

MANAGEMENT DISCUSSION AND ANALYSIS

BUSINESS REVIEW

Telecommunications Value-added Services

This year has marked a turning point in the history of the Company where the Group has now become one of the leading players in the telecommunications value-added services (“Telecom VAS”) industry in the PRC following the acquisition of 45% equity interest in Beijing Honglian 95 Information Industries Company Limited (“HL95”). HL95 is a leading Telecom VAS company in China, and provides governmental, business and leisure information nationwide, delivered via Interactive Voice Response Systems (“IVRS”) and Short Messaging Services (“SMS”).

IVRS

With a nationwide uniform access number for both fixed line and mobile phone, 95001, it is one of the largest coverage IVRS service providers in the PRC with coverage over 300 cities. HL95 currently co-operates with over 1,000 service partners to provide a variety of information to the public through its 95001 platform, including government information, stock quotations, weather forecast, song dedication, news and others. In particular, HL95 is a partner for government-related information provision such as traffic violation hotline, examination enquiry hotline, housing pension enquiry hotline, and others in designated cities.

SMS

The services offered by HL95 include:

- (1) Short Messaging Services (“SMS”) — Text only, typically personal greetings, jokes, lovers’ poems, etc;
- (2) Multi-media Messaging Services (“MMS”) — Text, pictures and sounds, typically comic figures with motion, pop-stars and signers, nature landscape, painting, etc; and
- (3) Various value-added services for mobile phone — Customized mobile phone screen decoration, for color or mono-screen phones comics, pop-music ring tone;

HL95 is also one of the top SMS providers in the country, utilizing a nationwide access number 9500 and through the operation of entertainment portal www.9500.com.cn (藝點網絡), to provide mobile value-added services.

With the rapid development of mobile telecommunications in the PRC, the market has experienced significant growth. Operating information provided by China Mobile and China Unicom collectively have shown that the number of SMS sent in aggregate were 94 billion and 200 billion for the year 2002 and 2003 respectively and according to information published by People’s Daily, there were approximately 10 billion short messages sent during the 1-week Chinese New Year holiday period in 2004.

BUSINESS REVIEW (continued)

The audited financial information of HL95 for the year ended 31st December 2002 and 2003 prepared in conformity with accounting principles generally accepted in China is as follows:

	2003 RMB'000	2002 RMB'000
Turnover	<u>321,476</u>	<u>112,942</u>
Profit before taxation	<u>44,957</u>	<u>6,710</u>
Profit attributable to shareholders	<u>29,175</u>	<u>5,033</u>

Both operating information on the number of SMS sent and financial information of HL95 mentioned above showed significant increases in 2003 which greatly strengthens management's confidence in the future development of the Telecom VAS industry.

HL95 is now jointly controlled and managed by the Company and a substantial shareholder, CITIC Guoan. Both the Company and CITIC Guoan appointed 4 directors to the Board of Directors of HL95. Following the acquisition, the Group and CITIC Guoan injected RMB22,500,000 and RMB27,500,000 respectively, according to their shareholding, to HL95 to enhance the capital base of HL95 for future development.

For the current year, the share of profit after taxation which is equity accounted for by the Group from the completion date of acquisition, 11th February 2004 to 31st March 2004 (approximately 1.5 months), after taking into adjustments to conform with accounting principles generally accepted in Hong Kong, was HK\$2,460,000.

System Integration and Software Development

The outbreak of SARS in 2003 hindered business in the first quarter of the fiscal year as many customers withdrew or delayed their corporate expansion plans, however, with the effort of management in the three succeeding quarters, the Group successfully obtained new contracts with total contract sum of RMB69,000,000 during the year.

The revenue derived from the sales of computer products, provision of system integration services, software development and network management for the current year was HK\$137,228,000 (2003: HK\$5,035,000) and the segment achieved a profit of HK\$1,428,000 (2003: loss of HK\$6,620,000). The significant increase in turnover was due to a full year results for the current year since this business was acquired in piecemeal from December 2002 to March 2003. The loss in the last year included goodwill written off of HK\$3,167,000. Disregarding the goodwill written off, the loss for the few months consolidated in the last year was HK\$3,453,000. The profit for the current year was only HK\$1,428,000 due to very keen competition within this industry and the effect of SARS in the first quarter of the fiscal year.

BUSINESS REVIEW (continued)

Real Estate

During the year, all investment properties and leasehold land and buildings of the Group in the PRC were disposed of to two subsidiaries of CITIC Group, a substantial shareholder of the Group. The consideration of HK\$36,660,000 was based on the valuation performed by an independent professional valuer at 31st March 2003 and the net book value before the date of disposal. The net loss on disposal of these properties was HK\$533,000.

