# MANAGEMENT DISCUSSION AND ANALYSIS

## FINANCIAL REVIEW

The key financial figures of the Group for the year ended 31st March 2006 and the comparative figures for the year ended 31st March 2005 were summarised as follows:

| | **2006** | 2005 | Growth rate |
|---|---|---|---|
| | **HK$'000** | HK$'000 | % |
| Turnover | **403,545** | 249,058 | 62.0 |
| Gross profit | **184,063** | 102,059 | 80.3 |
| Gross profit percentage | **45.6%** | 41.0% | N/A |
| Other income | **7,492** | 31,507 | (76.2) |
| Share option expense | **16,046** | 7,960 | 101.6 |
| Convertible bonds issue expenses | **26,480** | – | N/A |
| Change in fair value of convertible bonds | **1,420** | – | N/A |
| Change in fair value of loan receivable | **1,246** | – | N/A |
| Start up expenses of a jointly controlled entity | **1,207** | – | N/A |
| Other administrative and operating expenses | **135,358** | 117,982 | 14.7 |
| Share of profit of an associate | **9,725** | – | N/A |
| Profit before interest, taxes, depreciation and amortisation | **33,039** | 17,216 | 91.9 |
| Profit before interest, taxes, depreciation, amortisation and before one-off expenses for the convertible bonds and start up expenses, and non-cash expenses resulting from new accounting standards to use fair values to account for the convertible bonds, loan receivable and share options (and retrospective share option expense booked in previous year) | **79,438** | 25,176 | 215.5 |

## FINANCIAL REVIEW *(Continued)*

| | **2006** | 2005 | Growth rate |
|---|---|---|---|
| | **HK$'000** | HK$'000 | % |
| Net profit (loss) attributable to shareholders | **9,153** | (1,755) | N/A |
| Net profit attributable to shareholders before one-off expenses for the convertible bonds and start up expenses, and non-cash expenses resulting from new accounting standards to use fair values to account for the convertible bonds, loan receivable and share options (and retrospective share option expense booked in previous year) | **55,552** | 6,205 | 795.3 |
| Basic earnings (loss) per share | | | |
| Net profit (loss) attributable to shareholders | **0.28 cents** | (0.05) cents | N/A |
| Net profit attributable to shareholders before one-off expenses for the convertible bonds and start up expenses, and non-cash expenses resulting from new accounting standards to use fair values to account for the convertible bonds, loan receivable and share options (and retrospective share option expense booked in previous year) | **1.68 cents** | 0.19 cents | 784.2 |
| Diluted earnings per share | | | |
| Net profit attributable to shareholders | **0.27 cents** | N/A | N/A |
| Net profit attributable to shareholders before one-off expenses for the convertible bonds and start up expenses, and non-cash expenses resulting from new accounting standards to use fair values to account for the convertible bonds, loan receivable and share options (and retrospective share option expense booked in previous year) | **1.61 cents** | 0.19 cents | 747.4 |

## FINANCIAL REVIEW *(Continued)*

**Results**

– *Turnover*

Turnover of the Group for the year surged substantially from HK$249,058,000 to HK$403,545,000 representing an increase of 62.0% as compared with previous year. The increase was mainly due to the following reasons:

(a) The operating results of HL95, a 49%-owned jointly-controlled entity of the Group, were proportionately consolidated into the Group's consolidated income statement. In the current year, the Group's share of the turnover of HL95 increased from HK$189,767,000 in the last year to HK$297,588,000 in the current year, representing a growth of 56.8%. The Group's share of the turnover of HL95 comprised HK$164,193,000 (2005: HK$64,521,000) from short messaging services ("SMS"), HK$73,099,000 from fixed-line interactive voice response system ("IVRS") (2005: HK$72,111,000), and HK$60,296,000 (2005: HK$53,135,000) from other value-added services such as Internet-protocol phone and call centres. The increase in revenues was primarily from SMS as a result of the HL95's cooperation with content providers to provide more SMS content to stimulate usage of SMS in quizzes and games, and the increasing popularity in downloading pictures and ring tones to the mobile phones; and

(b) Revenue from system integration and software development increased by 99.9% from HK$59,291,000 in the last year to HK$118,522,000 in the current year as a result of securing more contracts from China Mobile totalling approximately RMB80 million, and providing system integration and software development services to HL95 and 中信國檢信息技術有限公司 (China Credit Information Technology Company Limited) ("CCIT") as these affiliates upgrade or build up its telecommunication or database infrastructure.

