

## MANAGEMENT DISCUSSION AND ANALYSIS

### BUSINESS REVIEW

After the strategic business consolidation in the previous year, Start Technology Company Limited ("Start Technology"/"the Group") achieved an improved performance in the first half of 2001. Its three core businesses – Systems Value-added Services, Software Development & Systems Integration and General Software – recorded satisfactory growth, forming the solid foundations for the Group's future expansion. For the six months ended 30 June 2001, the Group recorded a turnover of HK\$439,692,000, representing a substantial increase of 83% when compared to last year's figure of HK\$240,379,000. Gross profit for the period was HK\$57,204,000, surging 54% when compared to last year. Profit attributable to shareholders was HK\$1,924,000, compared to last year's figure of HK\$5,432,000.

Profit attributable to shareholders did not show a corresponding growth to that of turnover, due mainly to the significant expenditures and finance costs incurred in developing the businesses of the Group, which offset part of the gross profit during the period. In addition, profit for the same period last year included a profit of HK\$11,163,000 from the disposal of interests in a subsidiary. If these factors are disregarded, the performance of the Group's businesses in fact recorded a substantial improvement during the period. We believe that this will bring better returns to shareholders in the near future.

### Systems Value-added Services Business

During the period under review, Start Futong Technology Co., Ltd. ("Start Futong") continued to perform well, with sales increasing 91% when compared to the same period last year. The gross profit margin reached 12.2% which is well ahead of the industry average of 8%–10%. Start Futong continued to be the largest systems value-added services provider of IBM products in the PRC and the Asia Pacific regions. With its total sales volumes accounting for 70% of IBM's relevant business, Start Futong is firmly in the lead among its competitors.

**BUSINESS REVIEW** *(Continued)*

Start Futong continues to enjoy close relationships with its major customers – banks, telecommunications companies, government organisations, small and medium enterprises and systems integration providers. In addition to its wide range of mainframe and networking products, its excellent after-sales services and professional training services have also played an essential role in Start Futong's success. These professional value-added services not only reinforce Start Futong's competitiveness, but also effectively increase the profit margins of the Group.

Start Futong aims to provide one-stop value-added services to customers. In addition to being a key provider of IBM mainframes, data storage systems, servers and systems application software, Start Futong has also become a distributor of Nortel's networking products. The network department selling Nortel's products was set up in the first quarter of 2001 and commenced operations in the second quarter. The Group believes that the synergies generated by the complementary nature of IBM mainframe products and Nortel networking products will further enlarge Start Futong's market share, and will also enable it to capture the excellent opportunities generated by the construction of various city networking projects in the PRC in the next few years.

**Software Development & Systems Integration Business**

For the period under review, sales generated from the Software Development & Systems Integration Business increased by 41% to HK\$23,095,000. The gross profit margin also increased from 9.2% to 16.2% over the same period.

Start Technology strategically restructured its customer portfolio last year, venturing into the public and social security industries in view of their greater market potential and higher profit margins. With its unrelenting efforts over the past year, the Group has not only secured a substantial market share in the health care sector in Fujian province, it has also extended its social security and health care systems and software to Guangdong, Wunan, Inner Mongolia and Jiangxi provinces. During the period under review, the Group successfully obtained social security contracts in Guangdong Province and Inner Mongolia.

**BUSINESS REVIEW** *(Continued)*

As well established social security system forms the basis of China's Socialist Market Economy, the Chinese government is endeavoring to propel and mature a comprehensive social security system, and is expecting approximately 90% of the head districts to implement a basic healthcare security system by 2001. In this regard, healthcare security management information systems are playing a significant role in supporting the entire healthcare security system, consequently there is widespread demand for information systems and software in this sector. Riding on its distinctive capabilities in the area of healthcare security software as well as its systems integration capabilities, Start Technology possesses the most mature and well-developed healthcare information management systems together with an excellent track record of 20 successful case references, forming a powerful competitive edge for the Group. Apart from the healthcare security business, the Group is also in high gear to develop the "Five in One" social security business. Negotiations with Fujian province for the "Five in One" project has reached the final stage and the project is expected to commence in the later half of the year.

Leveraging its profound experience in healthcare security management information systems, as well as its knowledge in the operational processes relating to the social and healthcare security, Start Technology is in the best position to develop software and systems for bodies related to healthcare security. During the period, the Group successfully launched the hospital information systems software which is currently being implemented in over ten hospitals in Fujian province, and will soon be further introduced to hospitals outside Fujian province.

With regard to the public security sector, the Group is working to upgrade the capability and compatibility of its Immigration and Exit Control software to prepare for further expansion plans.

**General Software Business**

As a result of changes in the control over the board of directors of Start Ming Tai Computer Application Technology Development Co., Ltd. ("Start Ming Tai"), Start Ming Tai has been treated as a jointly controlled entity of the Group and its accounts have been equity accounted for in the consolidated accounts of the Group starting from this year. Despite the above changes, the General Software Business will continue to be the Group's main business focus. During the period, its sales recorded substantial growth and its profit margin is maintained at over 60%.

