



Management Discussion and Analysis

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Terms of revenue mix, turnover from smartphones accounted for 98% of the Group's turnover in 2006, as compared with 92% in 2005.

REVIEW OF OPERATIONS

Turnover

For the year ended 31 December 2006, the Group achieved a turnover of HK\$640.9 million, representing an increase a growth of 81% over that of the year ended 31 December 2005. The revenue from the smartphones amounted to HK\$630.7 million, representing the 98% of the total revenue.

	2006		2005	
	HK\$ million	% of turnover	HK\$ million	% of turnover
Wireless systems solutions				
PHS Intelligent Coverage System	10.2	2%	22.1	6%
Integrated Telecom Business Platform	—	—	6.3	2%
Subtotal	10.2	2%	28.4	8%
Smartphones				
Dual-mode smartphone	526.5	82%	297.4	84%
CDMA smartphone	104.2	16%	28.2	8%
Subtotal	630.7	98%	325.6	92%
Total	640.9		354.0	

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Gross Profit

The Group's gross profit increased by 93.4% to HK\$240.0 million in 2006. Although the competition was fierce, the gross profit margin of the Group still increased by 2.3% to 37.4% in 2006, as compared with 35.1% in 2005. The increase is attributable to the technology strength of the Group and its well production cost control.

Selling and distribution costs

Selling and marketing expenses increased significantly by 119.3% from HK\$39.4 million in 2005 to HK\$86.4 million in 2006, representing 13.5% of the total revenue of the Group. The increment principally reflected the stepping up of promotional and advertising activities, the higher staff costs as the number of marketing staff was increased, and the extended distribution network. Faced with market competition, the Group placed more emphasis on market promotion to enhance the "Coolpad" brand reputation.

Administrative expenses

Administrative expenses increased by 206.0% from HK\$34.9 million in 2005 to HK\$106.8 million in 2006, representing 16.7% of the total revenue of the Group. The sharp increase was mainly attributable to higher research and development expenses including recruiting more R&D employees, paying substantial R&D fees to some 3G companies such as TI, Qualcomm and Datang and so on.

Income tax expense

In 2006, the Group's profit tax charge was nil, as compared to HK\$9.4 million in 2005. In accordance with the Income Tax Law of the PRC for Foreign Investment Enterprise and Foreign Enterprises and as approved by relevant tax authorities, Shenzhen Yulong a wholly-owned subsidiary of the Company operating in Mainland China, which is qualified as a high-technology enterprise and operates in Shenzhen, was exempted from the corporate income tax of the PRC for the two years starting from the first profitable year of operations and was entitled to a 50% relief from the corporate income tax of the PRC for the following six years. The first profitable year of operations of Shenzhen Yulong was 1996. An income tax rate of 15% was applied for the year ended 31 December 2006. No provision for taxation has been made as Shenzhen Yulong suffered a loss for the year.

Coolpad Software was set up on 7 March 2006 and commenced operation in September 2006. Coolpad Software also enjoyed exemption from corporation income tax for the two years starting from the first profitable year of operation and was entitled to a 50% relief from the corporate income tax of the PRC for the following three years. Since the tax holiday of Coolpad Software commenced in 2006, no provision for income tax was needed in current year.

Dongguan Yulong was set up on 3 November 2006. There were no operations for Dongguan Yulong up to the end of December 2006.

Net Profit

For the year ended 31 December 2006, the Group recorded a net profit of HK\$53.7 million, representing a slight increase of 5.5% over 2005. The net profit margin dropped significantly from 14.4% in 2005 to 8.4% in 2006. The major reasons was that, during the reporting period: the Group increased its research and development expenses; and the Group increased its marketing promotion and brand building expenses.

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BUSINESS ACTIVITIES

As one of the leading wireless data total solutions providers and the smartphone (especially dual-mode smartphone) leaders in the world, the Group offers innovative products and personalised solutions to satisfy demands of different clients and various industries for domestic and overseas markets.

2006 was an exciting year. The "Coolpad" brand was widely recognised and enjoyed enhanced reputation in the PRC and the international smartphone market. The "Coolpad" brand became the most famous brand in dual-mode and CDMA smartphone market in the PRC. In order to further boost the awareness of the "Coolpad" brand, the Group actively participated in many domestic and global telecommunication exhibitions and also placed substantial amount of advertisement in newspapers, aviation magazine and outdoor media and so on.