– *Gross profit percentage*

The gross profit percentage of the Group during the year ended 31st March 2006 improved to 45.6% from 41.0% of the previous year mainly because of the increased margin in Grand Cycle, the Group's business unit engaged in software development and system integration services. During the year, Grand Cycle has focussed on projects with higher margins and larger contract sums.

– *Other income*

Other income of HK$7,492,000 principally comprised of interest income. In the year ended 31st March 2005, other income principally comprised gain on disposal of subsidiaries of HK$13,103,000 and recovery of bad debts of HK$10,000,000.

## FINANCIAL REVIEW *(Continued)*

**Results** *(Continued)*

– *Share option expense*

Share option expense represents a non-cash expense recorded by the Group commencing in the current year in accordance with the requirements of a new accounting standard, Hong Kong Financial Reporting Standard ("HKFRS") 2 Share-based Payment. Under HKFRS 2 the fair value of share options granted to directors and employees of the Company are determined at the date of grant of the share options. Such fair value is expensed over the period from the date of grant of the share options to the date when the share options become exercisable. For the year ended 31st March 2006, the fair value of the share options expensed in the income statement was HK$16,046,000. HKFRS 2 requires retrospective treatment for share options granted after 7th November 2002 and had not yet vested on 1st April 2005 and for the year ended 31st March 2005 the fair value of these share options expensed in the income statement was HK$7,960,000.

– *Convertible bonds issue expenses and change in fair value of convertible bonds*

During the year, the Group issued US$70,000,000 zero coupon convertible bonds due 2010 and incurred one-off expenses of HK$26,480,000 for the issuance of these convertible bonds.

For the year ended 31st March 2006, the Group adopted for the first time new accounting standards, Hong Kong Accounting Standard ("HKAS") 32 Financial Instruments: Disclosure and Presentation and HKAS 39 Financial Instruments: Recognition and Measurement, for convertible bonds. At 31st March 2006, change in fair values of the convertible bonds was determined, and the difference of HK$1,420,000 between the fair value of the convertible bonds and the proceeds of the convertible bonds was recognised as an expense in the income statement. The HK$1,420,000 reflected the difference between the fair value and book value of the convertible bonds and was not a cash expense to the Group.

A total of HK$27,900,000 has been recognised as expenses in the income statement in relation to the convertible bonds.

– *Change in fair value of loan receivable*

On 3rd March 2006, the Group entered into loan agreements with its joint controlled entity CCIT in which the Group granted a non-interest bearing two-year loan of US$6,900,000 (HK$53,820,000) to CCIT for the development of PIATS business. At 31st March 2006, the amount of the loan receivable stated in the consolidated balance sheet was HK$25,664,000 after inter-company balance elimination of the Group's 50% share of CCIT and a change in fair value of HK$1,246,000 for deemed interest. Change in fair value of loan receivable arise from the adoption for the first time new accounting standards, HKAS 32 Financial Instruments: Disclosure and Presentation and HKAS 39 Financial Instruments: Recognition and Measurement for loan receivable. On the initial adoption of these accounting standards, the difference of HK$1,246,000 between the fair value and the face value of the loan receivable was recognised as an expense in the income statement. However, the difference of HK$1,246,000 was not a cash expense to the Group.

## FINANCIAL REVIEW *(Continued)*

**Results** *(Continued)*

– *Start up expenses of a jointly controlled entity*

During the year, the Group incurred one-off start up expenses of HK$1,207,000 relating to the formation of CCIT, a joint venture between 中華人民共和國國家質量監督檢驗檢疫總局信息中心 (Information Centre of the General Administration of Quality Supervision, Inspection and Quarantine of the PRC) ("AQSIQ"), China Telecom and the Group, the operator of PIATS. The joint venture has a term of 30 years commencing from the issuance date of the business licence on 27th January 2005. However, these start up expenses have not been amortised over the life of the joint venture, but instead recorded as a one-off expense in the year ended 31st March 2006.

