

MANAGEMENT DISCUSSION & ANALYSIS

FINANCIAL REVIEW

Turnover

For the year ended 31 December 2004, the Group accomplished a turnover of HK\$245,545,000, a growth of 61.7% over that of 2003. The increase was the result of a shift of business focus to smartphone products in response to market demand, which led to a sharp surge in smartphone sales from HK\$18,086,000 in 2003 to HK\$175,399,000 in 2004.

In terms of revenue mix, turnover from smartphones accounted for 71% of the Group's turnover in 2004, as compared with 12% in 2003. Contribution from sales of wireless coverage system decreased from 19% of the Group's turnover in 2003 to 11% in 2004, while that of integrated telecom business platform decreased from 11% in 2003 to 4% in 2004. Sales from other terminal products accounted for 14% of the turnover for the period under review, as compared with 58% in 2003. The significant change in revenue mix was attributable to the upgrading of the Group's wireless terminal products and the changing environment for the market and technologies developments.

	2004 HK\$000	% of turnover	2003 HK\$000	% of turnover
Wireless systems solutions				
PHS Intelligent Coverage System	26,713	11%	9,431	6%
Paging system	—		19,370	13%
Integrated Telecom Business Platform	9,752	4%	17,066	11%
Subtotal	36,465	15%	45,867	30%
Wireless terminals				
Smartphones	175,399	71%	18,086	12%
Fixed wireless terminals	32,198	13%	83,888	55%
One-way wireless terminals	1,483	1%	3,967	3%
Subtotal	209,080	85%	105,941	70%
Total	245,545		151,808	

Gross Profit

The Group's gross profit increased by 54.0% from HK\$64,539,000 in 2003 to HK\$99,408,000 in 2004. The gross profit margin was 40.5% in 2004, as compared with 42.5% in 2003. The slight decline was attributable to a smaller proportion of revenue from system solutions, which offer higher gross profit margin, in the revenue mix during the reporting period.

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Selling and distribution costs

Selling and marketing expenses increased by 133.4% from HK\$11,108,000 in 2003 to HK\$25,926,000 in 2004. The increment principally reflected the stepping up of promotional and advertising activities, the higher staff costs as the marketing staff force was enlarged, and the extended distribution network.

Administrative expenses

Administrative expenses increased by 53.2% from HK\$14,202,000 in 2003 to HK\$21,758,000 in 2004. The increase was mainly attributable to higher research and development expenses as the Group enlarged the research and development staff force specialising in smartphone, PHS and 3G.

Income tax expenses

In 2004, the Group's profit tax charge amounted to HK\$7,528,000, as compared to HK\$3,103,000 in 2003. According to the Income Tax Law of the PRC for Foreign Investment Enterprise and Foreign Enterprises and as approved by relevant tax authorities, an income tax rate of 15% applied to the Group for the year ended 31 December 2004, as compared to 7.5% in 2003.

Net Profit

For the year ended 31 December 2004, the Group recorded a net profit of HK\$43,667,000, representing an increase of 18.5% from the net profit of HK\$36,863,000 in 2003. The net profit margin dropped from 24.3% in 2003 to 17.8% in 2004. The major reasons were that, during the reporting period: (1) the gross profit margin of the Group dropped as mentioned above; (2) the Group's applicable income tax rate increased from 7.5% in 2003 to 15% in 2004; and (3) the Group significantly increased its marketing promotion and brand building expenses.

LIQUIDITY AND FINANCIAL RESOURCES

In connection with the share offer and listing of the Company's shares on the Stock Exchange on 9 December 2004, a total of 132,000,000 shares with a nominal value of HK\$0.01 each were offered for subscription by way of placing and public offer comprising (i) a public offer of 13,200,000 new shares by the Company and (ii) a placing of 118,800,000 shares including 86,800,000 offered by the Company and 32,000,000 sale shares sold by JAFECO Asia Technology Fund as vendor respectively at HK\$0.86 per share. The Group's financial position significantly improved in the year ended 31 December 2004 as the Group received gross proceeds (before related expenses) of HK\$86,000,000.

For the year ended 31 December 2004, the Group's operating capital was mainly generated from cash from its daily operation and bank borrowings.

Some of the principal financial data of the Group were set out below:

- As at 31 December 2004, the Group had cash and cash equivalents of HK\$80,352,000, as compared to HK\$17,589,000 as at 31 December 2003. The increase was mainly attributable to the proceeds from issue of shares.

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- As at 31 December 2004, the Group's total assets amounted to HK\$381,298,000 (2003: HK\$206,138,000).
- As at 31 December 2004, the Group's total liabilities was HK\$166,288,000 (2003: HK\$111,016,000).
- As at 31 December 2004, the Group's capital and reserves amounted to HK\$215,010,000 (2003: HK\$95,122,000).
- As at 31 December 2004, the Group had a gearing ratio of 44% (based on debt over total assets) (2003: 54%).
- As at 31 December 2004, the Group had a current ratio of 48% (based on current liabilities over current assets) (2003: 63%).
- As at 31 December 2004, the Group did not have any significant contingent liabilities.
- As at 31 December 2004, the Group's interest-bearing bank borrowings amounted to HK\$56,396,000 (2003: HK\$29,702,000).
- As at 31 December 2004, HK\$29,890,000 (2003: HK\$7,773,000) of the Group's bank deposits were pledged to secure general bank borrowings.
- For the year ended 31 December 2004, the Group's finance costs was HK\$2,048,000 as compared to HK\$1,834,000 for the year ended 31 December 2003.



