	135,520	117,030
Unallocated	14,111	3,532
	595,981	645,214

The carrying amount of segment assets and capital expenditure, which represent additions to property, plant and equipment and intangible assets, analysed by geographical markets is presented below:

	Segment assets	
	2008 RMB'000	2007 RMB'000
PRC	169,952	116,270
USA	14,577	7,983
Hong Kong	19,094	5,559
Unallocated	1,316,787	1,714,848
	1,520,410	1,844,660

7. SEGMENT INFORMATION (Cont'd)

	Capital expenditure	
	2008	2007
	RMB'000	RMB'000
PRC	**68,308**	47,440
Hong Kong	**14,507**	—
USA	**—**	64
	82,815	47,504

8. REVENUE AND GAINS

	2008	2007
	RMB'000	RMB'000
Revenue		
Online game revenue	**595,981**	645,214
Other revenue and gains		
Advertising income	**7,865**	—
Dividend income from available-for-sale financial asset	**176**	—
Fair value gain on financial asset at fair value through profit or loss	**—**	106
Fair value gain on derivative financial instrument	**32,231**	—
Government grants *(note)*	**24,608**	735
Interest income on bank balances and loan receivables stated at amortised cost classified as at fair value through profit or loss	**24,316**	7,008
Interest income on financial assets at fair value through profit or loss	**4,832**	—
Others	**1,055**	472
	95,083	8,321
	691,064	653,535

Note: Government grants totally RMB2,196,000 (2007: RMB735,000) were received from the PRC government for subsidising the Group in conducting and launching projects relating to software or technology development. The remaining amounts mainly represented various subsidies received from the PRC government authorities to encourage the Group's subsidiaries invested in Fujian. There are no unfulfilled conditions or contingencies relating to these grants.

9. PROFIT BEFORE INCOME TAX

The Group's profit before income tax is arrived at after charging the following items:

	2008 RMB'000	2007 RMB'000
Auditors' remuneration	1,358	603
Amortisation of intangible assets	3,378	—
Amortisation of land use rights	103	5
Depreciation of property, plant and equipment *(notes (i) and (ii))*	33,315	9,341
Operating lease charges on:		
– land and buildings	2,845	2,262
– computer equipment	38,215	17,507
Development costs *(note (ii))*	89,823	37,253
Staff costs *(note (iii))*	141,863	68,935
Net foreign exchange losses	13,111	3,710
Loss on disposals of property, plant and equipment	175	20
Impairment on receivables	1,660	541

Notes:

(i) Depreciation of property, plant and equipment of RMB15,628,000 (2007: RMB4,127,000) has been included in cost of revenue, RMB452,000 (2007: RMB308,000) in selling and marketing expenses and RMB15,655,000 (2007: RMB4,806,000) in administrative expenses.

(ii) Development costs mainly comprise depreciation of property, plant and equipment of RMB1,580,000 (2007: RMB100,000), and staff costs of RMB81,093,000 (2007: RMB36,268,000), which are also included in the total amounts disclosed separately above for each of these types of expenses.

The Group did not capitalise any development costs for the year ended 31 December 2008 (2007: Nil).

(iii) Breakdown of staff costs, including directors' remuneration, is as follows:

	2008 RMB'000	2007 RMB'000
Wages, salaries and bonus	123,776	59,946
Welfare, medical and other benefits	10,227	5,457
Contribution to pension plans	6,846	3,532
Equity-settled share-based payments	1,014	—
	141,863	68,935

10. REMUNERATION OF DIRECTORS AND FIVE HIGHEST PAID INDIVIDUALS

(i) Directors' remuneration

The aggregate amount of remuneration paid and payable to the directors of the Company by the Group during the year are as follows:

	2008					
	Fees RMB'000	Salaries and allowances RMB'000	Discretionary bonus RMB'000	Contribution to pension plans RMB'000	Equity-settled share-based payments RMB'000	Total RMB'000
Executive directors						
Mr Liu Dejian	—	455	—	—	—	455
Mr Liu Luyuan	—	453	—	10	—	463
Mr Zheng Hui	—	129	—	9	—	138
Mr Chen Hongzhan	—	171	—	11	—	182
Non-executive directors						
Mr Lin Dongliang	—	—	—	—	—	—
Mr Zhu Xinkun	—	—	—	—	—	—
Independent non-executive directors						
Mr Chao Guowei, Charles	180	—	—	—	133	313
Mr Lee Kwan Hung	240	—	—	—	133	373
Mr Liu Sai Keung, Thomas	—	—	—	—	133	133
	420	1,208	—	30	399	2,057

10. REMUNERATION OF DIRECTORS AND FIVE HIGHEST PAID INDIVIDUALS (Cont'd)

(i) Directors' remuneration (Cont'd)

	2007				
	Fees	Salaries and allowances	Discretionary bonus	Contribution to pension plans	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Executive directors					
Mr Liu Dejian	—	817	—	—	817
Mr Liu Luyuan	—	407	—	4	411
Mr Zheng Hui	—	151	—	4	155
Mr Chen Hongzhan	—	328	—	6	334
Non-executive directors					
Mr Lin Dongliang	—	—	—	—	—
Mr Zhu Xinkun	—	—	—	—	—
Independent non-executive directors					
Mr Chao Guowei, Charles	38	—	—	—	38
Mr Lee Kwan Hung	50	—	—	—	50
Mr Liu Sai Keung, Thomas	—	—	—	—	—
	88	1,703	—	14	1,805

There is no arrangement under which a director waived or agreed to waive any remuneration during the year.

10. REMUNERATION OF DIRECTORS AND FIVE HIGHEST PAID INDIVIDUALS (Cont'd)

(ii) Five highest paid individuals

Of the five highest paid individuals in the Group, there were no directors of the Company whose emoluments were included in the disclosure in note 10(i) above (2007: two). The emoluments of the remaining five (2007: three) highest paid individuals were as follows:

	2008 RMB'000	2007 RMB'000
Salaries and allowances	3,569	1,859
Discretionary bonus	—	—
Contribution to pension plans	—	—
Equity-settled share-based payments	615	—
	4,184	1,859

The number of non-director, highest paid employees whose remuneration fell within the following bands is as follows:

	Number of employees	
	2008	2007
Emoluments bands:		
Nil to RMB1,000,000	4	3
RMB1,000,000 to RMB1,500,000	1	—
	5	3

No emolument was paid by the Group to the directors or any of five highest paid individual as an inducement to join or upon joining the Group, or as compensation for loss of office.

11. INCOME TAX EXPENSE

The major components of income tax expense for the year are as follows:

	2008 RMB'000	2007 RMB'000
Current tax		
– PRC *(note (i))*		
Tax for the year	31,859	51,786
Over-provision in prior years	(9,666)	—
– USA *(note (ii))*		
Tax for the year	442	601
Over-provision in prior years	—	(290)
	22,635	52,097
Deferred income tax *(note 33)*	—	147
Income tax expense	22,635	52,244

11. INCOME TAX EXPENSE (Cont'd)

Notes:

(i) PRC enterprise income tax ("EIT") is calculated at the applicable rates in accordance with the relevant laws and regulations in the PRC.