– *Other administrative and operating expenses*

Other administrative and operating expenses for the year ended 31st March 2006 was HK$135,358,000, representing an increase of 14.7% over the previous year. The increase was mainly due to higher staff cost as a result of increase in headcount, especially in HL95 to cope with the expanding business.

– *Share of profit of an associate*

The share of profit of an associate represents the equity income contribution from Dongfang Customs. The Group completed the acquisition of a 30% interest in Dongfang Customs on 31st March 2005, therefore, Dongfang Customs commenced contributing to the Group's results for the year ended 31st March 2006.

– *Profit before interest, taxes, depreciation and amortisation*

Profit before interest, taxes, depreciation and amortisation of HK$33,039,000 represented an increase of 91.9% as compared with the previous year. However, included in profit before interest, taxes, depreciation and amortisation was one-off expenses of HK$26,480,000 for the issuance of the convertible bonds and one-off start up expenses of HK$1,207,000 in relation to formation of CCIT (a joint venture between AQSIQ, China Telecom and the Group), and non-cash expenses of HK$18,712,000 resulting from new accounting standards using fair values to account for the convertible bonds, loan receivable and share option expense. The fair values to account for convertible bonds, loan receivable and share options expense resulted from the Group's first time adoption of new accounting standards HKAS 32 Financial Instruments: Disclosure and Presentation, HKAS 39 Financial Instruments: Recognition and Measurement for the convertible bonds and loan receivable, and HKFRS 2 Share-based Payment for the share options. Before the one-off expenses of HK$27,687,000 and non-cash expenses of HK$18,712,000 from the first time adoption of new accounting standards, the profit before interest, taxes, depreciation and amortisation would be HK$79,438,000 or an increase of 215.5% over the previous year's profit before interest, taxes, depreciation, amortisation and the non-cash share option expense of HK$7,960,000 (retrospectively booked in the previous year due to HKFRS 2 Share-based Payment).

## FINANCIAL REVIEW *(Continued)*

**Results** *(Continued)*

– *Profit before interest, taxes, depreciation and amortisation (Continued)*

The Group recorded a significant improvement in profit before interest, taxes, depreciation, amortisation and before one-off expenses of HK$27,687,000 and non-cash expenses of HK$18,712,000 from the first time adoption of new accounting standards because of the following reasons:

(a) Increase in turnover and gross profit as explained above; and

(b) The Group recorded a share of net profit of HK$9,725,000 from a 30%-owned associate, Dongfang Customs, which has became an associate of the Group since 31st March 2005.

– *Net profit attributable to shareholders*

Net profit attributable to shareholders of HK$9,153,000 as compared to a loss of HK$1,755,000 in the previous year. If the one-off convertible bonds issuance expenses of HK$26,480,000, one-off start up expenses of HK$1,207,000 for the establishment of CCIT, and non-cash expenses of HK$18,712,000 for the first time adoption of new accounting standards to use fair values for convertible bonds, loan receivable from CCIT and share option expense were excluded, the net profit attributable to shareholders would be HK$55,552,000, an increase of 795.3% over the previous year after adjusting for non-cash share option expenses of HK$7,960,000 (retrospectively booked in the previous year due to HKFRS 2 Share-based Payment).

– *Earnings per share*

Basic and diluted earnings per share are 0.28 cents and 0.27 cents. If the one-off expenses of HK$27,687,000 and non-cash expenses of HK$18,712,000 for the year ended 31st March 2006 and the non-cash expenses of HK$7,960,000 for the year ended 31st March 2005 were excluded, the basic and diluted earnings per share would be 1.68 cents and 1.61 cents, representing increases of 784.2% and 747.4% respectively over the previous year.

