

MANAGEMENT DISCUSSION & ANALYSIS

REVIEW OF OPERATIONS

Turnover

For the six months ended 30 June 2006, the Group accomplished a turnover of HK\$434.3 million, representing a growth of 151.9% over that of the same period of 2005. The increase was principally attributable to sales of the smartphones products which increased by 167.5% to HK\$428.9 million from HK\$160.4 million in 2005. During the period under review, approximately 100,000 units of smartphones have been sold, compared to 45,000 units of smartphones sold over the same period of 2005.

In terms of revenue mix, during the period under review, turnover from smartphones accounted for 99% of the Group's turnover, as compared with 93% for corresponding period in 2005. Contribution from sales of wireless system solutions decreased from 7% for the six months ended 30 June 2005 to 1% over the corresponding period in 2006.

	The six months ended at 30 June			
	2006 HK\$'000	% of turnover	2005 HK\$'000	% of turnover
Wireless systems solutions				
PHS Intelligent Coverage System	4,876	1	7,488	4
Integrated Telecom Business Platform	487	0	4,524	3
Subtotal	5,363	1	12,012	7
Smartphones				
Dual-mode smartphones	372,052	86	139,008	81
Single-mode smartphones	56,892	13	21,376	12
Subtotal	428,944	99	160,384	93
Total	434,307		172,396	

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Gross Profit

The Group's gross profit increased by 147.2% to HK\$158.6 million for the six months ended 30 June 2006. The gross profit margin slightly decreased by 0.7% to 36.5% in the first half of 2006. The reasons of the decline was mainly attributable to a smaller proportion of revenue from wireless system solutions, which offer relatively higher gross profit margin, in the revenue mix during the reporting period.

Selling and distribution costs

Selling and marketing expenses increased by 83.3% from HK\$16.6 million for the six months ended 30 June 2005 to HK\$30.4 million of the corresponding period in the first half of 2006, however, the ratio for selling and distribution costs over turnover decreased by 2.6% from 9.6% for the six months ended 30 June 2005 to 7% over the corresponding period in 2006.

Administrative expenses

Administrative expenses increased by 464% from HK\$10.5 million for the six months ended 30 June 2005 to HK\$59.4 million of the corresponding period in 2006. The significant increase was principal attributable to higher research and development expenses for 3G including TDSCDMA, CDMA2000 and WCDMA and the employment of more research and development staff.

Income tax expenses

For the six months ended 30 June 2006, the Group's profit tax charge amounted to HK\$11 million, as compared to HK\$5.84 million for the same period in 2005. According to the Income Tax Law of the PRC for Foreign Investment Enterprise and Foreign Enterprises and as approved by relevant tax authorities, the income tax rate of 15% was applied for the six months ended 30 June 2006, which is same as that of the corresponding period of 2005.

Net Profit

For the six months ended 30 June 2006, the Group recorded a net profit of HK\$62.3 million, an increase of 91.1% over the same period of 2005. The net profit margin dropped from 18.9% in the first half of 2005 to 14.3% in the first half of 2006. The major reasons were that the Group significantly increased its expenses in research and development, including the purchase of 3G equipment and the employment of more research and development staff.

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LIQUIDITY AND FINANCIAL RESOURCES

As at 30 June 2006, the Group's total assets amounted to HK\$750.4 million (2005: HK\$420.4 million) whereas the Group's current liabilities was HK\$324.3 million (2005: HK\$179.6 million).

As at 30 June 2006, the Group had a gearing ratio of 43% (based on total debt over total assets) (2005: 43%) and a current ratio of 1.8 (based on current assets over current liabilities) (2005: 2).

BUSINESS ACTIVITIES

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

In the reporting period, the Group successfully developed 4 new models of smartphones with propriety operation system, including one GSM-GSM model, one PHS-GSM model and two CDMA models. The successful development of these series of multi-mode products means that the Group had fully mastered multi-mode technologies and established itself as one of the leaders of multi-mode technologies. Besides these multi-mode technologies based on 2.5G networks (CDMA network, GSM network and PHS network), in the reporting period, the Group also successfully developed 3G TDSCDMA-GSM dual-mode smartphone which is being tested in TDSCDMA trial network.