BUSINESS REVIEW

As a leading wireless data total solutions provider in the PRC, the Group offers innovative products and personalised solutions to satisfy demands of different clients and different industries.

For its system solutions business, the Group strengthened the research and development of PHS network coverage system, while at the same time extended its business of call center solutions. During the reporting period, the Group entered into agreements with Hubei Unicom, Yunnan Unicom and Xinjiang Unicom, are of which are subsidiaries of China United Telecommunications Corporation ("China Unicom"), for their call center projects. It also secured a contract from the headquarters of China Unicom for phase 2 of its call center project and another call center project from Shandong Unicom, which is also a subsidiary of China Unicom.

After the launch of the first smartphone with proprietary operating system in 2003, the Group offered 3 new models of smartphones in 2004, namely the GSM/GPRS smartphone, CDMA smartphone and GSM-CDMA dual-mode smartphone. The GSM-CDMA dual-mode smartphone was adopted by China Unicom as the fourth model of its "Worldwind" mobile phones series. In addition, the Group actively explored the corporate market, offering integrated solutions from back-end system to wireless intelligent terminals with proprietary operating system, and achieved outstanding performances in serving the public security, aviation, securities, industrial and commercial sectors.

During the reporting period, the Group established close strategic partnerships with well-known enterprises such as Microsoft Corporation, AnyDATA Corporation and Spreadtrum Communications Inc.. Through these cooperations, the Group is able to strengthen the development of its wireless data solutions with more functions and various applications for different industries and customers, closely monitor the development trends of the wireless data market and related technologies, as well as consolidate its first mover and leading position in the wireless data communications market in the PRC.

The Group expanded its sales network to over 20 provinces and 50 cities during the reporting period. The Group was also exploring various opportunities to forming international partnerships with an aim of penetrating in the international market.

In addition to the above significant achievements, the Group's "Coolpad" brand is recognised as one of the leaders in the wireless data market in the PRC and enjoys high reputation.



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OUTLOOK

The smartphone market in the PRC started to take shape in 2000. Its total sales volume grew substantially between then and 2003, with a compound annual growth rate of 240%. According to the forecast by the China Center of Information Industry Development ("CCID"), the sales of smartphones in the PRC between 2004 and 2008 will grow rapidly at a compound annual growth rate of over 45%. The demand for smartphones with proprietary operating systems capable of supporting personalised and integrated solutions that meet specific customer requirements in different industries will be further increased. CCID's forecast was based on: (1) the relatively low penetration rate of smartphones in the PRC, which took less than 2% of the overall mobile phone market as at 2003; (2) the versatile data applications of smartphones; and 3) the continuous improvement of the telecom network infrastructure.

As China's 3G policies become clearer, the Group also see a promising imminent prospect for its 3G wireless data total solutions. The Group has invested considerable resources into strengthening its 3G wireless data solutions and 3G network coverage, and developing its 3G multi-media data platform. Its objective is to equip itself with the capacity be able to launch integrated 3G solutions tailored for 3G terminal products, network systems and back-end systems to capture the market demand in time when China commences 3G network development.

In 2005, the Group will further consolidate its harmonious business relationship with various telecom operators in the PRC, expand its marketing network, further exploit the PRC market and broaden its industry client base. In the meantime, the Group will seek to develop international partnerships to facilitate its tapping of the overseas market and keeping itself abreast of the latest international technology and market development.

The Company plans to launch 6 to 8 new smartphone models targeting different industries and different customers to provide wireless data total solutions in 2005. Depending on the progress of development of the 3G network in the PRC, the Group may also launch 3G wireless data solutions and 3G integrated solutions when appropriate.

Looking ahead, the Group will seek to maintain a healthy financial position, boost its existing market, aggressively develop innovative products and new markets, and launch system solutions to cater to the different needs of different industries and clients.



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USE OF PROCEEDS

The Company was listed on the Main Board of the Stock Exchange on 9 December 2004. As at 31 December 2004, the Company has not used any of its listing proceeds and the same was deposited with financial institutions in Hong Kong and China.

FOREIGN EXCHANGE EXPOSURE

During the reporting period, the Group's expenses, assets and liabilities were mainly denominated in Renminbi. Taking into account the Group's operation and capital needs, the Directors considered that the Group did not have any significant foreign exchange exposure.

EMPLOYEES AND REMUNERATION POLICY

As at 31 December 2004, the Group employed a total of 502 employees (2003: 420). During the year, staff cost amounted to HK\$22,168,000 (2003: HK\$11,791,000). The remuneration of the Group's employees are commensurate with their responsibilities and market levels, with discretionary bonuses given on a merit basis.

SIGNIFICANT INVESTMENTS

There were no significant investments held by the Group as at 31 December 2004.

MATERIAL ACQUISITION AND DISPOSALS DURING THE YEAR

There were no material acquisitions and disposals of the Company, its subsidiaries and associated companies as at 31 December 2004.