
CHINASOFT INTERNATIONAL LIMITED

中 軟 國 際 有 限 公 司*

*(Incorporated in the Cayman Islands with limited liability)*

(Stock Code: 8216)

* for identification purpose only

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*This report, for which the directors of Chinasoft International Limited (the "Company") collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on the GEM of the Stock Exchange for the purpose of giving information with regard to the Company. The directors of the Company, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief:– (1) the information contained in this report is accurate and complete in all material respects and not misleading; (2) there are no other matters the omission of which would make any statement in this report misleading; and (3) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.*

## HIGHLIGHTS

- Accomplished a gross profit and a net profit of approximately RMB60,723,000 and RMB24,509,000 respectively (2005: RMB47,262,000 and RMB18,202,000) for the six months ended 30 June, 2006, representing an increase of approximately 28.5% and 34.7% respectively as compared to the corresponding period in 2005.

- Achieved a gross profit margin and a net profit margin of approximately 45.4% and 18.3% respectively (2005: approximately 28.9% and 11.1% respectively) for the six months ended 30 June, 2006, representing an increase of approximately 16.5% and 7.2% respectively as compared to the corresponding period in 2005. The growth in the profit margin indicates the Group successfully transformed its business to a higher profit margin business (software development, IT outsourcing and BPO) from a lower profit margin business (hardware business).

- Achieved a turnover of approximately RMB133,789,000 (2005: RMB163,546,000) for the six months ended 30 June, 2006, representing a decrease of approximately 18.2% as compared to the corresponding period in 2005 which was in line with business transformation of the Group to focus on software development, IT outsourcing and BPO and reduce the portion of hardware business.

- Basic earnings per share and diluted earnings per share of the Company were approximately RMB0.0334 (2005: RMB0.0261) and RMB0.0245 (2005: RMB0.0251) respectively for the six months ended 30 June, 2006.

- The Directors do not recommend the payment of an interim dividend for the six months ended 30 June, 2006.

## INTERIM RESULTS

The board of Directors (the “Board”) of Chinasoft International Limited (the “Company”) is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (the “Group”) for the three months and six months ended 30 June, 2006, respectively, with corresponding figures as follows:

# CONSOLIDATED PROFIT AND LOSS ACCOUNT (UNAUDITED)

| | | For the three months ended 30 June, | | For the six months ended 30 June, | |
|---|---|---|---|---|---|
| | | **2006** | 2005 | **2006** | 2005 |
| | *Notes* | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Turnover | *2* | **70,721** | 74,471 | **133,789** | 163,546 |
| Cost of sales | | **(37,790)** | (48,906) | **(73,066)** | (116,284) |
| Gross profit | | **32,931** | 25,565 | **60,723** | 47,262 |
| Other operating income | | **2,488** | 255 | **3,966** | 255 |
| Distribution costs | | **(7,424)** | (7,615) | **(11,816)** | (10,947) |
| Administrative expenses | | **(11,224)** | (6,950) | **(23,034)** | (16,315) |
| Amortisation of intangible assets | *11* | **(926)** | (636) | **(1,853)** | (1,274) |
| Profit from operations | | **15,845** | 10,619 | **27,986** | 18,981 |
| Finance costs | | **(2)** | (143) | **(3)** | (26) |
| Share of result of associates | | **959** | 199 | **1,273** | 564 |
| Profit before taxation | | **16,802** | 10,675 | **29,256** | 19,519 |
| Taxation | *3* | **(2,792)** | (518) | **(4,747)** | (1,317) |
| Profit for the year | | **14,010** | 10,157 | **24,509** | 18,202 |
| Attributable to: | | | | | |
| Equity holders of the parent | | **14,132** | 10,157 | **24,524** | 18,202 |
| Minority interests | | **(122)** | – | **(15)** | – |
| | | **14,010** | 10,157 | **24,509** | 18,202 |
| Dividend | *4* | **18,859** | 7,394 | **18,859** | 7,394 |
| Earnings per share | | | | | |
| – Basic (cents) | *5* | **1.94** | 1.46 | **3.34** | 2.61 |
| – Diluted (cents) | *5* | **1.39** | 1.42 | **2.45** | 2.51 |

## CONSOLIDATED BALANCE SHEET

| | Notes | (Unaudited) 30 June, 2006 RMB'000 | (Audited) 31 December, 2005 RMB'000 |
|---|---|---|---|
| Non-current assets | | | |
| Property, plant and equipment | | **29,159** | 23,288 |
| Intangible assets | | **22,372** | 18,003 |
| Goodwill | 6 | **154,410** | 79,168 |
| Other investment | | **361** | – |
| Interest in associates | | **5,086** | 8,303 |
| Prepaid lease payments | | **–** | 216 |
| | | **211,388** | 128,978 |
| Current assets | | | |
| Inventories | | **34,602** | 22,670 |
| Trade and other receivables | 7 | **220,944** | 182,113 |
| Amount due from a related company | | **32** | 1,815 |
| Loan to a related company | | **–** | 1,450 |
| Pledged deposits | | **872** | 1,653 |
| Bank balances and cash | | **134,402** | 100,086 |
| | | **390,852** | 309,787 |
| Current liabilities | | | |
| Trade and other payables | 8 | **118,545** | 98,270 |
| Bills payable | | **16,143** | 26,781 |
| Amount due to a shareholder | | **26** | 9 |
| Dividend payable to a shareholder | | **76** | – |
| Taxation payable | | **5,227** | 2,846 |
| | | **140,017** | 127,906 |
| Net current assets | | **250,835** | 181,881 |
| Total assets less current liabilities | | **462,223** | 310,859 |
| Non-current liabilities | | | |
| Deferred tax liabilities | | **2,578** | 1,824 |
| Net assets | | **459,645** | 309,035 |
| Capital and reserves | | | |
| Share capital | 9 | **48,931** | 38,816 |
| Reserves | | **407,206** | 256,187 |
| Equity attributable to equity holders of the parent | | **456,137** | 295,003 |
| Minority interests | | **3,508** | 14,032 |
| Total equity | | **459,645** | 309,035 |

# UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| | Attributable to the equity holders of the parent company | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Ordinary share capital | Ordinary share premium | Issuable shares | Redeemable convertible preferred share capital | Preferred share premium | Translation reserve | Share options reserve | General reserve fund | Statutory enterprise expansion fund | Statutory surplus reserve fund | Statutory public welfare fund | Accu-mulated profits | Total | Minority interests | Total |
| | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* | *RMB'000* |
| At 1 January, 2005 | 36,968 | 85,185 | – | – | – | 90 | 3,492 | 1,250 | 589 | – | – | 71,932 | 199,506 | – | 199,506 |
| Profit for the year | – | – | – | – | – | – | – | – | – | – | – | 18,202 | 18,202 | – | 18,202 |
| New issue of shares | 1,848 | 35,487 | – | – | – | – | – | – | – | – | – | – | 37,335 | – | 37,335 |
| Shares issuable on acquisition of subsidiaries | – | – | 24,420 | – | – | – | – | – | – | – | – | – | 24,420 | – | 24,420 |
| Acquisition of subsidiaries | – | – | – | – | – | – | – | – | – | – | – | – | – | 10,692 | 10,692 |
| Dividend for 2005 paid | – | – | – | – | – | – | – | – | – | – | – | (7,394) | (7,394) | – | (7,394) |
| At 30 June, 2005 | 38,816 | 120,672 | 24,420 | – | – | 90 | 3,492 | 1,250 | 589 | – | – | 82,740 | 272,069 | 10,692 | 282,761 |
| At 1 January, 2006 | 38,816 | 120,672 | 24,420 | – | – | (2,047) | 7,098 | 1,573 | 728 | 63 | 32 | 103,648 | 295,003 | 14,032 | 309,035 |
| Exchange adjustment | (1,099) | (3,415) | (235) | – | – | | – | – | – | – | – | – | (4,749) | – | (4,749) |
| New issue of redeemable convertible preferred shares | – | – | – | 10,017 | 150,251 | – | – | – | – | – | – | – | 160,268 | – | 160,268 |
| New issue of ordinary shares | 1,197 | 22,988 | (24,185) | – | – | – | – | – | – | – | – | – | – | – | – |
| Expenses incurred in connection of issue of shares | – | – | – | – | (1,941) | – | – | – | – | – | – | – | (1,941) | – | (1,941) |
| Recognition of equity-settled share based payments | – | – | – | – | – | – | 1,891 | – | – | – | – | – | 1,891 | – | 1,891 |
| Acquisition of additional interest of a subsidiary | – | – | – | – | – | – | – | – | – | – | – | – | – | (12,856) | (12,856) |
| Acquisition of a subsidiary | – | – | – | – | – | – | – | – | – | – | – | – | – | 2,332 | 2,332 |
| Dividend for 2005 paid | – | – | – | – | – | – | – | – | – | – | – | (18,859) | (18,859) | – | (18,859) |
| Profit for the period | – | – | – | – | – | – | – | – | – | – | – | 24,524 | 24,524 | – | 24,524 |
| At 30 June, 2006 | 38,914 | 140,245 | – | 10,017 | 148,310 | (2,047) | 8,989 | 1,573 | 728 | 63 | 32 | 109,313 | 456,137 | 3,508 | 459,645 |

## CONSOLIDATED CASH FLOW STATEMENT (UNAUDITED)

| | Six months ended 30 June, | |
|---|---|---|
| | **2006** | 2005 |
| | ***RMB'000*** | *RMB'000* |
| Cash flows from operating activities | **(35,570)** | (32,094) |
| Cash flows from investing activities | **(91,112)** | (8,145) |
| Cash flows from financial activities | **160,998** | (7,444) |
| Net increase (decrease) in cash and cash equivalents | **34,316** | (47,683) |
| Cash and cash equivalents at the beginning of the period | **100,086** | 74,029 |
| Cash and cash equivalents at the end of the period | **134,402** | 26,346 |

# NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## 1. BASIS OF PRESENTATION

The financial statements of the Group have been prepared in accordance with the applicable disclosure requirements of Chapter 18 of the Rules Governing the Listing of Securities on the GEM of the Stock Exchange and Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants.

## 2. TURNOVER

Turnover, which is stated net of valued-added tax and other sales tax and returns, represents amounts invoiced to customers, except in respect of provision of solutions services and IT outsourcing services where turnover represents the value of work done during the year, including amounts not yet invoiced.

| | For the three months ended 30 June, | | For the six months ended 30 June, | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| Solutions | **40,122** | 62,385 | **74,470** | 136,145 |
| IT outsourcing | **23,111** | 8,165 | **47,016** | 22,463 |
| IT consulting and training services | **2,814** | 2,915 | **5,404** | 3,436 |
| Standalone software product | **4,674** | 1,006 | **6,899** | 1,502 |
| | **70,721** | 74,471 | **133,789** | 163,546 |

## 3. TAXATION

Pursuant to an approval document issued by the State Bureau of Beijing Haidian District dated 21 November 2000, Beijing Chinasoft International Information Technology Limited ("Beijing Chinasoft"), a major operating subsidiary of the Group, has been designated as an advanced technology enterprise and is entitled to the three year's exemption from income tax followed by three years of 50% tax reduction commencing from the first-profit-making year with effect from 2000.

Beijing Chinasoft is subject to the income tax computed at the rate of 7.5% for the three years ending 31st December 2005 and at the rate of 15% on its taxable profit thereafter.

