

Highly competitive operating environment

In 2003, the IT and IT related industries in China continued to be the battlefields for market share and profits. In particular, intensified competition in the market for system integration and hardware products had severely slashed profit margins of IT companies. Besides, the outbreak of SARS during the first half of the year aggravated the market situation, in which companies already facing a tight budget had to savagely cut or suspend their IT spending.

Rise to the challenge in a new capacity as pure IT solution provider

Despite the challenges and difficulties, the Group took the advantage of its newly completed business transformation into a pure IT solution provider to consolidate and expand its operations. Well ahead of its competitors, the Group offered its financial, electronic payment and telecommunication clients a wide range of value-added consultancy and IT services that aim at raising cost-effectiveness and service quality.

During the year, the Group also actively expanded its electronic payment solutions under the PAX brand name. The Group seized on the opportunities arising from improved market sentiment after the containment of SARS by raising its EFT POS terminal sales to a new high level.

On the front of telecommunication, the Group successfully capitalised on its deep insight, profound knowledge of the industrial trend and long term dedicated services to be awarded an exclusive contract, subject to exceptions, to run the IVR platform for China Mobile, the major mobile telecommunication company in China. The Group believes that the IVR operation business enjoys the prospect of growing into a significant revenue and profit contributor for this financial year.

Significant improvement in operating results

The Group's turnover for the year 2003 amounted to approximately HK\$359.79 million, representing a slight drop of 3% from that of the previous year. The modest adjustment was due to a decline of HK\$46.95 million in hardware and product sales and the absence of contribution from the discontinued construction business that accounted for approximately HK\$3.95 million in 2002. The reduced contribution from these items was offset by the increase of HK\$40.69 million in turnover from the provision of consultancy and IT services.

Capitalising on the market recovery and completion of contracts during the second half of the year, the Group's turnover for this period increased by 74% from the first half of the year to HK\$228.63 million.

Apart from a stable turnover, the Group had succeeded in narrowing down its loss from approximately HK\$40.83 million in 2002 to HK\$3.45 million in 2003. The remarkable improvement evidenced the Group's successful strategy to switch its sales composition from low margin product sales to high margin consultancy and IT services and the Group's effective cost control measures. During the year, the Group's gross profit increased from HK\$69.88 million in 2002 to HK\$101.88 million, while the gross profit margin improved from 19% in 2002 to 28%.

The Group's transformation into a pure IT solution provider received further proof of success. In the second half of the year, the Group returned to profitability and reported a net profit of HK\$5.11 million against a loss of HK\$8.56 million in the first half of the year.

Financial solutions, application, services and related products – Major turnover and profit contributor of the Group

This business segment remained the major contributor to the Group's turnover and profit for the year under review. Turnover and profit from this business segment amounted to HK\$260.55 million (2002: HK\$287.17 million) and a profit of HK\$5.6 million (2002: loss of HK\$26.44 million). The outstanding performance in this segment was mainly attributed to the Group's exercising of stringent cost control during the second half of the year and substantial growth in the high margin consultancy and IT services operation, which continued to increase its contribution to this business segment. During 2003, consultancy and IT services accounted for 46% (2002: 27%) and 76% (2002: 53%) of the turnover and gross profit of this business segment respectively, while hardware products accounted for 54% (2002: 73%) and 24% (2002: 47%) of the turnover and gross profit of this business segment respectively.

Consultancy and IT services – New growth driver of the Group

IT services had become a new growth driver of this business segment and ranked the highest in terms of profit growth within the Group in 2003. During the year under review, IT services reported a gross profit of HK\$54.22 million, which represented 92% increase from that of the previous year and accounted for 76% of the gross profit generated from this business segment. The upsurge in the profit growth of IT services was mainly due to the contribution from several major contracts during the year. These contracts included the upgrading of the core banking systems of ICBC (Asia) Limited and Bank of Communications of China with the Group's IBS. The application of the Group's integrated banking system ("IBS") in two of China's largest banks not only marked the Company's core competitiveness and market niche, but also the Company's successful transformation from a traditional system integrator to a leading high value-added IT service provider.