TQ Digital is a foreign-invested enterprise and was approved to be a hi-tech enterprise located in high technology development zone on 29 July 2005. Pursuant to the Circular on Some Preferential Policies for the Enterprise Income Tax (關於企業所得稅若干優惠政策的通知) issued by the Ministry of Finance (財政部) and the State Administration of Taxation (國家稅務總局) on 29 March 1994, TQ Digital is entitled to a preferential income tax rate of 15%. The qualification of hi-tech enterprise is subject to review once every two years and TQ Digital continued to be recognised as a hi-tech enterprise on 16 August 2007. On 25 December 2003, TQ Digital was approved to be a software enterprise. Pursuant to the Circular on the Tax Policies for Encouraging the Development of Software and Integrated Circuit Industries (關於鼓勵軟件產業和集成電路產業發展有關稅收政策問題的通知) issued by the Ministry of Finance (財政部), the State Administration of Taxation (國家稅務總局) and the General Administration of Customs (海關總署) on 22 September 2000, TQ Digital is entitled to tax benefits of tax exemption for two years starting from the first year of profitable operations after offsetting prior year tax losses, followed by 50% tax reduction for three years. 2003 was the first profitable year for TQ Digital. Accordingly, the EIT tax rate applicable to TQ Digital for 2007 was 7.5%

Pursuant to a notice issued by a government authority (福建省科學技術廳) on 25 November 2008, TQ Digital continued to be recognised as a hi-tech enterprise and is thereby subject to EIT tax rate of 15% for 2008.

NetDragon (Fujian) continued to be recognised as a hi-tech enterprise located in high technology industrial development zone on 9 November 2004. Pursuant to the Circular on Some Preferential Policies for the Enterprise Income Tax (關於企業所得稅若干優惠政策的通知) as mentioned in the previous paragraph, NetDragon (Fujian) was entitled to paying EIT at the reduced tax rate of 15% for 2006. Pursuant to a notice issued by a government authority (福建省科學技術廳) on 16 August 2007, NetDragon (Fujian) continued to be recognised as a hi-tech enterprise and is thereby subject to EIT tax rate of 15% for 2007.

On 16 March 2007, the PRC promulgated the Law of the PRC on Enterprise Income Tax (the "New Tax Law") by order No. 63 of the president of the PRC, which became effective on 1 January 2008. According to the New Tax Law, the income tax rate applicable to the Group's PRC subsidiaries is unified at 25%. Since NetDragon (Fujian) did not apply to be a hi-tech enterprise in the current year, the EIT tax rate applicable to NetDragon (Fujian) for 2008 was 25% accordingly.

NetDragon (Shanghai) is subject to EIT tax rate of 25% (2007: 33%).

TQ Online, a newly incorporated PRC subsidiary, is also subject to EIT tax rate of 25%.

(ii) The USA income tax rates applicable to the Group are 34% (2007: 34%) for federal tax and 8.84% (2007: 8.84%) for state income tax.

11. INCOME TAX EXPENSE (Cont'd)

Notes: (Cont'd)

(iii) The Group is not subject to any taxation under the jurisdiction of the Cayman Islands and British Virgin Islands ("BVI") during the year (2007: Nil). Provision for Hong Kong profits tax is not made as the Group has not derived any assessable profits in Hong Kong during the year (2007: Nil).

(iv) There was no share of tax attributable to associate included in "Share of results of an associate" in the consolidated income statement (2007: Nil).

A reconciliation of income tax expense and accounting profit at applicable tax rate is as follows:

	2008	2007
	RMB'000	RMB'000
Profit before income tax	**261,904**	427,081
Tax calculated at domestic tax rates applicable to profits in the respective jurisdictions	**26,821**	65,721
Share of results of an assoicate	**69**	—
Tax exemptions	**(26,505)**	(30,917)
Tax effect of non-taxable income	**(10,344)**	(2,229)
Tax effect of non-deductible expenses	**42,273**	19,991
Over-provision in prior years	**(9,666)**	(290)
Others	**(13)**	(32)
Income tax expense	**22,635**	52,244

12. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS

The profit attributable to equity holders is dealt with in the financial statements of the Company to the extent of RMB110,905,000 (2007: RMB216,482,000).

13. DIVIDENDS

	2008 RMB'000	2007 RMB'000
Special dividends	—	79,069
Interim dividend declared and paid of HK$0.1 per share (2007: Nil)	47,496	—
Proposed final dividend of HK$0.11 per share (2007: RMB0.4 per share)	51,275	216,093
	98,771	295,162

The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting and therefore, has not been recognised as a liability at the balance sheet date.

The interim dividend of RMB47,496,000 for the year had been approved by the directors at the board meeting and was subsequently paid on 16 September 2008.

An amount of RMB9,057,000 directly dealt with in the retained profits of the Group and Company represents an exchange difference arising from recognising the final dividend for the year ended 31 December 2007 as a liability after the approval by the shareholders in the annual general meeting on 28 April 2008.

The final dividend of RMB216,093,000 for the year ended 31 December 2007 was paid on 2 May 2008.

14. EARNINGS PER SHARE

The calculation of basic earnings per share attributable to the equity holders of the Company is calculated based on consolidated profit attributable to the equity holders of the Company for the year of RMB239,381,000 (2007: RMB374,854,000) and on the weighted average number of 538,082,015 shares (2007: 440,953,947 shares) in issue, after adjusting the effect of treasury shares held by the Company and contingently issuable shares arising from the share award scheme.

No diluted earnings per share has been presented as the award shares of the Company outstanding as at the year ended 31 December 2008 were anti-dilutive to the Group's earnings per share.

Diluted earnings per share for the year ended 31 December 2007 has not been presented as there were no dilutive potential shares.

15. FINANCIAL RESULTS AND FINANCIAL ASSETS AND LIABILITIES BY CATEGORY OF FINANCIAL INSTRUMENTS

Financial results by category

Net gains/(losses) from financial assets and financial liabilities by category of financial instruments are set out below:

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Financial assets at fair value through profit or loss	**(30,385)**	106	**(30,385)**	—
Derivative financial instrument	**32,231**	—	**32,231**	—
Loans and receivables	**22,656**	6,467	**3,387**	3,584
Net amounts reported in the consolidated income statement	**24,502**	6,573	**5,233**	3,584

15. FINANCIAL RESULTS AND FINANCIAL ASSETS AND LIABILITIES BY CATEGORY OF FINANCIAL INSTRUMENTS (Cont'd)

Financial assets by category

The carrying amount of the Group's financial assets by category of financial instruments included in the consolidated balance sheet and the headings in which they are included are as follows:

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Non-current assets				
Available-for-sale financial asset	**4,000**	4,000	**—**	—
Loan receivables	**6,835**	—	**—**	—
Current assets				
Financial assets at fair value through profit or loss				
– Designated as such upon initial recognition	**311,806**	—	**311,806**	—
– Derivative financial instrument	**31,857**	—	**31,857**	—
Loans and receivables				
– Loan receivables	**440**	—	**—**	—
– Trade and other receivables	**34,124**	33,080	**—**	3,280
– Amounts due from related parties	**—**	8,832	**—**	—
– Amount due from a subsidiary	**—**	—	**341,953**	225,052
– Term deposits with initial term of over three months	**629,454**	50,000	**—**	—
– Cash and cash equivalents	**332,009**	1,651,380	**33,965**	1,317,532
	1,350,525	1,747,292	**719,581**	1,545,864

15. FINANCIAL RESULTS AND FINANCIAL ASSETS AND LIABILITIES BY CATEGORY OF FINANCIAL INSTRUMENTS (Cont'd)

Financial liabilities by category

The carrying amount of the Group's financial liabilities by category of financial instruments included in the consolidated balance sheet and the headings in which they are included are as follows:

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Current liabilities				
Financial liabilities measured at amortised cost				
– Trade and other payables and accruals	**28,374**	21,187	**873**	7,402
– Amount due to a related party	**—**	76	**—**	—
– Amounts due to subsidiaries	**—**	—	**1,817**	2,967
	28,374	21,263	**2,690**	10,369