Pursuant to an approval document issued by the Guangzhou Science and Technology Bureau dated 31 March 2004, Chinasoft International (Guangzhou) Information Technology Limited ("Chinasoft Guangzhou"), a subsidiary of the Group, had been designated as an advanced technology enterprise and its income tax rate was reduced from 33% to 15%. Moreover, pursuant to another approval document issued by the Guangzhou National Tax Bureau dated 2 June 2004, Chinasoft Guangzhou was entitled to a two year's exemption from income tax followed by three years of 50% tax reduction commencing from the first profit-making year with effect from 2003.

Pursuant to an approval document issued by the Beijing Science and Technology Commission dated 25 June, 2004, Chinasoft Resources Information Technology Services Limited ("Chinasoft Resources Beijing"), a subsidiary of the Company, had been designated as an advanced technology enterprise and its income tax rate was reduced from 33% to 15%. Moreover, Chinasoft Resources Beijing was entitled to three year's exemption from income tax followed by three years of 50% tax reduction commencing from the first profit-making year with effect from 2004.

Pursuant to an approval document issued by the State Bureau of Shenzhen Nanshan District dated 1 March, 2005, Shenzhen Chinasoft Resources Information Technology Services Limited ("Chinasoft Resources Shenzhen"), a subsidiary of the Company, had been designated as a newly established software enterprise. As a result, Chinasoft Resources Shenzhen was entitled to two year's exemption from income tax followed by three years of 50% tax reduction commencing from the first profit-making year with effect from 2004.

No provision for Hong Kong Profits Tax has been made for the relevant periods as the Group did not have any assessable profit arised in Hong Kong during the relevant period.

There were no significant unprovided deferred taxation during the relevant periods and as at the respective balance sheet dates.

## 4. DIVIDEND

On 30 March 2006, the Company declared final dividend amounting to HK$18,309,311 (equivalent to RMB18,858,590) for the year ended 31 December, 2005 to its shareholders. The amount was paid to its shareholders on 25 May 2006.

## 5. EARNINGS PER SHARE

The calculation of the basic earnings per share for the three months and the six months ended 30 June, 2006 was based on the net profit of approximately RMB14,010,000 and approximately RMB24,509,000 respectively (three months and six months ended 30 June, 2005: net profit of approximately RMB10,157,000 and RMB18,202,000 respectively) divided by the weighted average number of shares issued during the three months ended 30 June, 2006 of 755,620,755 shares (2005: 697,500,000 shares) and the six months ended 30 June, 2006 of 732,372,453 shares (2005: 697,500,000 shares) as if the sub-division of the Company's shares as described in Appendix VI of the prospectus of the Company dated 10 June, 2003 ("Prospectus") had taken place at the beginning of the relevant periods.

The calculation of diluted earnings per share for the three months and the six months ended 30 June, 2006 was based on the net profit of RMB14,010,000 for the three months ended 30 June, 2006 and RMB24,509,000 for the six months ended 30 June, 2006, respectively divided by the weighted average number of shares used in calculation of the diluted earnings per share for the three months and the six months ended 30 June, 2006 of 1,009,710,852 shares (2005: 713,435,000 shares) and 999,751,728 shares (2005: 726,610,000 shares) respectively.

## 6. GOODWILL

Goodwill arose mainly from the acquisition of the remaining 49% interest of a subsidiary, Chinasoft Resources Information Technology Services Limited (北京中軟資源信息科技服務有限公司) and the additional 50% interest in a subsidiary, CS&S Cyber Resources Software Technology (Tianjin) Co. Ltd. (中軟賽博資源軟件技術(天津)有限公司) during the period.

## 7. TRADE AND OTHER RECEIVABLES

| | **(Unaudited) 30 June, 2006** ***RMB'000*** | (Audited) 31 December, 2005 *RMB'000* |
|---|---|---|
| Trade receivables | **166,298** | 142,593 |
| Advances to suppliers | **9,352** | 2,362 |
| Deposits, prepayments and other receivables | **45,294** | 37,158 |
| | **220,944** | 182,113 |

The credit terms of the Group ranged from 30 to 90 days.

Aged analysis of trade debtors are as follows:

| | **(Unaudited) 30 June, 2006** ***RMB'000*** | (Audited) 31 December, 2005 *RMB'000* |
|---|---|---|
| 0 – 90 days | **46,858** | 83,047 |
| 91 – 180 days | **37,150** | 12,740 |
| 181 – 365 days | **63,288** | 24,503 |
| Over 365 days | **19,002** | 22,303 |
| | **166,298** | 142,593 |

The fair value of the Group's trade and other receivables at 30 June 2006 was approximately equal to the corresponding carrying amount.

## 8. TRADE AND OTHER PAYABLES

| | **(Unaudited) 30 June, 2006** ***RMB'000*** | (Audited) 31 December, 2005 *RMB'000* |
|---|---|---|
| Trade payables | **56,781** | 80,438 |
| Deposits received from customers | **814** | 906 |
| Other payables and accrued charges | **60,950** | 16,926 |
| | **118,545** | 98,270 |

Aged analysis of trade creditors are as follows:

| | (Unaudited) 30 June, 2006 *RMB'000* | (Audited) 31 December, 2005 *RMB'000* |
|---|---|---|
| 0 – 90 days | **12,172** | 28,978 |
| 91 – 180 days | **1,704** | 11,167 |
| 181 – 365 days | **17,127** | 15,931 |
| Over 365 days | **25,778** | 24,362 |
| | **56,781** | 80,438 |

The fair value of the Group's trade and other payables at 30 June 2006 was approximately equal to the corresponding carrying amount.