The rental income for the year was HK\$2,226,000 (2003: HK\$5,316,000) with a profit of HK\$918,000 (2003: HK\$6,668,000). The decrease in turnover and profit was due to disposal of the properties during the last two years.

OUTLOOK

With the strong support from our largest shareholder, CITIC Group, the Group acquired its interest in a leading nationwide telecommunications value-added services business, HL95, during the year.

As HL95 is a leading SMS and IVRS provider in the PRC, with the exponential increase in demand of information and data through fixed lines and mobile phones in the PRC, the Group expects the business of HL95 to continue to grow in the coming year.

Apart from organic growth, the Group expects to explore other lucrative business and investment opportunities in China's Telecom VAS market. The management is confident that the Group will achieve satisfactory results for the shareholders in the coming year.

FINANCIAL REVIEW

Summary

Turnover of the Group increased substantially from HK\$10,600,000 for the last year to HK\$139,454,000 for the current year which shows an increment of 12.16 times. The significant increase is mainly due to the full year contribution from the system integration and software development business, which was acquired in piecemeal from December 2002 to March 2003. The turnover from system integration and software development for the current year was HK\$137,228,000 (2003: HK\$5,035,000).

The Group incurred an operating loss of HK\$5,024,000 for the year (2003: HK\$25,522,000) and the loss attributable to shareholders decreased to HK\$2,035,000 for the year (2003: HK\$27,054,000). The substantial decrease was mainly due to (1) operating profit of HK\$1,428,000 contributed by the system integration and software development business which recorded a loss of HK\$6,620,000 in the last year; (2) recovery of a long outstanding debt of HK\$7,000,000, which was provided in previous year, from a former joint venture partner in the current year; (3) write back of provision for litigation of HK\$6,868,000; and (4) a contribution before taxation of HK\$4,685,000 from the newly acquired jointly controlled entity, HL95, in the current year.

FINANCIAL REVIEW (continued)

Significant Investments and Capital Expenditure

During the year, the Group completed the acquisition of 45% of HL95, a leading nationwide telecommunication value-added services provider in China. The consideration for the acquisition amounted to HK\$12,837,000. After the acquisition, the Group injected HK\$21,226,000 to HL95 for its further expansion.

To satisfy the cash expenditure of the acquisition of and capital injection into HL95, the Group disposed of all investment properties in China at a consideration of HK\$36,660,000.

In February 2004 the Group signed an agreement to acquire an additional 4% of HL95 with a consideration of HK\$3,028,000. The acquisition was completed in June 2004 after obtaining relevant governmental authorities approvals.

Liquidity and Financial Resources

The total assets of the Group as at 31st March 2004 was HK\$307,000,000 (2003: HK\$175,759,000) which was financed by shareholders' fund of HK\$218,083,000 (2003: HK\$102,034,000), current liabilities of HK\$88,837,000 (2003: HK\$73,640,000) and minority interest of HK\$80,000 (2003: HK\$85,000). The current ratio of the Group increased from 1.76 to 2.90.

The significant increase in shareholders' funds was mainly due to two placements conducted during the year. In November 2003, 75,000,000 shares were placed and subscribed by Uni-Tech at HK\$0.60 per share and in March 2004, 97,500,000 shares were placed and subscribed by Uni-Tech at HK\$0.80 per share. Together with 540,000 shares issued on exercise of share options, the issued share capital increased to 3,282,306,000 shares at 31st March 2004.

After the placements, the financial position of the Group was further strengthened. The cash and bank balances of the Group increased to HK\$173,193,000 at 31st March 2004 (2003: HK\$75,342,000).

At 31st March 2004, the Group had a HK\$6,594,000 short-term bank loan for the daily operation of the system integration and software development business. The bank loan was secured by bank deposits of HK\$7,000,000. Total interest bearing borrowing as at 31st March 2004 was HK\$11,721,000 (2003: HK\$4,880,000) and the gearing ratio, calculated by all interest-bearing borrowings over shareholders' funds, was 5.4% (2003: 4.8%).

The Group's transactions and cash and bank balances are mainly denominated in Hong Kong dollars and Renminbi. The Directors consider that Renminbi is stable and the exposure to exchange fluctuation is minimal.

Contingent liabilities

The Group had no material contingent liabilities as at 31st March 2004.

EMPLOYEES AND REMUNERATION POLICIES

As at 31st March 2004, excluding jointly controlled entities, the Group employed a total of 115 (2003: 139) full-time employees, including the Directors, of whom 13 (2003: 14) were based in Hong Kong and the remaining were in China. Employees are awarded by reasonable and competitive remuneration on a performance-related basis to motivate employees to provide greater contribution to the Group. The Group has also set up share option schemes pursuant to which employees of the Group may be granted options to subscribe for the Company's shares.