The Group had also targeted its consultancy services at personal banking, credit card and brokerage, and the strategy had proved to be successful. Prestigious clients of the Group included Industrial and Commercial Bank of China ("ICBC"), China Construction Bank, Bank of China and Guangdong Securities Company Limited, etc.

System integration and hardware trading – Effective inventory and cost control helped mitigate adverse impact from severe competition

The Group's hardware product business experienced a retreat in profit margin as a result of severe market competition and reduced investment in IT infrastructure within the financial sector. To cope with these challenges, the Group adopted a "zero-inventory sales strategy", which enabled the Group to mitigate risk of capital lock-up as well as helped boost profitability.

During the second half of the year, the Group also optimized management resources, which emphasised profit margin-oriented operation. Through contracting out lower margin activities and retaining higher margin activities, the Group better utilised its resources and improved cost-effectiveness.

Electronic payment solutions and products – Outstanding performance in the second half of 2003

The electronic payment business segment made a sharp turnabout in the second half of the year, realising a profit of HK\$6.59 million as compared to a loss of HK\$2.73 million in the first half of the year. For the full year of 2003, this segment reported a turnover and profit of HK\$69.96 million (2002: HK\$45.74 million) and HK\$3.86 million (2002: loss of HK\$6.33 million) respectively. During the first half of the year, this business segment suffered from the adverse impact of the outbreak of SARS, which led to deferred business negotiation, contracts and delivery. With the containment of the SARS epidemic by the end of the first half of 2003 and the rapid development of our major clients, demand for the Group's EFT POS terminals quickly bounced back.

Under the PAX brand name, EFT POS terminals, PIN pads and smart card readers had been gaining increasing market recognition and acceptance. By the end of the year under review, PAX terminal sales growth had ranked the Group the major EFT POS terminal vendor in China and positioned it well for becoming a major player in Hong Kong and Southeast Asia.

Certifications for PAX products obtained up to 2003:

P60-S Terminal

1. China UnionPay ("CUP") in China
2. Europay International, Mastercard International, Visa International ("EMV") Level I and II
3. Network for Electronic Transfers (Singapore) Pte Ltd. ("NETS") Cash Card in Singapore
4. Easy Payment System ("EPS") in Hong Kong
5. American Express ("AMEX")

P70-S Terminal

1. CUP (in China)
2. CUP (in Hong Kong for BOCI)
3. EMV Level I and II
4. EPS (with CUP) in Hong Kong
5. Proton World in Malaysia
6. NETS Cash Card in Singapore
7. VisaCash in Korea
8. Certification for China Compulsory Product Certification ("CCC")
9. AMEX

PP20-C PinPAD

1. CUP (in China)
2. VISA PIN Entry Device

As PAX is an important partner of Visa International in the Asia Pacific region with respect to the transition to EMV infrastructure, PAX, through Visa International, is currently seeking collaboration with Small Terminal Interoperability Platform ("STIP") Consortium. STIP Consortium is an international association of secure transaction solution providers, including terminal manufacturers, payphone manufacturers, smart card manufacturers and others, for the development of interoperable platform specification for secure transaction devices. The Group intends to collaborate with STIP Consortium in developing PAX POS terminals that can implement STIP specification. Such collaboration would enable the Group to enhance its know-how in the development of PAX products and its technical capability through acquiring the latest technology and experience of the international electronic payment industry.

Telecommunication solutions, services and related products, and a big partner earned through dedicated services

Competition among IT service providers in China's telecommunication market remained acute during the year under review. Turnover and loss from this business segment for 2003 were HK\$29.24 million (2002: HK\$33.15 million) and loss of HK\$2.16 million (2002: HK\$4.55 million) respectively. Compared with last year's results, this segment had substantially reduced its loss by HK\$2.39 million. If the approximately HK\$1.8 million attributable to the initial investment in the IVR operation were excluded, this segment would have further narrowed down its loss to less than HK\$1 million.