## 9. SHARE CAPITAL

| | Ordinary shares | | | Redeemable convertible preferred shares | | | |
|---|---|---|---|---|---|---|---|
| | Number of shares | Nominal value per share *HK$* | Ordinary shares capital *HK$* | Number of shares | Nominal value per share *HK$* | Redeemable convertible preferred shares capital *HK$* | Total *HK$* |
| **Authorised shares capital** | | | | | | | |
| At 1 January 2005 and 31 December 2005 | 1,500,000,000 | 0.05 | 75,000,000 | – | – | – | 75,000,000 |
| Creation of redeemable convertible preferred shares | – | – | – | 625,000,000 | 0.05 | 31,250,000 | 31,250,000 |
| At 30 June 2006 | 1,500,000,000 | 0.05 | 75,000,000 | 625,000,000 | 0.05 | 31,250,000 | 106,250,000 |
| **Issued shares capital** | | | | | | | |
| At 1 January 2005 | 697,500,000 | 0.05 | 34,875,000 | – | – | – | 34,875,000 |
| Issue of ordinary shares | 34,872,453 | 0.05 | 1,743,623 | – | – | – | 1,743,623 |
| At 31 December 2005 | 732,372,453 | 0.05 | 36,618,623 | – | – | – | 36,618,623 |
| Issue of redeemable convertible preferred shares | – | – | – | 194,500,000 | 0.05 | 9,725,000 | 9,725,000 |
| Issue of ordinary shares | 23,248,302 | 0.05 | 1,162,415 | – | – | – | 1,162,415 |
| At 30 June 2006 | 755,620,755 | 0.05 | 37,781,038 | 194,500,000 | 0.05 | 9,725,000 | 47,506,038 |

## 10. CAPITAL COMMITMENTS

The Group had no capital expenditure in respect of acquisition of property, plant and equipment contracted but not provided for in the financial statements.

## 11. RELATED PARTY TRANSACTIONS

(i) During the relevant periods in 2005 and 2006, the Group had the following transactions with the following related parties:

| | **For the three months ended 30 June,** | | **For the six months ended 30 June,** | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| | ***RMB'000*** | *RMB'000* | ***RMB'000*** | *RMB'000* |
| China National Computer Software & Technology Service Corporation ("CS&S") *(Note a)* | | | | |
| – Rental expenses *(Note b)* | **1,072** | 695 | **2,144** | 1,389 |
| Microsoft Corporation ("Microsoft") *(Note c)* | | | | |
| – Provision of IT outsourcing services | **14,066** | – | **21,464** | – |

*Notes:*

(a) A director of CS&S is also a director of Beijing Chinasoft.

(b) The transactions were carried out in accordance with the relevant agreements.

(c) Microsoft was interested in 97,250,000 Shares which could be issued to it upon the conversion of the 97,250,000 Series A Preferred Shares agreed to be subscribed for by it pursuant to a subscription agreement with the Company dated 26th September 2005 subject to the satisfaction of condition precedents set forth in the subscription agreement.

(ii) Pursuant to an agreement entered into between CS&S and Beijing Chinasoft on 10 May 2002 (the "Agreement"), CS&S has granted to Beijing Chinasoft an exclusive right for no consideration to use the trademark as defined in the Agreement in the PRC for a period pending registration of such trademark with the Trademark Bureau of the PRC. Under the Agreement, CS&S has agreed to enter into a further trademark licence agreement pursuant to which CS&S will grant an exclusive licence to Beijing Chinasoft for a period of 25 years.

(iii) Under a trademark licence agreement (the "Licence Agreement") dated 3 June 2002 made between CS&S and Beijing Chinasoft, CS&S granted to Beijing Chinasoft a non-exclusive right for no consideration to use the trademarks as defined in the Licence Agreement in the PRC for 10 years.

The Directors are of the opinion that the above transactions were conducted under normal commercial terms in the usual course of business of the Company.

## 12. SEGMENT INFORMATION

### (A) Business segments

For management purposes, the Group is currently organised into four operating divisions – solutions, IT outsourcing, IT consulting and training services and sale of standalone software product. These divisions are the basis on which the Group reports its primary segment information.

(i) Segment information about these businesses for the six months ended 30 June 2006 is presented below:

**Income statement**

| | Solutions<br>*RMB'000* | IT outsourcing<br>*RMB'000* | IT consulting and training services<br>*RMB'000* | Standalone software product<br>*RMB'000* | Consolidated<br>*RMB'000* |
|---|---|---|---|---|---|
| Turnover | 74,470 | 47,016 | 5,404 | 6,899 | 133,789 |
| Segment result | 42,305 | 13,107 | 3,035 | 2,276 | 60,723 |
| Unallocated corporate revenue | | | | | 3,966 |
| Unallocated corporate expenses | | | | | (36,703) |
| Finance costs | | | | | (3) |
| Share of result of an associate | | | | | 1,273 |
| Profit before taxation | | | | | 29,256 |
| Taxation | | | | | (4,747) |
| Net profit before minority interests | | | | | 24,509 |

(ii) Segment information about these businesses for the six months ended 30 June 2005 is presented below:

**Income statement**

| | Solutions RMB'000 | IT outsourcing RMB'000 | IT consulting and training services RMB'000 | Standalone software product RMB'000 | Consolidated RMB'000 |
|---|---|---|---|---|---|
| Turnover | 136,145 | 22,463 | 3,436 | 1,502 | 163,546 |
| Segment result | 42,623 | 2,143 | 1,852 | 644 | 47,262 |
| Unallocated corporate revenue | | | | | 255 |
| Unallocated corporate expenses | | | | | (28,536) |
| Finance costs | | | | | (26) |
| Share of result of an associate | | | | | 564 |
| Profit before taxation | | | | | 19,519 |
| Taxation | | | | | (1,317) |
| Net profit before minority interests | | | | | 18,202 |

No business segment information for the assets, liabilities, capital contributions, depreciation and other non-cash expenses of the Group is shown as all the assets and liabilities are shared by the business segments and cannot be separately allocated.

**(B) Geographical segments**

No geographical segments information of the Group is shown as the operating business of the Group is solely carried out in the PRC and the Group's assets are substantially located in the PRC.