16. PROPERTY, PLANT AND EQUIPMENT

	Buildings RMB'000	Leasehold improvements RMB'000	Computer and office equipment RMB'000	Motor vehicles RMB'000	Construction in progress RMB'000	Total RMB'000
The Group						
Cost:						
At 1 January 2007	—	1,585	28,810	1,474	—	31,869
Additions	1,505	469	41,751	3,779	—	47,504
Disposals	—	—	(34)	—	—	(34)
At 31 December 2007 and 1 January 2008	1,505	2,054	70,527	5,253	—	79,339
Additions	2,081	3,535	53,697	1,727	7,517	68,557
Disposals	—	(312)	(40)	(268)	—	(620)
Exchange difference	—	(2)	(36)	—	—	(38)
At 31 December 2008	**3,586**	**5,275**	**124,148**	**6,712**	**7,517**	**147,238**
Accumulated depreciation:						
At 31 December 2006 and 1 January 2007	—	670	7,968	20	—	8,658
Charge for the year	14	440	8,201	686	—	9,341
Disposals	—	—	(4)	—	—	(4)
At 31 December 2007 and 1 January 2008	14	1,110	16,165	706	—	17,995
Charge for the year	304	1,315	30,213	1,483	—	33,315
Disposals	—	(73)	(24)	(102)	—	(199)
Exchange difference	—	—	(33)	—	—	(33)
At 31 December 2008	**318**	**2,352**	**46,321**	**2,087**	**—**	**51,078**
Net carrying amount:						
At 31 December 2008	**3,268**	**2,923**	**77,827**	**4,625**	**7,517**	**96,160**
At 31 December 2007	1,491	944	54,362	4,547	—	61,344

The Group's buildings are situated in the PRC and held under long-term lease.

17. LAND USE RIGHTS

The Group's interests in land use rights represent prepaid operating lease payments in respect of land located in the PRC and their carrying amounts are analysed as follows:

	The Group	
	2008	2007
	RMB'000	RMB'000
Carrying amount at 1 January	**1,174**	—
Additions	**6,291**	1,179
Amortisation for the year	**(103)**	(5)
Carrying amount at 31 December	**7,362**	1,174

The land use rights are amortised on a straight line basis over the lease period ranging from 54 to 55 years.

18. INTANGIBLE ASSETS

	Trademark
	RMB'000
The Group	
Cost:	
At 31 December 2007 and 1 January 2008	—
Additions	14,258
Exchange difference	(165)
At 31 December 2008	**14,093**
Accumulated amortisation:	
At 31 December 2007 and 1 January 2008	—
Charge for the year	3,378
Exchange difference	(39)
At 31 December 2008	**3,339**
Net carrying amount:	
At 31 December 2008	**10,754**
At 31 December 2007	—

19. INTEREST IN AN ASSOCIATE

	2008 RMB'000	2007 RMB'000
Share of net assets – unlisted	224	—

Name	Percentage of registered capital indirectly held by the Group	Place of incorporation	Registered capital	Principal activity
上海合進數據信息咨詢有限公司 (Shanghai Hejin Data Information Co., Ltd.*)	49.68%	the PRC	RMB1,000,000	Provision for film marketing and research services

The following table illustrates the summarised financial information of the associate extracted from its management accounts for the period from 2 December 2008 (date of incorporation) to 31 December 2008:

	2008 RMB'000	2007 RMB'000
Financial position		
Total assets	850	—
Total liabilities	(401)	
Net assets	449	—
Group's share of net assets of associate	224	—
Results for the period		
Revenue	—	—
Loss	552	—

* *for identification purpose only*

20. INTERESTS IN SUBSIDIARIES

	2008 RMB'000	2007 RMB'000
Investments in subsidiaries – unlisted shares, at cost	167,871	167,871
Amounts due from subsidiaries *(note)*	350,288	—
	518,159	167,871

Note: The amounts due are unsecured, interest-free and have no fixed terms of repayment. In the opinion of the directors, the settlement of these amounts due is neither planned nor likely to occur in the foreseeable future and in substance, the amounts due from subsidiaries are extensions of the Company's investments in these subsidiaries.

Particulars of the subsidiaries as at 31 December 2008 are as follows:

Name	Place and date of incorporation / establishment and kind of legal entity	Particulars of issued and fully paid share capital / registered capital	Effective interest held by the Company	Principal activities
Interests held directly				
NetDragon Websoft Inc.	Incorporated on 8 January 2003 in the BVI, limited liability company	US$222,203.93	100%	Investment holding
Interests held indirectly				
福建網龍計算機網絡信息技術有限公司 (Fujian NetDragon Websoft Co., Ltd.*)	Established on 25 May 1999 in the PRC, limited liability company	RMB10,000,000	99.36%[Δ]	Operation of online games
Fujian TQ Digital Inc (福建天晴數碼有限公司)	Established on 28 February 2003 in the PRC, wholly-owned foreign enterprise [#]	RMB345,000,000	100%	Development of online games and licensing and servicing of the developed games

20. INTERESTS IN SUBSIDIARIES (Cont'd)

Name	Place and date of incorporation / establishment and kind of legal entity	Particulars of issued and fully paid share capital / registered capital	Effective interest held by the Company	Principal activities
上海天坤數碼科技有限公司 (Shanghai Tiankun Digital Technology Ltd.*)	Established on 20 December 2004 in the PRC, limited liability company	RMB1,000,000	99.36%Δ	Provision of support services to a group company in the PRC
NetDragon Websoft Inc.	Incorporated on 10 July 2003 in the USA, domestic stock corporation	US$600,000	100%	Provision of support services to a group company in the USA (note)
NetDragon Websoft (Hong Kong) Limited（網龍香港有限公司）	Incorporated on 28 June 2007 in Hong Kong, limited liability company	HK$1	100%	Licensing and servicing of the developed games and provision of support services to a group company in Hong Kong
Glory More Limited（展凱有限公司）	Incorporated on 31 January 2008 in Hong Kong, limited liability company	HK$1	100%	Investment holding
Fujian TQ Online Interactive Inc.（福建天晴在線互動科技有限公司）	Established on 18 March 2008 in the PRC, wholly-owned foreign enterprise	RMB50,000,000	100%	Development of online games and licensing and servicing of developed games

Note: NetDragon (USA) was engaged in operation of online games before June 2007.

* for identification purpose only

\# converted to be a wholly-owned foreign enterprise on 28 November 2003

Δ interest existed by virtue of certain contractual arrangements as described in note 1.

The amounts due from/to subsidiaries as disclosed under current assets/liabilities are of non-trade nature, unsecured, interest free and repayable on demand. In the opinion of the directors, the carrying amounts of the amounts due at the balance sheet date approximate their fair values.

21. AVAILABLE-FOR-SALE FINANCIAL ASSET

	The Group	
	2008	2007
	RMB'000	RMB'000
Unlisted equity investment – PRC	**4,000**	4,000
Represented by:		
Available-for-sale financial asset	**4,000**	4,000

The unlisted equity investment represents 9.5% interest in 福建楊振華 851 生物科技股份有限公司 which was established in the PRC. Mr Liu Dejian and Mr Zheng Hui, directors of the Company, are directors of the entity and Ms Lin Yun, a beneficial owner of the Company, has equity interest in the entity.

The available-for-sale financial asset is denominated in RMB.

The available-for-sale financial asset is stated at cost less impairment. The directors are of the opinion that due to the investment does not have a quoted market price in an active market, its fair value cannot be measured reliably accordingly. The Group plans to hold this investment for the foreseeable future.

22. LOAN RECEIVABLES

	The Group	
	2008	2007
	RMB'000	RMB'000
Loan receivables from:		
Key management – fixed-rate loan *(note (i))*	**700**	—
Staff – fixed-rate loan *(note (i))*	**4,975**	—
Staff – floating-rate loan *(note (ii))*	**1,600**	—
	7,275	—
Analysed into:		
Amount repayable in more than one year included in non-current assets	**6,835**	—
Amount repayable in less than one year included in current assets	**440**	—
	7,275	—

Notes:

(i) The amounts represented the fixed-rate loans to key management and other senior staff. The loans are unsecured, interest-bearing at 5.48% per annum. The loans are either repayable by instalments until 2013 or repayable in 2013.