During the report period, the Group achieved outstanding performances. The Group delivered approximately 100,000 units of smartphones, among which approximately 80,000 units were CDMA-GSM dual-mode smartphones, 5,000 units were PHS-GSM dual-mode smartphones, approximately four hundreds units were GSM-GSM dual-card smartphones and the remaining numbers were CDMA smartphones.

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OUTLOOK

During the second half of 2006, the Group will launch 5 to 6 new smartphone models targeting different customers and telecom operators to provide wireless data total solutions. Among the new smartphone models, 2 will be CDMA-GSM dual-mode smartphone and 2 models will be CDMA smartphone for China Unicom, 1 PHS-GSM dual-mode for China Telecom and China Netcom and 1 model of TDSCDMA-GSM will be for TDSCDMA network telecom operators.

Besides the smartphone products, with China expected to formally announce its 3G policies in the foreseeable future, the Group sees a promising imminent prospect for the 3G coverage systems and 3G wireless data total solutions in the second half of 2006. The Group will further enhance its 3G coverage systems to cater for telecom operators in the PRC. In addition, since wireless data transmission speed in 3G network is markedly quicker than the current 2.5G network, the Group believes that market potential for 3G wireless data solutions would be huge. During the reporting period, the Group place more resources on the research and development of 3G technologies and has also achieved outstanding performances. The Group believes such investment will benefit the long term development of the Group.

The Group's "Coolpad" brand has been a famous brand name in the CDMA smartphone and multi-mode smartphone market. With the Group successfully obtained the GSM and CDMA handset licenses from NDRC (National Development and Reform Commission) in the first half of 2006, further marketing efforts will be made to promote its "Coolpad" brand.

USE OF PROCEEDS

The Company was listed on the Main Board of the Stock Exchange on 9 December 2004. As at 30 June 2006, the Company had used up its listing proceeds as set out in the Company's listing prospectus except for the HK\$5 million budgeted for strategic investments.

In December 2005, the Company and Data Dreamland Holdings Limited ("Data Dreamland"), a substantial shareholder of the Company and the placing agents entered into an agreement pursuant to which the Company issued and placed 40,000,000 new Shares, at a price of HK\$1.05 per Share by way of top up placing. The net proceeds from the placement of the Company were approximately

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HK\$40.5 million, of which HK\$35 million had been utilised for the purchase of materials and components, and of which HK\$5.5 million for marketing and promotion of new smartphone products at 30 June 2006.

In January 2006, the Company and Data Dreamland and the placing agents entered into an other agreement pursuant to which the Company issued and placed 40,000,000 new Shares, at a price of HK\$1.22 per Share by way of top up placing. The net proceeds from the placement of the Company were approximately HK\$47.6 million, of which HK\$40 million had been utilised for the purchase of materials and components and HK\$7.6 million for marketing and promotion of new smartphone products at 30 June 2006.

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

During the year, the staff cost amounted to HK\$20,796,000. The remuneration of the Group's employees are commensurate with their responsibilities and market levels, with discretionary bonuses and training given on a performance-related basis.

SIGNIFICANT INVESTMENTS

As disclosed in the announcement of the Group dated 23 February 2006, Shenzhen Yulong had successfully acquired a property located in North District, Hi-New Technology Industrial Park, Shenzhen with a total construction area of 48,455 square metres at the consideration of RMB87,076,000 (approximately HK\$84,590,000). It is intended that this property will be occupied by the Group for office use.

MATERIAL ACQUISITION AND DISPOSALS DURING THE PERIOD

Except for the acquisition of a piece of land and buildings thereon located in the Hi-New Technology Industrial Park of Shenzhen, the PRC as disclosed in the Company's announcement and circular dated 23 February 2006 and 16 March

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2006 respectively, there were no material acquisitions and disposals of the Company, its subsidiaries and associated companies for the six months ended 30 June 2006.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's articles of association and of the laws of the Cayman Islands, being the jurisdiction in which the Company was incorporated, which would oblige the Company to offer new shares on a pro rata basis to existing shareholders.