Management systems and value added systems for telecommunication carriers remained the two principal solutions of this segment. Major systems completed during the year included the billing systems for 18 provinces for China Unicom, the billing systems for 3 provinces for China Mobile, the billing system for Beijing Telecom, decision support systems for Jilin Telecom and Inner Mongolia Telecom, and customer service systems for China Unicom in Yunnan, Jiangxi and Ningxia.

The long term dedicated services of the Group earned the recognition of China Mobile, the leading mobile telecommunication carrier in China, which entered into an exclusive agreement with the Group towards the end of the year under review on the use of the Group's IVR system. The contract provides the Group with a new significant growth driver.

Under the cooperative agreement, the Group acts as the operator, responsible for constructing and managing the infrastructure for the "12586 mobile chat services" and the "12590 voice-SMS (Short Messages Services) information services" offered by China Mobile. The Group is entitled to a share of revenue from China Mobile and the Service Providers for those services through the Group's unified high network capacity platform. The Group's platform is designed to cater for the future growth of the voice businesses of China Mobile. 12590 voice-SMS information services provide a platform that supports voice response system. Through touch-tone input, users can retrieve voice messages from themselves or others, receive and send voice-SMS messages. On the other hand, 12586 mobile chat services provide China Mobile's users with a registered "chat room", where members can chat with friends from far and wide.

China Mobile and the other carriers in China have unswervingly been pursuing their business expansion. Short Message Service (SMS), which has grown at a compound annual growth rate of over 200% in the past three years and continues to be the main source of revenue and profit growth for carriers, is a remarkable case in point. Although the development of IVR is still in the initial investment stage, it is expected to experience rapid growth for the coming years.

As China becomes the world's largest mobile telecommunication market and China Mobile is the major mobile carrier in the country, the Group sees its collaboration with China Mobile on the IVR business an important step in diversifying into value-added telecommunication services and establishing a strong presence in a market of enormous growth potential.

Liquidity and Financial Resources

As at 31 December 2003, the Group reported a total assets of HK\$163.68 million, which were financed by liabilities of HK\$102.92 million and equity of HK\$60.76 million. The net assets value was HK\$60.76 million (2002: HK\$64.21 million). It amounted to HK\$0.18 per share as compared to HK\$0.19 per share as at 31 December 2002.

As at 31 December 2003, the Group had cash of HK\$42.52 million and bank borrowings of HK\$24.48 million. The net cash position as at that date was HK\$18.04 million as compared to HK\$36.07 million as at 31 December 2002. All the borrowings were short-term loans and overdrafts utilised to fund the Group's working capital requirements. The gearing ratio (defined as total interest bearing debts divided by shareholders' equity) was 0.40 compared to 0.89 as at 31 December 2002 due to the repayment of certain bank borrowings after the rights issue exercise in December 2002. The gearing ratio is considered healthy and suitable for the continued growth of the Group's business.

Capital Structure and Details of Charges

The Group's bank borrowings are short term loans and overdrafts with interests charged at floating rates. As at 31 December 2003, bank loans amounting to RMB9.2 million (equivalent to HK\$8.6 million) were denominated in Renminbi with average interest rates of 5.31%. Short term bank loans and overdrafts amounting to US\$0.62 million (equivalent to HK\$4.85 million) and HK\$11.03 million were denominated in US dollar and Hong Kong dollar respectively. The Hong Kong dollar and US dollar denominated loans were charged at Hong Kong Prime Lending rate and floating interest rate respectively.

Approximately HK\$17.52 million, HK\$24.17 million and HK\$0.83 million of the Group's cash balances were denominated in Renminbi, Hong Kong dollar and US dollar respectively as at 31 December 2003.

The bank loans were secured by fixed deposits of HK\$14.46 million, deposits in bank guaranteed funds of HK\$4.42 million and a personal guarantee of HK\$7 million from a Director of the Company, and corporate guarantee of HK\$30 million by the Company.

Exchange Rates Exposure

The Group derives its revenue, makes purchases and incurs expenses denominated mainly in US dollar, Renminbi and Hong Kong dollar. Currently, the Group has not entered into agreements or purchased instruments to hedge the Group's exchange rate risks. Any material fluctuation in the exchange rates of Hong Kong dollar or Renminbi may have impact on the operating results of the Group.