## **BUSINESS REVIEW** *(Continued)*

Leveraging its superb research capability, Start Ming Tai has successfully launched its Oriental CD Rom Magician software and two innovative products, namely the Oriental Remote Control Specialist and the Oriental 3D Specialist products which combine soft- and hard- ware and are able to effectively prevent pirated editions. We expect these products to generate satisfactory profits for the Group. These three products were launched simultaneously at the end of May and have been well received by customers with nearly 50,000 sets being sold in total up to July.

## **PROSPECTS**

Looking ahead, with the PRC's imminent accession into WTO, most PRC enterprises need to increase their competitiveness with the help of computerised systems. With the synergies generated among the Group's three core businesses, it will be able to seize market opportunities as they arise to ultimately bring in better results for the Group.

For the Software Development and Systems Integration Business, as at 30 June 2001, outstanding contracts on hand amounted to HK\$30,000,000. According to market statistics, no more than 25% of head districts have installed computerised management information systems so far. It is conservatively estimated that in the next three years, over 250 head districts will need to equip their facilities with healthcare security management information systems, with total investment expected to reach RMB2.5 billion. The potential in the healthcare security market is therefore immense. With its substantial experience in the healthcare security industry, Start Technology plays a leading position in the market and is regarded as one of the first choices in software development and systems integration by the healthcare security bodies in the various districts. We believe this highly satisfactory environment will generate positive profits for the Group.

In addition, as Start Technology is well known for its outstanding Immigration and Exit Control software in the PRC, it has established an excellent relationship with the public security departments. This facilitates the Group's penetration into the market for the provision of in-house software and systems integration services for the different public security departments. At present, the Group is actively developing firewall software products for the intranet systems of a number of public security and military departments, catering for the huge market need for such software and systems in the PRC.

## PROSPECTS *(Continued)*

In the Group's Systems Value-added Services Business, Start Futong's outstanding contracts on hand amounted to HK\$51,000,000 as at 30 June 2001. In the second half of the year, the Group expects Start Futong to begin integrating the competitive advantages of IBM's mainframe, Nortel's networking products and its professional services to provide comprehensive one-stop services to customers, further enlarging the Group's market share.

In the General Software Business, Start Ming Tai will continue to capitalise on its strong research capabilities to develop more new products for different market needs. During the period, Start Ming Tai has obtained contracts from software companies in Taiwan and the USA, helping them to localise their software products for the PRC market. These collaborations reaffirm the outstanding capability and market knowledge of Start Ming Tai in developing software, which outperforms other competitors in the industry. Additionally, the Group will seek opportunities to cooperate with well-known international and local enterprises to further strengthen its product research capability and to develop more innovative general software. The Group will also actively improve its existing distribution channels in the PRC and thereafter move into the global market.

With the above plans in place, and with the synergies generated from the three core businesses, the Group will achieve even better results in the second half of 2001, thereby enhancing returns for shareholders.

## LIQUIDITY AND FINANCIAL RESOURCES

As at 30 June 2001, the Group had cash and bank balances of HK\$126.7 million (31 December 2000: HK\$167.2 million) of which HK\$60.1 million (31 December 2000: HK\$48.3 million) were pledged to banks for facilities granted to the Group. About 32% and 26% of these liquid funds were denominated in Reminbi and US dollars respectively and the remainder in HK dollars.

As at 30 June 2001, the Group had available aggregate banking facilities of HK\$146.9 million (31 December 2000: HK\$132.2 million) of which HK\$50 million (31 December 2000: HK\$50 million) was not utilized. Total bank borrowings, wholly repayable within one year, amounted to HK\$49.1 million (31 December 2000: HK\$32.5 million) of which HK\$41.3 million were denominated in Reminbi and the remainder in US dollars as at 30 June 2001.

**LIQUIDITY AND FINANCIAL RESOURCES** *(Continued)*

Assets charged as security for banking facilities included properties of the Group valued at HK\$7.3 million (31 December 2000: HK\$7.3 million) other than bank deposits totalling HK\$60.1 million (31 December 2000: HK\$48.3 million) as at 30 June 2001.

As at 30 June 2001, the Group maintained net cash (being the total cash and bank balances net of total bank borrowings) of HK\$77.6 million (31 December 2000: HK\$134.7 million) and the net cash to equity ratio was 29.6% (31 December 2000: 51.9%). The Group's liquidity position remains strong and the Directors believe that the Group has sufficient financial resources to satisfy its commitments and working capital requirements.

**EXCHANGE RISK**

As the Group's operations are principally in the PRC and all assets and liabilities are denominated either in Reminbi, HK dollars or US dollars, the Directors believe that the operations of the Group are not subject to significant exchange risk.

**EMPLOYEES, TRAINING AND REMUNERATION POLICIES**

As at 30 June 2001, the Group had approximately 670 (31 December 2000: 630) employees of which approximately 220 (31 December 2000: 170) were technicians. Training programme is provided to technicians, especially new recruits, to ensure their technical proficiency.

Employees' costs (excluding directors' emoluments) amounted to approximately HK\$20.6 million (2000: HK\$13.7 million) for the period. The Group ensures that the pay levels of its employees are competitive and employees are rewarded on a performance related basis.

The Company operates a share option scheme (the "Scheme") whereby the Board of Directors may at their absolute discretion, grant options to employees and Executive Directors of the Company and any of its subsidiaries to subscribe for shares in the Company. The subscription price, exercisable period and the maximum number of options to be granted are determined in accordance with the prescribed terms of the Scheme.