**13. EMPLOYEE AND OTHER INFORMATION**

The remuneration for the employees of the Group amounted to approximately RMB47,210,000, including the directors' emoluments of approximately RMB984,000 during the six months ended 30 June, 2006 (2005: approximately RMB17,400,000, including the directors' emoluments of approximately RMB668,800). The increase in employee remuneration resulted from the increase in the number of employees from 493 to 1,676 and the increase in bonus to individual staff during the relevant period.

The depreciation and amortisation charge of the Group including amortisation of intangible assets of RMB1,853,000 (2005: RMB1,274,000) during the six months ended 30 June, 2006 amounted to RMB5,898,000 (2005: RMB2,533,000).

## INTERIM DIVIDEND

The Directors do not recommend the payment of an interim dividend for the six months ended 30 June, 2006 (2005: Nil).

## MANAGEMENT DISCUSSION AND ANALYSIS

## FINANCIAL REVIEW

*Results*

For the six months ended 30 June, 2006, the Company reported an unaudited turnover of approximately RMB133,789,000 (2005: RMB163,546,000), representing a decrease of approximately 18.2% as compared with the corresponding period last year. The decrease in turnover was attributable to the business transformation of the Group as to focus on software development, IT outsourcing and BPO and reduce the portion of hardware business.

For the six months ended 30 June, 2006, the Company recorded an unaudited net profit attributable to Shareholders of RMB24,509,000 (2005: RMB18,202,000), representing an increase of 34.7% as compared with the corresponding period last year. The gross profit margin was approximately 45.4% (2005: 28.9%). Basic earning per share was approximately RMB0.0334 (2005: RMB0.0261). Diluted earnings per share was approximately RMB0.0245 (2005: RMB0.0251).

The gross profit margin and the net profit margin of the Group for the six months ended 30 June, 2006 was approximately 45.4% and 18.3% respectively (Year 2005: approximately 28.9% and 11.1% respectively) representing an increase of approximately 16.5% and 7.2% respectively as compared to the corresponding period in 2005. The remarkable increase in both gross profit margin and net profit margin of the Group was attributable to the business transformation of the Group as to focus on software development and whole-range IT services provider.

The ratio of distribution costs to turnover was 8.8%, representing an increase of 2.1% as compared to 6.7% of the corresponding period last year since the ratio of selling expenses of software development is comparatively higher but with a higher gross profit margin. The percentage of administrative expenses to turnover was 17.2% representing an increase of 7.2% as compared to 10% of the corresponding period last year. With an expansion of the size of the Group's operations, the increase in administrative expenses due to the increase in technical support staff and increase in amortisation and depreciation are reasonable.

*Financial resources and liquidity*

As at 30 June, 2006, shareholders' funds of the Group amounted to approximately RMB459,645,000. Current assets amounted to approximately RMB390,852,000, of which approximately RMB134,402,000 were cash and bank deposits. The Group had no other non-current liabilities except deferred tax liabilities of RMB2,578,000 and its current liabilities amounted to approximately RMB140,017,000, mainly consists of trade creditors, bills payable and accrued charges. The net asset value per share was RMB0.61. The Group expresses its gearing ratio as a percentage of bank borrowing and long-term debts over equity. As at 30 June, 2005, the Group had a gearing ratio of nil.

The Group recorded an increase in trade and other receivables as at 30 June, 2006 as compared with the same in December 2005. This was mainly due to the substantial increase in sales at the end of the 2006 interim period in relation to the sales of Group's solutions services, in particular the e-Tobacco and e-Audit. The Group maintains a stringent credit policy to minimize its credit risk including credit control, negotiations and discussion with customers, issuance of demand letters.

During the six months ending 30 June, 2006, as all the Group's sales and purchases were substantially denominated in Renminbi, the Board considers that potential risk relating to foreign exchange has limited effect on the Group.

# BUSINESS REVIEW

Net profit for the reporting period rose 34.7% compared to the same period last year

Launched the maintenance of phases 1 and 2 of the "tobacco production and operation decision system of the tobacco industry"

Secured the industry data application and economic operation analysis platform project

Commissioned to develop phase 3 of the "tobacco production and operation decision system of the tobacco industry"

Undertook the development of the statistics merge module of the "tobacco production and operation decision system of the tobacco industry"

Started planning for phase 1 of the provincial "e-Audit" project for the Audit Bureau of Sichuan Province

Phase 1 of the "e-Audit" project expanded to the Audit Bureaus of Hunan Province, Changning and Hongkou Districts, Shanghai

Secured the further development of the analyzing capability of the State Audit Bureau's AO2005 version software

Undertook the development of "Social Insurance Intranet Audit Software" for the Audit Bureau of Qingdao City

Successfully acquired the entire interests in Powerise International

Successfully acquired the Microsoft outsourcing business of Opportune Technology

Successfully acquired 50% of the equity interest in Cyber Resource

Established a subsidiary in the United States

## 1. NET PROFIT FOR THE REPORTING PERIOD ROSE 34.7% COMPARED TO THE SAME PERIOD LAST YEAR

For the reporting period, that is, the six months ending 30 June, gross profit amounted to RMB60,723,000 and gross profit margin was 45.4%, representing increases of 28.5% and 16.5% respectively over the corresponding period last year. Net profit was RMB24,509,000 and net profit margin was 18.3%, representing increases of 34.7% and 7.2% over the corresponding period last year.

The three month period ending 30 June reported gross profit of RMB32,931,000 and gross profit margin of 46.6%, representing increases of 28.8% and 12.3% over the previous quarter. Net profit amounted to RMB14,010,000 and net profit margin was 19.8%, rising 37.9% and 6.2% over the previous quarter.