Contingent Liabilities

The Group had no contingent liability as at 31 December 2003.

MANAGEMENT DISCUSSION AND ANALYSIS

Employees

The total number of employees of the Group as at 31 December 2003 was 627. The breakdown of employees by division is as follows:

Financial solutions, services and related products	392
Electronic payment solutions and products	85
Telecommunication solutions, services and related products	77
IVR operation	65
Corporate office	8
	<hr/>
	627

The Group ensures that its remuneration packages are comprehensive and competitive. Employees are remunerated with a fixed monthly income plus annual performance related bonuses. The Group also sponsors selected employees to attend external training courses that suit the needs of the Group's businesses.

Share Options

To provide further incentive to motivate talented employees, the Company adopted a share option scheme in November 2001. On 17 March 2004, 33,000,000 share options were granted to Directors and employees at HK\$0.374 (the average closing price of the shares as quoted in the daily quotations sheets issued by The Stock Exchange of Hong Kong Limited for the five business days immediately preceding 18 March 2004) with an expiry date of 17 March 2014.

USE OF PROCEEDS

The net proceeds of HK\$68 million raised from the Rights Issue completed in December 2002 had already been utilised. As at 31 December 2003, the application of the net proceeds was as follows:

Intended application of proceeds as disclosed in the Company's Circular dated 4 December 2002

	Intended application <i>HK\$ million</i>	Utilised <i>HK\$ million</i>
Expansion of the Group's IT Business	15	10
Expansion of the Group's electronic payment products and services	10	14
Reduction of the Group's indebtedness	25	26
General working capital	18	18
	<hr/>	<hr/>
	68	68

PROSPECTS

Promising outlook with enormous room for growth

2004 is a year full of opportunities. Demand for upgrading of IT infrastructure in the financial industry and the transition to EMV infrastructure promoted by international payment associations such as Visa International, MasterCard International, etc. are expected to create much room for development for the Group.

MANAGEMENT DISCUSSION AND ANALYSIS

With respect to the financial sector, the establishment of the China Banking Regulatory Commission, changes in China's financial policies, new rules regarding the granting of licence to financial institutions and intensified competition will lead to continued enhancement of IT infrastructure in the industry. However, more and more IT service providers are expected to vie for a market share in the industry. Taking the advantage of its leading and first-mover position, the Group is confident in enlarging its market coverage through taking the following initiatives: 1) to continue to explore the markets for banking and insurance core business products and IT services; 2) to further develop the service market for credit card business; 3) to upgrade the value services added of consultancy business; 4) to strengthen the Group's data processing and analysis systems and 5) to realign the Group's management resources and technical resources, in order to meet the growing demand for IT consultancy in respect of project management, supervision and software development management.

In 2004, the Group's electronic payment business is expected to continue to display strong performance. A large number of traditional POS terminals have to be renewed by 2006 in order to comply with the requirements of EMV infrastructure, which is an accelerating trend in the payment industry. The Group believes its EFT POS terminals under the PAX brand name will continue to enjoy a solid competitive advantage over its major competitors. To cater for different needs and enrich the Group's existing product portfolio, the Group is launching a number of new hardware and software products in 2004.

Besides, the PAX products have been consolidating its leading position in China due to its price competitiveness, quality and technical support. For the year under review, through its collaboration with CUP, the country's national card association, the Group has taken approximately 25% of the new deployment market in China. In view of CUP's dominant position and rapid development, the Group believes there will be uniquely big room for the growth of the PAX products sales in China.

On the telecommunication front, the Group expects its IT business to generate satisfactory income in respect of capacity expansion and system upgrade of the management and value-added system projects for telecommunication carriers. More significantly, as the sole operator of China Mobile's IVR system services, the Group anticipates that its IVR business will become a key profit driver of the Group in the future. The market size of the IVR operation in China is expected to reach US\$300 million within the next two to three years.

In its new capacity, the Group is committed to maintaining its leading IT consultancy and service provider position in China and to creating greater shareholder value.