PURCHASE, REDEMPTION OR SALE OF LISTED SECURITIES OF THE COMPANY

During the period under review, neither the Company nor any of its subsidiaries has purchased, redeemed or sold any of the Company's listed securities.

SHARE OPTION SCHEME

The Company has adopted a share option scheme ("Share Option Scheme") by a written resolution of all shareholders of the Company on 21 November 2004. Details of options granted under the Scheme were disclosed in Note 19 to the Condensed Financial Statements.

DIRECTORS' RIGHTS TO ACQUIRE SHARES

Save as disclosed under the headings "Directors' and chief executive's interests and short positions in shares, underlying shares and debentures" above and "Share option scheme" above, at no time during the period under review were rights to acquire benefits by means of the acquisition of shares in the Company granted to any director or their respective spouse or minor children, or were any such rights exercised by them; or was the Company, or any of its subsidiaries a party to any arrangement to enable the directors to acquire such rights in any other corporate.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 30 June 2006, the interests and short positions of the directors, the chief executive or their associates in the share capital, underlying shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")), as recorded in the

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register required to be kept by the Company pursuant to Section 352 of the SFO, or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the “Model Code”), were as follows:

(i) Long positions in the Shares

Name of director	Note	Number of Shares in which interested					Total	% of Company's issued share capital
		Directly beneficially owned	Through spouse or minor children	Through controlled corporation	Beneficiary of a trust	Founder of a discretionary trust		
Mr Guo Deying	1 & 2	—	207,792,812	14,000,000	—	207,792,812	221,792,812	44.52%
Ms Yang Xiao	1	—	207,792,812	—	—	207,792,812	207,792,812	41.71%
Mr Jiang Chao	3	—	—	—	14,000,000	—	14,000,000	2.81%

(ii) Long positions in shares of associated corporation

Name of director	Note	Number of shares held, capacity and nature of interest			% of issued share capital of the associated corporation
		Name of associated corporation	Through spouse or minor children	Founder of a discretionary trust	
Mr Guo Deying	1	Data Dreamland Holding Limited	1,000	1,000	100
Ms Yang Xiao	1	Data Dreamland Holding Limited	1,000	1,000	100

Notes:

- The entire issued share capital of Data Dreamland Holding Limited (“Data Dreamland”) is held by Barrie Bay Limited (“Barrie Bay”), which is acting as the trustee of the Barrie Bay Unit Trust. The Barrie Bay Unit Trust is a unit trust, of which 9,999 units are held by HSBC International Trustee Limited (“HSBC Trustee”) acting as the trustee of the Barrie Bay Trust and the remaining 1 unit is held by Ms Yang Hua. The Barrie Bay Trust is a discretionary trust set up by Mr Guo Deying (“Mr Guo”) an executive Director and his spouse, Ms Yang Xiao (“Ms Yang”), a non-executive Director, the beneficiary objects of which include the minor children of Mr Guo and Ms Yang. Each of Mr Guo and Ms Yang is taken to be interested in the 207,792,812 Shares held by Data Dreamland as each of them is a settlor of the Barrie Bay Trust and by virtue of the interests of their children under the Barrie Bay Trust. The long position of each of Mr Guo and Ms Yang under the column “Through spouse or minor children” and the column “Founder of discretionary trust” under the table headed “Long position in shares of the Company” above refers to the same 207,792,812 Shares.

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Each of Mr Guo and Ms Yang is taken to be interested in the entire issued share capital of Data Dreamland as each of them is a settlor of the Barrie Bay Trust and by virtue of the interests of their children under the Barrie Bay Trust. The long position of each of Mr. Guo and Ms Yang under the column "Through spouse or minor children" and the column "Founder of discretionary trust" under the table headed "Long position in shares of associated corporation" above refers to the same 1,000 shares in Data Dreamland.