The strong performance is mainly attributed to the Group putting an end to its hardware integration business and focusing on the more profitable business of software outsourcing and IT services. Apart from this, income generated by the acquired outsourcing business had been consolidated into the financial statement of the Group for the period. With stronger internal control, the Group's cost structure has become more logical. The Group currently relies mainly on continual income from existing clients. Tobacco-related and e-Audit operations remained the Group's business with market dominance. Market share secured by the Group's strategic client Microsoft continued to expand. Up till the present, there has been no loss of strategic clients, and the turnover from these clients has been increasing.

As for the professional personnel, the Group has been actively training its existing employees and recruiting new ones. At present, it has 1,676 employees, representing a dramatic increase of 1,183 employees when compared with the 493 employees in the corresponding period last year. The increase is mainly attributable to the growth of the outsourcing service and that the service that can be provided by the Group can meet the demand from high-end, mid-end and low-end markets. In addition, the increase illustrates that the scope of the Group has been expanding.

## 2. AS TO THE TOBACCO INDUSTRY

### (1) Launched the maintenance of phases 1 and 2 of the "tobacco production and operation decision system of the tobacco industry"

Upon the full implementation of phases 1 and 2 of the "tobacco production and operation decision system of the tobacco industry" which the Group developed for the tobacco industry, the Group began, during the reporting period, to provide the tobacco industry with maintenance service and technical support for these two phases of the project. Such services were provided with charges.

**(2) Secured the tobacco industry data application and economic operation analysis platform project**

With the State Tobacco Monopoly Administration's adoption and application of the "tobacco production and operation decision system of the tobacco industry", the industry's various aspects of production, operation and management have formed a massive data collection network. Collection and processing of data at each stage of tobacco production and operation eventually led to the birth of a data center. To further analyze and apply such data, the Group has designed an "industry data application and economic operation analysis platform". It includes:

- Analysis of economic operation: to achieve consolidated analysis from all angles of all aspects and factors of the industry's production and operation;
- Warning and forecast: to follow closely the economic cycle of development of tobacco business as well as the trend and changes in the tobacco consumer market;
- Industry interaction: mainly includes negotiation practice, sharing of factors and cross-checking of results. The main objectives of industry interaction are to establish a uniformed economic operation analysis model and mechanism for analysis, to standardize the subject matter and benchmarks for analysis, to regulate methods and means of analysis as well as the ways of interactive management;
- Monitoring economic operation: to achieve monitoring of key procedures and elements in the production and operation of the industry, which include arrangement for production plans, sales and stock levels, price fluctuation, etc;
- Assessment and evaluation: to assess and evaluate the economic operation of various provincial bureaus and industrial enterprises;
- Analysis of brands: to achieve comprehensive analysis of brand evaluation.

**(3) Commissioned to develop phase 3 of the "tobacco production and operation decision system of the tobacco industry"**

During the reporting period, the Group launched phase 3 of the "tobacco production and operation decision system of the tobacco industry" project (that is, the "operation decision system for the encoding of pieces on receipt and order collection system by the State Bureau"). Based mainly on phases 1 and 2 of the project, this phase provides more accurate and timely data to the State Tobacco Monopoly Administration. Data collection has been upgraded from box-based (each box with one bar code, 1 box =10,000 cigarettes=50 cartons) to carton-based (1 carton=200 cigarettes). The amount of data will multiply by 50 times to 9 billion items. The Group expects the scale of this project to be comparable with the aggregate of phases 1 and 2. It plans to promote the project to 350 commercial firms, 318 warehouses and 27 provincial commercial enterprises.

**(4) Undertook the development of the statistics merge module of the "tobacco production and operation decision system of the tobacco industry"**

As the "tobacco production and operation decision system of the tobacco industry" has become a system for tobacco production and operation decision management based on the industry's information network, it has now realized the capture of comprehensive, timely and accurate information on tobacco production and operation, including essential data like the brands of cigarettes, specifications, quantity, buyer, seller, stock, wholesale and retail prices. At the same time, the collection of information changed from passive to active. Automatic collection and daily report of information have been achieved, ensuring the promptness and accuracy of basic information. By streamlining the report of data, duplication of information and overlapping of data can be avoided.

It is crucial that the collection of industrial and operational data for the decision system be made compatible with all the other indication systems and functional requirements of the existing statistics software. Hence, the State Tobacco Monopoly Administration decided to commission the Group to incorporate a statistics merge module, which will include:

- Control of collection procedure by urging the report of data, renew reporting and supplementary reporting;

- Checking function at the issuance of report.

## 3. AS TO THE AUDIT INDUSTRY

**(1) Began planning for phase 1 of the provincial "e-Audit" project for the Audit Bureau of Sichuan Province**

During the reporting period the Group entered into an agreement with the Audit Bureau of Sichuan Province to plan and implement the "audit management system" throughout the province. The agreement will involve the Audit Bureau of Sichuan Province, 21 cities and prefectures, as well as 100 districts and counties.

**(2) Phase 1 of the "e-Audit" project expanded to the Audit Bureaus of Hunan Province, Changning and Hongkou Districts, Shanghai**

During the reporting period the Group continued to promote the on-site audit implementation system and the on-site audit management systems to the audit industry in various places.

**(3) Secured the further development of the analyzing capability of the State Audit Bureau's AO2005 version software**

The Group accepted the commission by the State Audit Bureau to upgrade its on-site audit implementation system developed by the Group, to provide additional functions and application modules.

**(4) Undertook the development of "social insurance intranet audit software" for the Audit Bureau of Qingdao City**

Social insurance intranet audit is a major task of phase 2 of the "e-Audit" project. At present, the circumstances for social insurance intranet audit have become favourable with the smooth progress of the national "e-Insurance" project. 80 out of the country's 400 major cities are using the "e-Insurance" network platform. A common information management platform has laid solid foundation for launching social insurance intranet audit.

The term "intranet audit" means that the auditor relies on the computer network to perform audit work. It involves application of computer audit program in off-site auditing. Intranet audit is efficient, trans-regional and real time.