(ii) The amounts represented the floating rate loans to senior employees. The loans to staff are unsecured, interest-bearing at 15% below of the market interest rate per annum for bank loan with similar terms and repayable in 2013.

The amortised cost of the loan receivables as at 31 December 2008 are calculated at the present value of the expected settlements from the key management and staff in accordance with the repayment plan of the respective key management and staff, discounted at the original effective interest rates of the loan receivables.

Having considered the financial position of the borrowers, management assessed that there is no indication of impairment in respect of these loan receivables.

Loan receivables are not past due or impaired as at year end date. In the opinion of the directors, the carrying amounts of these loan receivables at the balance sheet date approximate their fair values.

23. TRADE AND OTHER RECEIVABLES, PREPAYMENTS AND DEPOSITS

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Trade receivables *(note (i))*	**9,500**	26,940	**—**	—
Other receivables	**24,624**	6,140	**—**	3,280
Prepayments and deposits	**47,866**	34,215	**1,008**	2,148
	81,990	67,295	**1,008**	5,428

Notes:

(i) The ageing analysis of trade receivables at the balance sheet date is as follows:

	The Group	
	2008	2007
	RMB'000	RMB'000
Outstanding balances with ages:		
– 30 days or below	**6,976**	22,881
– 31 - 60 days*	**2,197**	1,983
– 61 - 90 days*	**56**	1,876
– 91 - 180 days*	**271**	—
– 181 - 365 days*	**—**	—
– Over 365 days*	**—**	200
	9,500	26,940

* *past due but not impaired*

At each balance sheet date, the Group's trade receivables are individually determined to be impaired. The individually impaired receivables, if any, are recognised based on the credit history of corporate partners, sales distributors and distribution partners, such as financial difficulties and default in payments, and current market conditions.

Trade receivables that are not yet past due relate to wide range of corporate partners, sales distributors and distribution partners for whom there was no recent history of default. Trade receivables that were past due but not impaired related to a number of independent corporate partners, sales distributors and distribution partners that have a good track record with the Group. Based on past experience, management believes that no impairment allowance is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable. The Group and the Company do not hold any collateral over these balances.

23. TRADE AND OTHER RECEIVABLES, PREPAYMENTS AND DEPOSITS (Cont'd)

Notes: (Con'd)

The Group allows an average credit period ranged from 30 days to 45 days to its trade debtors but the trade debtors usually settle the outstanding balance within 30 days from the billing date.

(ii) The movement of the allowance for doubtful debts during the year is as follows:

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
At 1 January	**—**	—	**—**	—
Impairment loss recognised	**1,660**	541	**—**	—
Amounts written off as uncollectible	**(1,660)**	(541)	**—**	—
	—	—	**—**	—

(iii) Trade and other receivables are interest-free and unsecured. Other receivables are neither past due nor impaired as at year end date. The directors considered that the carrying amounts of trade and other receivables, prepayments and deposits approximate their fair values because of their short maturities.

(iv) Included in trade and other receivables, prepayments and deposits are the following amounts denominated in a currency other than RMB:

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
HKD	**8,137**	5,560	**1,008**	5,428
USD	**14,539**	7,929	**—**	—

24. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Debt instruments – unlisted	**311,806**	—	**311,806**	—

During the year, the Group invested in two debt instruments, USD30,000,000 in 1-year USD denominated consecutive digital note ("USD Note") and AUD21,000,000 in 1-year AUD denominated credit-linked note ("AUD Note"). The principal of the USD Note is 100% recoverable at maturity. The return of the USD Note is calculated based on the exchange rates of USD against RMB on monthly observation dates as specified in the term sheet of the USD Note, and is receivable at maturity date. The principal of the AUD Note is 100% recoverable at maturity, with the redemption and extension clauses as specified in the term sheet of the AUD Note. The return of the AUD Note is 8.3% per annum, and is receivable at maturity date or redemption date or extension date, as appropriate. Both the USD Note and the AUD Note have been designated as financial assets at fair value through profit or loss by the management in their initial recognition.

As at 31 December 2008, the carrying amount of USD Note amounted to USD29,974,000 (equivalents to RMB204,877,000). The fair value of the USD Note has been determined by Asset Appraisal Limited, a firm of professional valuers using market approach (such as forward rates from reputable financial institution) and interpolation techniques on the forward rates as at 31 December 2008. The valuation has been performed with the following assumptions: i) all the monthly returns were estimated using the forward rate as at 31 December 2008; and ii) the Group held the USD Note to maturity.

As at 31 December 2008, the carrying amount of the AUD Note of AUD22,407,000 (equivalents to RMB106,929,000) The fair value of the AUD Note has been determined by Asset Appraisal Limited, the professional valuers using discounted cash flow method. The valuation has been performed with the following assumption: The risk of counterparties defaulting has been amplified during the 2008 financial crisis, systemative risk plays a significant role which threatens an entire market. The valuation does not take into account of the future systematic risk in the course of valuation.

The debt instruments are not designated as hedging instruments.

24. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS (Cont'd)

During the year, the net decrease in the fair value of the USD Note of approximately RMB1,551,000 was recognised and recorded in "Other operating expenses" in the consolidated income statement. The decrease in fair value for the year and cumulated changes of RMB1,551,000 was solely attributable to the changes in market conditions that give rise to market risk.

During the year, the net decrease in the fair value of the AUD Note of approximately RMB33,666,000 was recognised and recorded in "Other operating expenses" in the consolidated income statement. The decrease in fair value for the year and cumulated changes of RMB33,666,000 was solely attributable to the changes in market conditions that give rise to market risk. The interest income accrued in the AUD Note of approximately RMB4,832,000 was recognised and recorded in "Other revenue and gains" in the consolidated income statement.

25. DERIVATIVE FINANCIAL INSTRUMENT

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Foreign currency forward contract				
– unlisted	**31,857**	—	**31,857**	—

During the year, the Group entered into a 1-year foreign currency forward contract in respect of USD against AUD. The major terms of the foreign currency forward contract at the balance sheet date are as follows:

Notional amount	**Date of maturity**	**Forward contract rate**
One contract to buy USD in the amount equivalents to AUD21,000,000	19 June 2009	AUD1 : USD0.9188

The foreign currency forward contract is not designated as hedging instrument and was measured at fair value at the balance sheet date. Its fair value is determined by reference to the valuation conducted by Asset Appraisal Limited, the professional valuers.

During the year, the net increase in the fair value of the foreign currency forward contract of approximately RMB32,231,000 was recognised and recorded in "Other revenue and gains" in the consolidated income statement. The increase in fair value for the year and cumulated changes of RMB32,231,000 was solely attributable to the changes in market conditions that give rise to market risk.

26. TERM DEPOSITS WITH INITIAL TERM OF OVER THREE MONTHS

The effective interest rates of the term deposits of the Group with initial term of over three months for the year ended 31 December 2008 was 2.10% per annum (2007: 3.42% per annum).

As at 31 December 2008 and 2007, all the Group's term deposits are denominated in RMB with initial term of over three months.

27. CASH AND CASH EQUIVALENTS

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Cash in hand and at bank	**330,609**	1,650,102	**33,965**	1,317,532
Cash deposited with an online payment service provider *(note (i))*	**1,400**	1,278	**—**	—
	332,009	1,651,380	**33,965**	1,317,532

Notes:

(i) Cash deposited with the online payment service provider could be readily withdrawn by the Group. Before the second half of 2007, the accounts maintained with this online payment service provider were held on trust by the directors of NetDragon (USA) on behalf of the Group for the exclusive use of accepting online payment from customers. Since October 2007, the Group has set up a corporate account with the online payment service provider which is owned by and under the name of NetDragon (USA) and all the funds held by the directors of NetDragon (USA) on behalf of NetDragon (USA) has been transferred to the corporate account.