2. M. Guo is taken to be interested in the 14,000,000 Shares held by Wintech Consultants Limited as he is interested in the entire issued share capital of Wintech Consultants Limited.
3. Mr Jiang Chao, an executive director, is taken to be interested in the 14,000,000 Shares held by Wintech Consultants Limited as he is one of the discretionary objects under the China Wireless Employee Benefit Trust, a discretionary trust established for the benefit of the employees of the Group.

SUBSTANTIAL SHAREHOLDERS' AND OTHER PERSONS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 30 June 2006, the following interests and short positions of 5% or more in the issued share capital and share options of the Company were recorded in the register of interests required to be kept by the Company pursuant to Section 336 of the SFO:

Long positions in shares of the Company:

Name	Notes	Number of shares interested		Nature of interest	Total number of shares	Percentage of the Company's issued share capital
		Number of shares in which interested	Number of shares under equity derivatives			
Data Dreamland Holding Limited	1	207,792,812	—	Beneficial owner	207,792,812	41.71%
Barrie Bay Limited	2	207,792,812	—	Interest of controlled corporation	207,792,812	41.71%
HSBC International Trustee Limited	2	207,792,812	—	Trustee	207,792,812	41.71%

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Notes:

1. The entire issued share capital of Data Dreamland is held by Barrie Bay. Barrie Bay is acting as the trustee of the Barrie Bay Unit Trust. The Barrie Bay Unit Trust is a unit trust of which 9,999 units are held by HSBC Trustee, which is acting as the trustee of the Barrie Bay Trust and the remaining 1 unit is held by Ms. Yang Hua. The Barrie Bay Trust is a discretionary trust set up by Mr. Guo and Ms. Yang and the discretionary objects of which include the minor children of Mr. Guo and Ms. Yang.
2. The 207,792,812 Shares are held by Data Dreamland, the entire share capital of which is held by Barrie Bay, which is acting as the trustee of the Barrie Bay Unit Trust and the entire issued share capital of which is held by HSBC Trustee.

Save as disclosed above, as at 30 June 2006, so far as the directors are aware, there are no other persons, other than the directors and chief executive of the Company, who had interests or short positions in the shares, underlying shares or debentures of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO and are required to be recorded in the register required to be kept pursuant to Section 336 of the SFO.

COMPLIANCE WITH THE CODE OF CORPORATE GOVERNANCE PRACTICES

Code Provision A.2.1 of the Code of Corporate Governance Practices as was set out in Appendix 14 of the Listing Rules ("Code") stipulates that the roles of chairman and chief executive officer should be separate and should not be performed by the same individual. Currently, Mr. Guo Deying is the chairman of the Board and the Chief Executive Officer of the Company. The Board considers that this structure will not impair the balance of power and authority between the Board and the Management and believes that this structure enables the Group to make and implement decision promptly and efficiently. In addition, the Board is of the view that, in view of the currently scale of operations of the Group, the separation of the role of the chairman and chief executive officer of the Company may hinder administrative efficiency and is neither suitable to the Group nor in the interests of shareholders as a whole.

Save as disclosed above, none of the Directors is aware of any information which would reasonably indicate that the Company was not, for any part of the six months period ended 30 June 2006, in compliance with the Code of Corporate Governance Practices as was set out in Appendix 14 of the Listing Rules.

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MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (the “Model Code”) as set out in Appendix 10 of the Listing Rules as the Company’s code of conduct for dealings in securities of the Company by the directors. Based on specific enquiry of the Company’s Directors, the Directors have complied with the required standard set out in the Model Code, throughout the period under review.

AUDIT COMMITTEE

The audit committee (“Audit Committee”) of the Company comprising four independent non-executive Directors, has reviewed the accounting principles and practices adopted by the Company and has discussed auditing, internal control and financial reporting matters. The Audit Committee has reviewed the Group’s unaudited financial statements for the six months period ended 30 June 2006.

MATERIAL LEGAL PROCEEDINGS

As at 30 June 2006, as far as the Directors were aware, the Company was not involved in any material litigation or arbitration and no material litigation or claims was pending or threatened or made against the Company.