The Group was commissioned by the Audit Bureau of Qingdao City to develop a "social insurance intranet audit software" to perform intranet audit on contribution handling, expense processing, its financial system and management, in relation to the following types of insurance: unemployment insurance under social insurance (hereinafter referred to as "unemployment insurance"), basic medical insurance for city and town workers (hereinafter referred to as "medical insurance"), basic retirement insurance for enterprise workers (hereinafter referred to as "retirement insurance").

The project involves devising an operation model for social insurance intranet audit, to establish channels for the transmission of social insurance data to the Audit Bureau, a system to process and save audit data, to achieve automatic collection, transfer and clearing of social insurance intranet audit data, to work out intermediate intranet audit reports for the social insurance period, to devise auditing methods, tools, benchmarks for warning and proposals for social insurance audit, to produce and transfer audit documents and to incorporate and enquire on laws and regulations.

## 4. ACQUISITION, MERGER AND ESTABLISHMENT

### (1) Successfully acquired the entire interests in Powerise International

The Group entered into an agreement with Powerise Information Technology Co., Ltd. (hereinafter referred to as "Powerise") to acquire all the businesses of Powerise International Software Co., Ltd. (hereinafter referred to as "Powerise International") and Powerise Japan Co., Ltd. (hereinafter referred to as "Powerise Japan"). As at June 1998, the business of Powerise International came mainly from NEC, Microsoft, Ozburn-Hessey Logistics, NYU and the European Union. Services provided by Powerise International include design/encoding/test/documentation and other services, data entry, IT consultancy, staff training and deployment of technical personnel. It has more than one hundred employees.

The acquisition of Powerise International operation enhances our advantageous position in Microsoft business and rapid expansion into the Japanese market. For Microsoft-related operation, Powerise International has many employees with experience in enterprise resource planning system, as well as more than one hundred employees experienced in the Japanese market. Although Chinasoft International has attained great success in the European and U.S. outsourcing markets, entering the Japanese market is no doubt a complement to Chinasoft International's outsourcing operation on the whole. It marks also the expansion of Chinasoft International into the Japanese market.

In the meantime, the Group made use of the team after acquisition to establish 中軟國際(湖南)信息技術有限公司.

**(2) Successfully acquired the Microsoft outsourcing business of Opportune Technology**

The Group entered into an acquisition agreement with Opportune Technology Co. Ltd. (hereinafter referred to as "Opportune Technology") to acquire the latter's Microsoft outsourcing operation.

Opportune Technology is a company engaged in IT servicing. Its outsourcing services include localization, QA test, specified software development, mobile platform development and embedded software development. The operation that Chinasoft International acquired this time originates from Microsoft and involves mainly MED (Mobile and Embedded Division) business. Opportune Technology has a team of over 70 professionals, being part of the acquisition.

As one of the Group's major strategic clients, Microsoft's outsourcing business has always been an important area for development by the Group. With the acquisition of Powerise International and Opportune Technology, the Group is rapidly enlarging its market share in Microsoft business.

**(3) Successfully acquired 50% of the equity interest in Cyber Resource**

The clients of Cyber Resource include IBM, MOTOROLA, PANASONIC, EPSON and HP; all of them are strategic clients that the Group plans to further serve. Furthermore, the business of Cyber Resource has been growing steadily over the years. Its profit margin has remained at a comparatively high level among the industry. When compared with the Group's net profit in the same period, its net profit up to 31 December 2005 was 17.78% of the Group's. To further exploit the potential of Cyber Resource, to coordinate and plan for the Group's development in outsourcing business regarding strategic clients and to generate profit for the Group, the Group decided to increase its holding of Cyber Resource's equity interest to 76% by means of acquisition and entered into an agreement on 30 June, 2006 to acquire a further 50% equity interest in Cyber Resource. The acquisition carries strategic meanings to the Company's expansion in outsourcing business in addition to generating stable and long-term revenue. Apart from that, the Group has obtained, by means of the acquisition, a sure majority vote at a meeting of shareholders.

**(4) Established a subsidiary in the United States**

The Group has established a subsidiary in the United States, Chinasoft International Inc (USA). Branches were set up in the Silicon Valley of California, the State of Washington and New Jersey. An establishment and opening ceremony for the branches was held in Redmond, Washington at the research center of one of Microsoft and Chinasoft International's strategic partners. Over 50 clients including Microsoft attended to express their congratulations.

The establishment of Chinasoft International USA demonstrates the commitment of Chinasoft International to Microsoft and all their strategic partners and clients around the world. It helps to bridge the gap between the Group and its U.S. clients. It is also part of the Group's strategy to enhance globalization and an important step towards providing world-class software service and IT solutions to clients.

## PROSPECTS

- **Continue to strengthen our leading position in industries with market dominance**

(1) With the implementation of phase 3 of the "tobacco production and operation decision system of the tobacco industry" project, the Group plans to promote the project throughout the country in the future. It is estimated to involve a total of 695 commercial firms, warehouses and provincial commercial enterprises.

For the regional tobacco market, the Group will launch a series of marketing campaigns in the provinces of Xizang and Anhui, etc., as well as other cities and autonomous regions to promote the Company's service. Meanwhile, the Group will seek to negotiate with the tobacco industry to form a joint venture.

(2) Based on our continual promotion of phase 1 of "e-Audit" to the whole country, we will expand the intranet audit project to lay a solid foundation for the promotion of phase 2 of "e-Audit".

- **As to outsourcing**

  The Group will continue to focus on Microsoft business and to take advantage of the acquisition of Powerise International and Opportune Technology to expand its Microsoft business and to secure new orders. Meanwhile we will further expand into the European and U.S. telecommunications markets and establish our foothold in the Japanese outsourcing market with clients like NEC brought by Powerise International. We will continue to expand into this market by means of acquisition. In addition, due to the continuous accumulation in the industry, the Group has had a great pool of personnel and the service that can be provided is developing from the low-end to the high-end. Therefore, the Group will place more focus on the high-end market in the future in order to gain better return.