## FINANCIAL REVIEW *(Continued)*

**Significant investment and capital expenditure**

*During the year ended 31st March 2006*

**(i) Joint venture formation with 河北電視台 (Hebei Television Station China)**

On 26th August 2005, CITIC 21CN DIGITAL TELEVISION AND MOVIES LIMITED ("CITIC 21CN DIGITAL"), an indirectly wholly-owned subsidiary of the Company, entered into a joint venture agreement (the "JV Agreement") with 河北電視台 (Hebei Television Station China, "Hebei TV") pursuant to which Hebei TV and CITIC 21CN DIGITAL agree to establish a joint venture company (the "JV Company") which will be engaged in, inter alia, (i) development of digital television and multi services technology platform; (ii) development of new digital television technology; (iii) distribution, sales and leasing of set-top boxes; and (iv) acquisition of program contents and set up of program content library for digital television.

The JV Company will be owned as to 51% by Hebei TV and 49% by CITIC 21CN DIGITAL. Upon the establishment of the JV Company, it will become a jointly controlled entity of the Group.

Pursuant to the JV Agreement, the registered capital of the JV Company will be RMB70,000,000, 51% of which or RMB35,700,000 is to be contributed by Hebei TV in the form of intangible and tangible assets, and 49% or RMB34,300,000 by CITIC 21CN DIGITAL in the form of cash.

**(ii) US$6,900,000 loan to CCIT for second stage development of PIATS database/system**

On 3rd March 2006, the Group entered into loan agreements with CCIT in which the Group granted a non-interest bearing and unsecured two-year loan of US$6,900,000 (HK$53,820,000) to CCIT for the second stage development of PIATS database/system. At 31st March 2006, the amount of the loan receivable stated in the consolidated balance sheet was HK$25,664,000 after inter-company balance elimination of the Group's 50% share of CCIT and fair value adjustment for deemed interest.

*Subsequent to year end on 31st March 2006*

**(iii) Program licenses agreement with Beijing Oracle Software Systems Co., Ltd. ("Oracle")**

On 30th May 2006, the Group entered into an ordering document and agreement with Oracle in which the Group acquired database management software and middleware from Oracle.

The contract sum consists of the license fees and the support fees as detailed below to be payable in cash:

| **Fee types** | **Amount** |
|---|---|
| | RMB'000 |
| License fees | 72,203 |
| Support fees | 15,885 |
| | 88,088 |

License fees are paid for obtaining the unlimited deployment right of Oracle database management software and middleware. Support fees are paid for the first year for technical support on the database management software and middleware.

## FINANCIAL REVIEW *(Continued)*

**Financial resources, liquidity and foreign exchange exposures**

The financial positions of the Group as at 31st March 2006 and the corresponding comparative figures as at 31st March 2005 are summarised as follows:

| | **31st March 2006 HK$'000** | 31st March 2005 HK$'000 |
|---|---|---|
| Current assets | **817,722** | 306,614 |
| Including | | |
| – Bank balances and cash (mainly denominated in Hong Kong dollars and Renminbi) | **592,978** | 136,266 |
| – debtors | **153,135** | 128,947 |
| Current liabilities | **118,350** | 133,065 |
| – including short-term bank loans | **11,760** | 11,583 |
| Current ratio (current asset/current liabilities) | **6.91** | 2.30 |
| Quick ratio (Bank balances and cash & debtors/current liabilities) | **6.30** | 1.99 |
| Shareholders' equity | **337,765** | 308,787 |
| Convertible bonds | **547,420** | – |
| Gearing ratio (bank loans and convertible bonds/shareholders' equity) | **165.55%** | 3.75% |

## FINANCIAL REVIEW *(Continued)*

**Financial resources, liquidity and foreign exchange exposures** *(Continued)*

Bank balances and cash increased by 335.16% from HK$136,266,000 as at 31st March 2005 to HK$592,978,000 as at 31st March 2006. The increase in bank balances and cash was mainly due to the issue of US$55,000,000 and US$15,000,000 zero coupon convertible bonds in December 2005 and January 2006, respectively.

All bank loans of the Group as at 31st March 2006 were short-term in nature, denominated in Renminbi and repayable within one year, and carried interest at prevailing market rates.