In October 2008, the Group set up another corporate account with the online payment service provider which is owned and under the name of NetDragon (HK) for the exclusive use of accepting online payment from customers.

(ii) As at 31 December 2008, cash and cash equivalents of the Group denominated in RMB amounted to RMB246,035,000 (2007: RMB286,403,000). The conversion of RMB into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC government.

(iii) Cash deposited with banks bear interest at effective interest rates ranging from 0.1% to 1.7% per annum during the year (2007: 0.6% to 3.7%). Cash deposited with the online payment service provider bears interest at effective interest rates ranging from 1.4% to 4.6% per annum during the year (2007: 4.6% to 5.7%).

27. CASH AND CASH EQUIVALENTS (Cont'd)

Notes: (Cont'd)

(iv) Included in cash and cash equivalents are the following amounts denominated in a currency other than RMB:

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
HKD	**22,540**	1,318,539	**13,123**	1,317,532
USD	**60,878**	45,958	**18,854**	—
Japanese Yens	**567**	480	**—**	—
AUD	**1,989**	—	**1,989**	—

(v) The directors consider that the carrying amounts of cash equivalents approximate their fair values.

28. TRADE AND OTHER PAYABLES, ACCRUALS AND DEFERRED INCOME

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
Trade payables *(note (i))*	**219**	500	**—**	—
Accrued staff costs	**5,417**	5,789	**706**	—
Value added tax payables and other tax payables	**5,290**	5,333	**—**	—
Other payables and accrued charges	**25,913**	15,288	**167**	7,402
Deferred income	**16,838**	18,352	**—**	—
	53,677	45,262	**873**	7,402

28. TRADE AND OTHER PAYABLES, ACCRUALS AND DEFERRED INCOME (Cont'd)

Notes:

(i) The ageing analysis of trade payables at the balance sheet date, based on the invoice date, is as follows:

	The Group	
	2008	2007
	RMB'000	RMB'000
Outstanding balances with ages:		
– Within 90 days	**185**	500
– 91 - 180 days	**24**	—
– 181 - 365 days	**10**	—
– Over 365 days	**—**	—
	219	500

(ii) The directors consider that the carrying amounts of trade and other payables, accruals and deferred income approximate their fair values.

(iii) Included in trade and other payables, accruals and deferred income are the following amounts denominated in a currency other than RMB:

	The Group		The Company	
	2008	2007	**2008**	2007
	RMB'000	RMB'000	**RMB'000**	RMB'000
HKD	**3,886**	7,301	**873**	7,301
USD	**1,311**	809	**—**	101

29. SHARE CAPITAL

	Share capital				
	Number of common shares of US$0.01 each	Number of preferred shares of US$0.01 each	Total number of shares of US$0.01 each	Nominal value US$	Nominal value RMB'000
Authorised:					
At 1 January 2007	50,000,000	3,000,000	53,000,000	530,000	4,388
Increase in authorised share capital *(note (i))*	450,000,000	27,000,000	477,000,000	4,770,000	36,740
Increase in authorised share capital *(note (v))*	500,000,000	(30,000,000)	470,000,000	4,700,000	34,643
At 31 December 2007 and at 1 January 2008 and at 31 December 2008	1,000,000,000	—	1,000,000,000	10,000,000	75,771
Issued:					
At 1 January 2007	14,878,937	2,666,666	17,545,603	175,456	1,453
Issue of new shares *(note (ii))*	4,674,790	—	4,674,790	46,748	360
Issue of new shares *(note (iii))*	19,553,727	2,666,666	22,220,393	222,204	1,693
Conversion of preferred shares to common shares *(note (iv))*	5,333,332	(5,333,332)	—	—	—
Issue of new shares *(note (vi))*	399,967,074	—	399,967,074	3,999,671	29,481
Issue of new shares *(note (vii))*	95,600,000	—	95,600,000	956,000	7,046
Issue of new shares *(note (viii))*	16,200,000	—	16,200,000	162,000	1,194
Repurchase and cancellation of shares *(note (ix))*	(116,500)	—	(116,500)	(1,165)	(8)
At 31 December 2007 and at 1 January 2008	556,091,360	—	556,091,360	5,560,914	41,219
Repurchase and cancellation of shares *(note (x))*	(27,520,500)	—	(27,520,500)	(275,205)	(1,955)
At 31 December 2008	**528,570,860**	**—**	**528,570,860**	**5,285,709**	**39,264**

29. SHARE CAPITAL (Cont'd)

Notes:

(i) On 1 March 2007, the authorised share capital of the Company was increased from US$530,000 divided into 50,000,000 common shares of US$0.01 each and 3,000,000 preferred shares of US$0.01 each to US$5,300,000 divided into 500,000,000 common shares of US$0.01 each and 30,000,000 preferred shares of US$0.01 each by issuing additional 450,000,000 common shares of US$0.01 each and 27,000,000 preferred shares of US$0.01 each.

(ii) On 26 March 2007, an aggregate of 4,674,790 common shares of US$0.01 each were allotted and issued at par by the Company.

(iii) On 18 May 2007, in consideration for the shareholders of NetDragon (BVI) transferring the entire issued share capital in NetDragon (BVI), the immediate holding company of TQ Digital and NetDragon (USA), to the Company, an aggregate of 19,553,727 common shares of US$0.01 each and 2,666,666 preferred shares of US$0.01 of the Company were allotted and issued at par to the shareholders of NetDragon (BVI) (the "Shares Swap"). The total number of new shares issued by the Company is identical to the total number of shares of NetDragon (BVI) and the total number of shares of the Company in issue on that date.

(iv) On 15 October 2007, 5,333,332 preferred shares of US$0.01 each of the Company were converted into 5,333,332 common shares of US$0.01 each.

(v) On 15 October 2007, the authorised share capital of the Company decreased from US$5,300,000 to US$5,000,000 by the cancellation of 30,000,000 preferred shares and then the authorised share capital of the Company increased from US$5,000,000 to US$10,000,000 by the creation of 500,000,000 shares of US$0.01 each.

(vi) Pursuant to the written resolutions of the Company passed on 15 October 2007, 399,967,074 shares of the Company were allotted and issued, credited as fully paid at par of US$0.01 each to the then shareholder of the Company, by the capitalisation of the sum of US$3,999,671 (equivalent to RMB29,481,000) from the share premium account. Such allotment and capitalisation were conditional on the share premium account being credited as a result of the new shares issued in connection with the listing of the Company's shares on the Stock Exchange.

29. SHARE CAPITAL (Cont'd)

Notes: (Cont'd)

(vii) On 1 November 2007, 95,600,000 new shares of US$0.01 each of the Company were issued to the public by way of international placing and offer at HK$13.18 (equivalent to approximately RMB12.45) each. The gross proceeds received from the issue of the 95,600,000 new shares amounted to HK$1,260,000,000 (equivalent to RMB1,190,600,000). Part of the proceeds amounting to RMB7,046,000 was recorded as share capital, and the remaining balance proceeds of RMB1,183,554,000 was recorded in the share premium account. The shares of the Company were listed on the Stock Exchange on 2 November 2007.

(viii) On 9 November 2007, the over-allotment option was exercised. 16,200,000 new shares of US$0.01 each of the Company were issued to the public by way of placement at HK$13.18 (equivalent to approximately RMB12.45) each. The gross proceeds received from the issue of the 16,200,000 new shares amounted to HK$213,516,000 (equivalent to RMB201,753,000). Part of the proceeds amounting to RMB1,194,000 was recorded as share capital, and the remaining balance proceeds of RMB200,559,000 was recorded in the share premium account.