In 2006, the Group marketed six new models of smartphones with propriety operation system, including two CDMA-GSM smartphones, one GSM-GSM smartphone, one PHS-GSM smartphone and two CDMA smartphones. The Group successfully developed the Coolpad 288 dual-mode smartphone, which was the first medium-priced dual-mode smartphone to target popular people. With the launch of the Coolpad 288 dual-mode smartphone, an increasing number of customers are becoming attracted to and familiar with the dual-mode smartphone. The Coolpad 728B with its more powerful functions and attractive price attracted huge market interests upon its launch and the Group has secured a large order from China Unicom.

During the reporting period, the Group invested substantial resources in the research and development fields. To establish itself in the market and to increase its competitiveness, the Group employed a large number of experienced and skilled R&D engineers. Compared with the same period of last year, the number of R&D engineers increased more than 100%. In addition, to develop top quality and competitively-priced products, the Group actively cooperated with international well-known chipset companies and soft company such as TI, Qualcomm and Microsoft. To capture the TD-SCDMA 3G market and secure a leading advantage, the Group established close strategic partnerships with Datang Telecom company, the leading TD-SCDMA 3G standard developer. The Directors believe that these cooperations and the huge investment in R&D will yield successful outcomes and help to maintain the competitive advantage and market leader position in future.

LIQUIDITY AND FINANCIAL RESOURCES

For the year ended 31 December, 2006, the Group's operating capital was mainly generated from cash from its daily operations and bank borrowings.

- As at 31 December 2006, the Group had a gearing ratio of 58% (based on debt over total assets) (2005 : 47%)
- As at 31 December 2006, the Group had a current ratio of 1.7 (based on current assets over current liability) (2005 : 1.9)

PLEDGE OF ASSETS

As at 31 December 2006, approximately HK\$40 million of the Group's bank deposits was pledged to secure notes payable and HK\$5 million of the Company's bank deposits was pledged to secure a letter of credit. The Group's leasehold land with a net book value of approximately HK\$11.6 million was pledged to secure a short term bank loan of HK\$59.7 million and a long term bank loan of HK\$99.5 million granted to the Group.

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OUTLOOK

In 2007, the Group plans to launch at least 12 new smartphone models targeting different customers and telecom operators in different countries to provide wireless data total solutions. Among the 12 new smartphone models, 10 models will be based on 2.5G network while others will be based on TD-SCDMA 3G network. The Directors believe that the TD-SCDMA-GSM dual-mode smartphone will be marketed in the second half of 2007. The three models based on 2.5G network will target overseas markets. The revenue from overseas market is expected to increase significantly in 2007.

In 2007, in addition to maintaining a close working relationship with China Unicom, the Group will also concentrate on cooperation with other telecom operators. Currently, the GSM-GSM dual-mode smartphone is being tested. The Directors believe orders of GSM-GSM smartphone will be possible in the first half of 2007. With plans of various dual-mode smartphones to be marketed in 2007, the Group is actively seeking various distributors of its dual-mode smartphone products with a view to expanding its customers base.

Starting from the second half of 2007, the Group will move to a new larger building from the current dispersed offices, which will markedly improve the administrative efficiency of the Group.

As a R&D enterprise, the Group always places the R&D as it highest priority. In 2007, the Group will continue to employ some vigorous R&D strategies to maintain its strengths as a leader in technology by employing highly skilled and experienced personnel, furthering cooperation with key enterprises and perfecting its R&D management system.

USE OF PROCEEDS

The Company was listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 9 December 2004. As at 31 December 2006, the Company had used up its listing proceeds as set out in the Company's listing prospectus except for the HK\$5 million intended for strategic investments.

In December 2005, the Company and Data Dreamland Holdings Limited, 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 HK\$40.5 million, which had been used up as at 31 December 2006.

In January 2006, the Company and Data Dreamland Holdings Limited 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\$1.22 per share by way of top up placing. The net proceeds from the placement of the Company were approximately HK\$47.6 million, which had been used up as at 31 December 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.

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EMPLOYEES AND REMUNERATION POLICY

During the year, the staff cost amounted to HK\$70.5 million. The remuneration of the Group's employees is commensurate with their responsibilities and market levels, with discretionary bonuses and training given on a merit basis.

SIGNIFICANT INVESTMENTS

There were no significant investments held by the Group as at 31 December 2006.

MATERIAL ACQUISITION AND DISPOSALS DURING THE YEAR

There were no material acquisitions and disposals of the Company and its subsidiaries as at 31 December 2006.