The current ratio improved from 2.30 as at 31st March 2005 to 6.91 as at 31st March 2006 mainly due to the proceeds from the issue of US$55,000,000 and US$15,000,000 zero coupon convertible bonds in December 2005 and January 2006, respectively.

The quick ratio improved from 1.99 as at 31st March 2005 to 6.30 as at 31st March 2006 mainly due to the proceeds from the issue the convertible bonds.

Shareholders' equity increased from HK$308,787,000 as at 31st March 2005 to HK$337,765,000 as at 31st March 2006 mainly because of the profitable business operations of the Group during the year.

The Group's gearing ratio increased from 3.75% as at 31st March 2005 to 165.55% as at 31st March 2006 mainly due to the issue of convertible bonds.

The Group's operations and transactions are principally located in the People's Republic of China ("PRC") and all assets and liabilities are mainly denominated in either Hong Kong dollars or Renminbi with the exception of the convertible bonds which are denominated in US dollars. The Directors believe that there will not be material fluctuation in the exchange rate of Renminbi and US dollars against Hong Kong dollars, the reporting currency, in the foreseeable future and the operations of the Group are not subject to significant exchange rate risk.

Except as disclosed in note 39 to the financial statements, there are no material contingent liabilities as at 31st March 2006.

## BUSINESS REVIEW

The Group is an integrated information and content service provider, emphasizing on innovation as well as seeking ways to apply the latest information technology to provide unique information service to the PRC governmental departments, manufacturers and consumers. The Group's major clients are sizable and prestigious PRC manufacturers. Our information service will also expedite the development of small to medium size manufacturers. As a result, the Group has received strong support from the PRC government.

- **CCIT**

  CCIT, a joint venture between AQSIQ, China Telecom and the Group, is principally engaged in the provision of product quality supervision and enforcement information for the relevant PRC authorities through the operation of PIATS; the provision to the manufacturers with manufacturing, distribution through the supply chain, and sales information; the provision of a simple, convenient and rapid way for the consumers to enquire product information, information on counterfeit products or products with poor quality; and the provision of an interactive channel for the consumers to report counterfeit products or products with poor quality. CCIT has established a leading position in the PRC information service sector by providing manufacturers and consumers with these information value-added services.

  In January 2005, the joint-venture, CCIT, was established with the Group holding 50%, AQSIQ holding 30% and China Telecom holding 20% to build the system for, and engage in the business of PIATS. In the first half of 2005, CCIT invested and developed the PIATS database, which allows connection through different electronic means on the existing platform such as telephone, SMS, IVRS and the internet. Consumers can also be connected through the designated terminals installed in the shopping or distribution centres. Around the fourth quarter of 2005, CCIT launched PIATS in Hebei province and received positive response from manufacturers and consumers. In late 2005, CCIT began installing LCD terminals in major supermarket and shopping centers in major cities in Hebei province. These LCD terminals allow consumers to authenticate products in the supermarkets and shopping centers and to use telephone terminals at agricultural products specialty stores . In December 2005 and January 2006, the Company issued in total US$70,000,000 zero coupon bonds to raise funding for the development of PIATS. In March 2006, it was reported on CCTV the success of PIATS in Hebei province and the intention to rollout PIATS nationwide. In the same month, the Company lent CCIT US$6,900,000 for the second stage development of PIATs database/system. In July 2006, the Company established a strategic partnership with Oracle.

## BUSINESS REVIEW *(Continued)*

*Future prospect*

Since the launch of PIATS, CCIT has experienced positive response from manufacturers and consumers. AQSIQ, other government departments and senior government official have provided tremendous support for PIATS since it reduces counterfeit products and protects consumers, manufacturers and intellectual property rights. Together with the support from AQSIQ, CCIT is going to enter into the access service agreements in the near future with more than a hundred large and renowned domestic manufacturers including products of food, agriculture resources, construction materials and necessities, etc. In addition, the Group plans to commence installing enquiry terminals in major supermarkets and shopping centers throughout China in the second half of 2006 while the scope of service will be expanded to the industries of pharmaceutical, tobacco, alcohol and other merchandises. Given that there are no other companies that can provide a similar service as PIATS and the strong government support, the Directors believe there is great potential for PIATS.