(ix) The Company repurchased 116,500 of its own shares through purchase on the Stock Exchange during the year ended 31 December 2007. The shares have been cancelled upon being repurchased. The total amount to acquire the shares was approximately HK$1,670,000 (equivalent to RMB1,569,000) which have been deducted from the shareholders' equity.

(x) The Company repurchased 27,520,500 of its own shares through purchase on the Stock Exchange during the year ended 31 December 2008. The shares have been cancelled upon being repurchased. The total amount to acquire the shares was approximately HK$246,953,000 (equivalent to RMB224,074,000) which have been deducted from the shareholders' equity.

30. SHARE-BASED EMPLOYEE COMPENSATION

(i) Share option scheme

On 12 June 2008, in order to comply with the Listing Rules of Main Board regarding share option scheme of a Company, a new share option scheme (the "New Scheme") was adopted by the Company to replace GEM share option scheme, which was adopted on 15 October 2007.

The Company operates the New Scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Eligible participants of the New Scheme include executive directors, non-executive directors, employees, shareholders, suppliers, customers, consultants, advisers, other service providers, and joint venture partners, business or strategic alliance partners. The New Scheme became effective on 12 June 2008 and, unless otherwise cancelled or amended will remain in force for 10 years from that date.

The maximum number of the Company's shares which may be issued upon exercise of all options to be granted under the New Scheme and any other scheme of the Company shall not in aggregate exceed 10% of the issued share capital of the Company as at the date of listing of the Company's shares on the Stock Exchange. The New Scheme mandate limit may be refreshed by the shareholders in general meeting from time to time provided always that the New Scheme mandate limit so refreshed must not exceed 10% of the total number of shares in issue as at the date of approval of such refreshment by the shareholders in general meeting.

Notwithstanding any other provisions of the New Scheme, the maximum number of the Company's shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the New Scheme and any other scheme of the Company must not in aggregate exceed 30% of the total number of shares in issue from time to time.

30. SHARE-BASED EMPLOYEE COMPENSATION (Cont'd)

(i) Share option scheme (Cont'd)

Share options granted to a director, chief executive or substantial shareholder of the Company, or to any of their respective associates are subject to approval in advance by the independent non-executive directors (excluding an independent non-executive director who is the grantee of the options). In addition, any share options granted to a substantial shareholder or an independent non-executive director of the Company, or to any of their respective associates, in excess of 0.1% of the shares of the Company in issue at any time and with an aggregate value (based on the closing price of the Company's shares as stated in the daily quotation sheets issued by the Stock Exchange at the date of the grant) in excess of HK$5 million, within any 12-month period, are subject to shareholders' approval in advance in a general meeting.

The offer of a grant of share options may be accepted within 28 days from the date of the offer, upon payment of a nominal consideration of HK$1 in total by the grantee. The exercise period of the share options granted is determinable and notified by the directors, and may commerce on a date after the date upon which is granted but shall not be later than 10 years from the date of grant.

The exercise price of the share options must be at least the highest of (i) the nominal value of an ordinary share on the date of grant; (ii) the closing price of the Company's shares as stated in the daily quotations sheet of the Stock Exchange on the date of the offer of the share options; and (iii) the average closing price of the Company's shares as stated in the daily quotations sheet of the Stock Exchange for the five trading days immediately preceding the date of the offer.

Share options do not confer rights on the holders to dividends or to vote at shareholders' meetings.

No share options have been granted since the adoption of the Scheme and the Company had no share options outstanding at the balance sheet date.

(ii) Share award scheme

Pursuant to a circular to shareholders of the Company dated 3 September 2008 (the "Adoption Date"), the Company introduced a share award scheme ("Share Award Scheme"), whereby eligible participants are conferred rights by the Company to be issued or transferred fully-paid ordinary shares in the capital of the Company (hereinafter referred to as "Awards").

The rationale of the Share Award Scheme is to recognise the contributions by certain employees and to provide incentives in order to retain them for the continual operation and development of the Group, and to attract suitable personnel for further development of the Group. Unless early terminated by the board of directors, the Share Award Scheme shall be valid and effective for a term of ten years commencing on the Adoption Date. The selected employees are not required to pay for the grant of Awards or for the shares allotted or allocated pursuant to an Award.

30. SHARE-BASED EMPLOYEE COMPENSATION (Cont'd)

(ii) Share award scheme (Cont'd)

The aggregate number of Awards over which the committee, which comprised the directors of the Company duly appointed by the board of directors to administer the Share Award Scheme (the "Committee"), could grant shall not exceed 10% of the issued share capital of the Company from time to time. The maximum number of shares which may be awarded to a selected employee under the Share Award Scheme shall not exceed 1% of the issued share capital of the Company from time to time.

The eligibility of employees to participate in the Share Award Scheme and number of shares which are the subject of each Award at each date of grant to a selected employee in accordance with the Share Award Scheme shall be determined at the absolute discretion of the Committee which shall take into consideration various factors including the general financial condition of the Group, the rank and performance of the relevant employee and such other general criteria as the Committee may consider appropriate as well as other limitations set forth under the Listing Rules and those rules of the Share Award Scheme.

In determining the number of shares to be awarded each year the Committee shall have reference to the financial performance of the Group as reflected in the profit before income tax of the financial year.

The grant of an Award to the selected employee shall be accepted by the selected employee within 28 days from the date of offer. The Selected Employee may accept or refuse the whole but not part of a grant of an Award. If the grant of an Award is not accepted by the selected employee within 28 days from the date of offer, the offer shall upon the expiry of the 28 days period automatically lapse and shall be null and void.

Performance conditions (the "Performance Conditions") refers to the condition or conditions imposed by the Company on the selected employee's employment with the Company which must be fulfilled or satisfied by the selected employee prior to his eligibility for an Award. Performance period refers to the period of a participant employment with the Group which is used to assess the selected employee's work performance for the purpose of determining the grant of the selected employee's award.

The current Performance Conditions proposed by the Committee is that the shares vest only if the selected employees remain in employment for a certain period of time.

30. SHARE-BASED EMPLOYEE COMPENSATION (Cont'd)

(ii) Share award scheme (Cont'd)

Fair value of an Award at the grant date is determined by reference to the market price immediately available upon the grant date. Equity-settled share-based payments expenses recognised in the income statement according to the vesting periods are as follows:

Date of grant	RMB'000
15 October 2008	1,014

Awards granted during the year ended 31 December 2008 are as follows:

Name of selected employees	Date of grant	Awards granted during the year	Aggregate Awards vested and released since commencement to end of the year	Aggregate Awards have not yet released at end of the year
Independent Non-executive directors				
Mr. Chao Guowei, Charles	15 October 2008	197,019	49,255	147,764
Mr. Lee Kwan Hung	15 October 2008	197,019	49,255	147,764
Mr. Liu Sai Keung, Thomas	15 October 2008	197,019	49,255	147,764
Key management				
Wu Chak Man	15 October 2008	398,377	79,675	318,702
Other employee	15 October 2008	597,566	149,392	448,174
		1,587,000	376,832	1,210,168

Among the Awards granted on 15 October 2008, 376,832 Awards vested on 6 November 2008, 376,832 Awards vest on 6 November 2009, 524,594 Awards vest on 6 November 2010, 229,065 Awards vest on 6 November 2011 and the remaining 79,677 shares vest on 6 November 2012. The Awards are normally released to the selected employees within one month after the vesting date.

31. RESERVES

Details of the movements on the Group's reserves are set out in the consolidated statement of changes in equity on pages 73 and 74 of the financial statements.

(a) Company

	Share premium account RMB'000	Contributed surplus RMB'000	Capital redemption reserve RMB'000	Dividend reserve RMB'000	Treasury share reserve RMB'000	Employee share-based compensation reserve RMB'000	Translation reserve RMB'000	Retained profits RMB'000	Total RMB'000
At 1 January 2007	–	–	–	–	–	–	–	–	–
Exchange difference arising on translation and net expense recognised directly in equity	–	–	–	–	–	–	(11,597)	–	(11,597)
Profit for the year	–	–	–	–	–	–	–	216,482	216,482
Total recognised income and expense for the year	–	–	–	–	–	–	(11,597)	216,482	204,885
Arising from reorganisation *(note)*	–	166,178	–	–	–	–	–	–	166,178
Issue of new shares upon listing *(note 29(vii))*	1,183,554	–	–	–	–	–	–	–	1,183,554
Issue of new shares upon capitalisation issue *(note 29(vi))*	(29,481)	–	–	–	–	–	–	–	(29,481)
Issue of new shares upon exercise of over-allotment option *(note 29(viii))*	200,559	–	–	–	–	–	–	–	200,559
Share issue expenses	(59,839)	–	–	–	–	–	–	–	(59,839)
Repurchase and cancellation of shares *(note 29(ix))*	(1,561)	–	8	–	–	–	–	(8)	(1,561)
Proposed final dividend *(note 13)*	–	–	–	216,093	–	–	–	(216,093)	–
At 31 December 2007	1,293,232	166,178	8	216,093	–	–	(11,597)	381	1,664,295

31. RESERVES (Cont'd)

(a) Company (Cont'd)

	Share premium account RMB'000	Contributed surplus RMB'000	Capital redemption reserve RMB'000	Dividend reserve RMB'000	Treasury share reserve RMB'000 (note 31(b)(iv))	Employee share-based compensation reserve RMB'000 (note 31(b)(v))	Translation reserve RMB'000	Retained profits RMB'000	Total RMB'000
At 1 January 2008	1,293,232	166,178	8	216,093	—	—	(11,597)	381	1,664,295
Exchange difference arising on translation and net expense recognised directly in equity	—	—	—	—	—	—	(70,548)	—	(70,548)
Profit for the year	—	—	—	—	—	—	—	110,905	110,905
Total recognised income and expense for the year	—	—	—	—	—	—	(70,548)	110,905	40,357
Interim dividend declared *(note 13)*	—	—	—	47,496	—	—	—	(47,496)	—
Dividend paid *(note 13)*	—	—	—	(263,589)	—	—	—	(9,057)	(272,646)
Purchase of treasury shares	—	—	—	—	(14,107)	—	—	—	(14,107)
Recognition of share-based payments *(note 30)*	—	—	—	—	—	1,014	—	—	1,014
Vested shares paid to employees	—	—	—	—	1,675	(1,014)	—	(661)	—
Repurchase and cancellation of shares *(note 29(x))*	(222,119)	—	1,955	—	—	—	—	(1,955)	(222,119)
Proposed final dividend *(note 13)*	—	—	—	51,275	—	—	—	(51,275)	—
At 31 December 2008	**1,071,113**	**166,178**	**1,963**	**51,275**	**(12,432)**	**—**	**(82,145)**	**842**	**1,196,794**

Note: Contributed surplus of the Company represents the difference between the investment costs of NetDragon (BVI) and the nominal value of the shares issued by the Company pursuant to the Shares Swap as detailed in note 29(iii).

31. RESERVES (Cont'd)

(b) Group

(i) Share premium

On 10 January 2007, an aggregate of 2,200,000 common shares of US$0.01 each of NetDragon (BVI) were allotted and issued at a consideration of US$4.14 per share to the new investors of NetDragon (BVI), giving rise to additional share capital to the Group (the share capital of the Group before the Shares Swap taking place on 18 May 2007 represented the share capital of NetDragon (BVI)) of US$22,000 (equivalent to approximately RMB170,000) and share premium of US$9,086,000 (equivalent to approximately RMB69,984,000). Capital of approximately RMB21,755,000 was received in advance from certain of the new investors before January 2007, which was offset against the share premium arising on 10 January 2007.

The details of the capitalisation of reserves, placement of new shares upon listing and the exercise of over-allotment option are set out in note 29(vi) to (viii).

Under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands (the "Companies Law"), the share premium account can be applied by the Company subject to the provisions, if any, of its memorandum and articles of association in (a) paying distributions or dividends to members; (b) paying up unissued shares of the Company to be issued to members as fully paid bonus shares; (c) the redemption and repurchases of shares (subject to the provisions of section 37 of the Companies Law); (d) writing-off the preliminary expenses of the Company; (e) writing-off the expenses of, or the commission paid or discount allowed on, any issue of share or debentures of the Company; and (f) providing for the premium payable on redemption or purchase of any shares or debentures of the Company. No distribution or dividend may be paid to members out of the share premium account unless immediately following the date on which the distribution or dividend is proposed to be paid, the Company will be able to pay its debts as they fall due in the ordinary course of business.

31. RESERVES (Cont'd)

(b) Group (Cont'd)

(ii) Capital reserve

Capital reserve arose on combining the results and financial positions of the companies now comprising the Group using merger accounting and following the presentation basis as explained in note 1.

The Group does not have shareholding in NetDragon (Fujian) and NetDragon (Shanghai). The establishment of the Group's control over NetDragon (Fujian) and NetDragon (Shanghai) so as to obtain substantially all economic benefit from the activities is by virtue of the Structure Contracts. On this basis, their results and financial positions are consolidated with that of the Group. The combined capital of NetDragon (Fujian) and NetDragon (Shanghai) less the amount of capital of NetDragon (Fujian) shared by the minority shareholders is thereby included in capital reserve of the Group.

As at 1 January 2007, the Shares Swap (Note 29(iii)) had not yet taken place and the share capital of NetDragon (BVI) which was the then holding company of the Group, was included in the capital reserve of the Group. As at 31 December 2007, the Shares Swap had already taken place and accordingly, the capital reserve of the Group as at 31 December 2007 was reduced to RMB9,946,000 which only included the combined capital of NetDragon (Fujian) and NetDragon (Shanghai) less the amount of capital of NetDragon (Fujian) shared by the minority shareholders.

(iii) Statutory reserves

In accordance with the relevant laws and regulations in the PRC and the articles of association of NetDragon (Fujian) and NetDragon (Shanghai), NetDragon (Fujian) and NetDragon (Shanghai) are required to appropriate 10% and 5-10% of its profit after tax after setting off the accumulated losses brought forward from prior years, as determined in accordance with PRC accounting regulations, to the statutory surplus reserve (the "SSR") and the statutory public welfare fund reserve (the "SPWF") respectively. When the balance of SSR reaches 50% of the registered capital of NetDragon (Fujian) and NetDragon (Shanghai), any further appropriation is optional. The SSR may be used to make good previous years' losses, if any, and may be converted to increase paid-up capital of the respective entities, provided the remaining balance after the capitalisation is not less than 25% of the registered capital. The SPWF could be used for capital expenditure on staff welfare facilities.

No allocation to the SPWF is required for NetDragon (Fujian) from 1 January 2006 due to the revised laws and regulations in the PRC. The unutilised SPWF of NetDragon (Fujian) as at 31 December 2005 was transferred to SSR in 2006.