- **HL95**

  HL95 is a nationwide telecommunications VAS company in the PRC and is licensed by the relevant PRC government authorities on the provision of SMS and IVRS service in the PRC. HL95 is a telecommunication/information VAS provider (non-telecom operator) which provides IVRS services through both fixed telephone line network and mobile phone network (in collaboration with the telecom operators) which covers the whole country. HL95 offers governmental, commercial and entertainment information. HL95 also provides other telecommunication/information VAS such as internet protocol services and customer care call centers.

  *Future prospect*

  HL95 intends to enrich its service varieties and plans to work with more content providers, government departments and large corporation to provide more VAS. As an important platform for the Group, HL95 enables the Group to promote the information services of PIATS. For example, the Group used HL95's platform to enable consumers to enquire product information nation-wide by HL95's IVRS and SMS systems. The Directors believe that HL95 has good potential since the information services or content generated from the existing business or new business of the Group can be offered nation-wide using HL95's platform.

- **Dongfang Customs**

  Dongfang Customs, a joint venture with the PRC Customs Department and China Telecom, is engaged in electronic customs processing and other electronic government services. Dongfang Customs provides customs filing and declaration, identity authentication, online payments, electronic customs tax and foreign exchange filings, billing and other customs related services. Dongfang Customs' users principally include manufacturers and import/export corporations. As at 31st March 2006, Dongfang Customs had 260,000 users. Users are principally charged a time-based telecommunication fee for accessing the network platform.

## BUSINESS REVIEW *(Continued)*

*Future prospect*

The PRC government has been encouraging manufacturers and import/export corporations to perform the customs declaration processing electronically as it not only speeds up the customs declaration procedures but also helps minimise handling costs involved in the declaration. Given that as at 31st March 2006, there were only 260,000 users, and China is the manufacturing base for the world, the Directors believe that there is great potential for Dongfang Customs. In addition, the Group anticipates that the number of users will increase in line with the economic growth of the PRC.

- **Grand Cycle**

  Grand Cycle engages in system integration and software development. During the year, Grand Cycle has focused on projects with higher margins and larger contract sums and servicing HL95 and CCIT.

  *Future prospect*

  Grand Cycle will continue to expand its system integration and software development business and provide the corporations and customers with professional technical solutions.

- **Hebei TV**

  Hebei TV is in the process of formation.

  *Future prospect*

  The Group plans to participate in the PRC's national project to digitalise all television broadcasting in the PRC in year 2010 and thus entered into the JV Agreement. The Directors consider that, leveraging on the Group's business network in the PRC and its expertise in information technology and PRC media-related business, and together with the promising prospects of digital television business in the PRC, the formation of the JV Company will further expand the Group's business coverage in the PRC media industry and earning base, from which the future development will benefit the Group. The Group plans to expand the scope of such business to other provinces in the future if appropriate.

## EMPLOYEES AND REMUNERATION POLICIES

The numbers of full-time employees of the Company and its subsidiaries, HL95, CCIT and Dongfang Customs as at 31st March 2006 are detailed as follows:

| | Entities | | | |
|---|---|---|---|---|
| **Location** | **The Company and its subsidiaries** | **HL95 (49%-owned jointly controlled entity)** | **CCIT (50%-owned jointly controlled entity)** | **Dongfang Customs (30%-owned associate)** |
| – Hong Kong | 19 | – | – | – |
| – The PRC | 63 | 1,845 | 125 | 323 |
| Total | 82 | 1,845 | 125 | 323 |

Total staff costs of the Group for the year were HK$83,643,000 in which HK$44,366,000 and HK$4,023,000 were the portions attributable to the Group in HL95 and CCIT respectively. All the staff employed in Hong Kong participated in the Mandatory Provident Fund Scheme.

The Group's policy is to maintain a competitive pay structure and employees are rewarded on a performance related basis.

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 at their absolute discretion. The subscription price, exercise period and the number of options to be granted are determined in accordance with the prescribed terms of the schemes. During the year ended 31st March 2006, a total of 11,000,000 share options were granted to 5 employees and other eligible persons.