31. RESERVES (Cont'd)

(b) Group (Cont'd)

(iii) Statutory reserves (Cont'd)

In accordance with the relevant laws and regulations concerning foreign investment enterprise established in the PRC and the articles of association of TQ Digital and TQ Online, TQ Digital and TQ Online are also required to appropriate certain portion of its profits after tax after setting off the accumulated losses brought forward from prior years, as determined in accordance with PRC accounting regulations, to reserve fund and staff's and workers' bonus and welfare fund. The amount of appropriation is determined by the board of directors of TQ Digital and TQ Online except for the appropriation of 10% of the net profit to the reserve fund which is mandatory until the accumulated total of the fund reaches 50% of registered capital of TQ Digital and TQ Online. The usage of reserve fund and staff's and workers' bonus and welfare fund are similar to that of SSR and SPWF respectively.

The above reserves cannot be used for purposes other than those for which they are created and are non-distributable as cash dividends.

(iv) Treasury share reserve

The treasury shares held for the Share Award Scheme is the consideration paid, including any attributable incremental costs for purchase of shares under the Share Award Scheme, in accordance with the accounting policy set out in note 4(x).

(v) Employee share-based compensation reserve

Employee share-based compensation reserve is comprised of the fair value of the actual or estimated number of unvested awarded shares granted to employees of the Group recognised in accordance with the accounting policy adopted for share-based employee compensation set out in note 4(t)(ii).

32. RELATED PARTY TRANSACTIONS

Except as disclosed elsewhere in the financial statements, the Group and the Company have the following transactions with the following related parties during the year:

(i) Name of and relationship with related parties

Name of related parties	Relationship
Mr Liu Dejian	Executive director and beneficial owner of the Company
Mr Liu Luyuan	Executive director and beneficial owner of the Company
Mr Liu Ming	A close family member of Mr Liu Dejian
Mr Zheng Hui	Executive director and beneficial owner of the Company
Mr Chen Hongzhan	Executive director and beneficial owner of the Company
Ms Lin Yun	Beneficial owner of the Company and key management
Mr Wu Chak Man	Beneficial owner of the Company and key management
Mr Wu Jialiang	Key management
福建楊振華 851 生物工程技術研究開發有限公司	Mr Liu Dejian has equity interest in this entity
福州天亮網絡技術有限公司	Mr Zheng Hui, Mr Wu Jialiang and Mr Chen Hongzhan have equity interests in this entity
Beso Biological Research Inc.	This entity is wholly owned by a close family member of Mr Liu Dejian and Mr Liu Luyuan
DJM Holding Limited	A shareholder of the Company in which Mr Liu Dejian has equity interest
Richmedia Holdings Limited	A shareholder of the Company in which Mr Liu Luyuan has equity interest
IDG Technology Venture Investments, L.P.	A shareholder of the Company

32. RELATED PARTY TRANSACTIONS (Cont'd)

(ii) Significant related party transactions during the year

	2008 RMB'000	2007 RMB'000
Rentals paid to:		
– 福建楊振華 851 生物工程技術研究開發有限公司	270	270
– Beso Biological Research Inc.	—	124
After-sales service fee paid to:		
– 福州天亮網絡技術有限公司	1,831	2,972
Technical service fee paid to:		
– 福州天亮網絡技術有限公司	1,831	1,696
Loan advanced to a key management	700	—
Interest received on loan advanced to a key management	18	—

The directors consider that all related party transactions were carried outon terms agreed between the parties.

32. RELATED PARTY TRANSACTIONS (Cont'd)

(iii) Amounts due from/to related parties as at 31 December 2008

Group

	At 31 December		At 1 January
	2008	2007	2007
	RMB'000	RMB'000	RMB'000
Amounts due from related parties:			
– 福建楊振華851生物工程技術研究開發有限公司 *(note)*	—	4,197	6,891
– 福州天亮網絡技術有限公司 *(note)*	—	2,931	—
– DJM Holding Limited *(note)*	—	—	961
– Richmedia Holdings Limited *(note)*	—	—	107
– IDG Technology Venture Investments, L.P.	—	—	221
– Mr Zheng Hui *(note)*	—	1,695	2,361
– Ms Lin Yun	—	9	—
– Mr Liu Luyuan *(note)*	—	—	57
– Mr Chen Hongzhan *(note)*	—	—	300
– Mr Wu Jialiang	—	—	430
	—	8,832	11,328

Note:

Maximum amount due from these related parties during the year are as follows:

	2008	2007
	RMB'000	RMB'000
福建楊振華851生物工程技術研究開發有限公司	**4,197**	6,891
福州天亮網絡技術有限公司	**2,931**	2,931
DJM Holding Limited	—	961
Richmedia Holdings Limited	—	107
Mr Zheng Hui	**1,695**	2,361
Mr Liu Luyuan	—	57
Mr Chen Hongzhan	—	312

32. RELATED PARTY TRANSACTIONS (Cont'd)

(iii) Amounts due from/to related parties as at 31 December 2008 (Cont'd)

Group

	2008 RMB'000	2007 RMB'000
Amount due to a related party:		
– Mr Liu Dejian	—	76

Company

	At 31 December		At 1 January
	2008 RMB'000	2007 RMB'000	2007 RMB'000
Amounts due from related parties:			
– DJM Holding Limited *(note)*	—	—	961
– Richmedia Holdings Limited *(note)*	—	—	107
– IDG Technology Venture Investments, L.P.	—	—	221
– Mr Zheng Hui *(note)*	—	—	135
– Mr Chen Feng	—	—	29
	—	—	1,453

Note:

Maximum amount due from these related parties during the year are as follows:

	2008 RMB'000	2007 RMB'000
DJM Holding Limited	—	961
Richmedia Holdings Limited	—	107
Mr Zheng Hui	—	135

The balances are unsecured, interest-free and have no fixed term of repayment. The directors consider that the carrying amounts of the balances approximate their fair values.

32. RELATED PARTY TRANSACTIONS (Cont'd)

(iv) Key management remuneration

	2008	2007
	RMB'000	RMB'000
Salaries, allowances and other short-term employee benefits	2,714	2,568
Contribution to pension plans	67	12
Equity-settled share-based payments	214	—
	2,995	2,580

33. DEFERRED TAX ASSETS

The following are the deferred tax assets recognised by the Group and the movements thereon during the year are as follows:

	Tax losses	Development costs	Total
	RMB'000	RMB'000	RMB'000
At 1 January 2007	147	54	201
Charged to consolidated income statement *(note (11))*	(147)	—	(147)
At 31 December 2007 and 31 December 2008	—	54	54

The Company had no deferred tax assets/liabilities as at 31 December 2008 (2007: Nil).

Deferred tax liabilities of RMB32,829,000 (2007: Nil) have not been established for the withholding and other taxation that would be payable on the unremitted earnings of a subsidiary, as such amount are permanently reinvested; according to the PRC audited accounts of the subsidiary, such unremitted earnings totalled RMB328,287,000 at 31 December 2008 (2007: Nil).

34. CAPITAL COMMITMENTS

At the balance sheet dates, the Group had the following capital commitments:

	2008 RMB'000	2007 RMB'000
Contracted, but not provided for:		
– acquisition of property, plant and equipment	**1,283**	2,547

The Company had no capital commitments as at 31 December 2008 (2007: Nil).

35. OPERATING LEASE COMMITMENTS

The Group leases its office premises and certain property, plant and equipment under operating lease arrangements. At the balance sheet dates, the Group had committed to make the following future minimum lease payments in respect of non-cancellable operating leases falling due as follows:

	2008 RMB'000	2007 RMB'000
Land and buildings		
Within one year	**5,149**	1,448
In the second to fifth years	**5,598**	2,526
	10,747	3,974
Computer equipment		
Within one year	**4,045**	1,304
Total		
Within one year	**9,194**	2,752
In the second to fifth years	**5,598**	2,526
	14,792	5,278

The Company had no operating lease commitments as at 31 December 2008 (2007: Nil).

36. CONTINGENT LIABILITIES

The Group and the Company did not have significant contingent liabilities as at 31 December 2008 (2007: Nil).