- **As to acquisition and merger**

  The Group plans not only to continue the acquisition of outsourcing entities to enlarge its market share. It will also strengthen its capability by acquiring prominent companies in the industries with market dominance, in addition to identifying companies with good potential in other industries that the Group intends to enter.

## DIRECTORS' INTERESTS IN SHARES

As at 30 June, 2006, the following Directors had interests in the underlying shares of the Company set out below as recorded in the register required to be kept under section 352 of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) ("SFO"), or as otherwise notified to the Company and the Stock Exchange pursuant to the required standard of dealings by directors of listed issuer as referred to in rule 5.46 of the GEM Listing Rules:

**Long positions in shares of HK$0.05 each in the capital of the Company ("Shares")**

| Name of Director | No. of Shares | Approximate percentage of total issued ordinary share capital of the Company |
|---|---|---|
| Chen Yuhong | 22,967,472 | 3.04% |
| Cui Hui | 20,000,000 | 2.65% |
| Wang Hui | 7,017,838 | 0.93% |
| Tang Zhen Ming | 10,207,765 | 1.35% |

### Options to subscribe for Shares

| Name of Director | Exercise Price (HK$) | No. of share options outstanding as at 31 March 2006 | Percentage of total issued ordinary share capital of the Company | No. of underlying Shares interested in | Note |
|---|---|---|---|---|---|
| Chen Yuhong | 0.58 | 1,200,000 | 0.16% | 7,400,000 | (1) |
| | 0.65 | 5,000,000 | 0.66% | | (2) |
| | 0.97 | 1,200,000 | 0.16% | | (3) |
| Cui Hui | 0.65 | 500,000 | 0.07% | 500,000 | (2) |
| Duncan Chiu | 0.65 | 1,000,000 | 0.13% | 1,000,000 | (2) |
| Wang Hui | 0.58 | 1,000,000 | 0.13% | 5,500,000 | (1) |
| | 0.65 | 3,500,000 | 0.48% | | (2) |
| | 0.97 | 1,000,000 | 0.13% | | (3) |
| Tang Zhen Ming | 0.58 | 320,000 | 0.04% | 3,720,000 | (1) |
| | 0.65 | 2,600,000 | 0.34% | | (2) |
| | 0.97 | 800,000 | 0.11% | | (3) |

*Notes:*

(1) The above share options were offered on 13th August 2003 under the share option scheme of the Company adopted on 2nd June 2003 (the "Share Option Scheme") and were accepted on 27th August 2003. The share options are exercisable for a period of ten years from the date of offer, subject to the following conditions:

| Exercisable Period | | |
|---|---|---|
| **Commencing** | **Ending** | **Number of share options exercisable** |
| 13/08/2004 | 12/08/2013 | 25% of the total number of share options granted |
| 13/08/2005 | 12/08/2013 | 25% of the total number of share options granted |
| 13/08/2006 | 12/08/2013 | 25% of the total number of share options granted |
| 13/08/2007 | 12/08/2013 | 25% of the total number of share options granted |

(2) The above share options were offered on 13 May, 2004 under the Share Option Scheme and were accepted on 10 June, 2004. The share options are exercisable for a period of ten years from the date of offer, subject to the following conditions:

| **Exercisable Period** | | |
|---|---|---|
| **Commencing** | **Ending** | **Number of share options exercisable** |
| 13/05/2004 | 12/05/2014 | 25% of the total number of share options granted |
| 13/05/2005 | 12/05/2014 | 25% of the total number of share options granted |
| 13/05/2006 | 12/05/2014 | 25% of the total number of share options granted |
| 13/05/2007 | 12/05/2014 | 25% of the total number of share options granted |

(3) The above share options were offered on 30 March, 2006 under the Share Option Scheme and were accepted on 27 April, 2006. The share options are exercisable for a period of ten years from the date of offer, subject to the following conditions:

| **Exercisable Period** | | |
|---|---|---|
| **Commencing** | **Ending** | **Number of share options exercisable** |
| 30/03/2006 | 29/03/2016 | 25% of the total number of share options granted |
| 30/03/2007 | 29/03/2016 | 25% of the total number of share options granted |
| 30/03/2008 | 29/03/2016 | 25% of the total number of share options granted |
| 30/03/2009 | 29/03/2016 | 25% of the total number of share options granted |

Save as disclosed above and so far as was known to the Directors, as at 30 June, 2006 none of the Directors or chief executive of the Company had any interests or short positions in the shares, debentures or underlying shares of the Company or its associated corporations (as defined in Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which he is taken or deemed to have under such provisions of the SFO) or which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein or which were required, pursuant to the required standard of dealings by directors of listed issuers as referred to in Rules 5.46 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange.

## SHARE OPTION SCHEME

As at 30 June, 2006, share options to subscribe for an aggregate of 78,210,000 Shares granted to certain directors and employees of the Group pursuant to the Share Option Scheme with terms on the exercise of the share options granted as set out in Notes (1), (2) and (3) in the section headed "Directors' Interests in Shares" above were outstanding.

Save as disclosed above, no option had been granted, exercised and lapsed pursuant to such Share Option Scheme for the six months ended 30 June, 2006.

## DIRECTORS' RIGHTS TO ACQUIRE SHARES

Save as disclosed above, during the six months ended 30 June, 2006 none of the Directors was granted options to subscribe for shares of the Company and as at 30 June, 2006 none of the Directors had any rights to acquire shares in the Company.

## REQUIRED STANDARD OF SECURITIES DEALINGS BY DIRECTORS

During the six months ended 30 June, 2006, the Company had adopted a code of conduct for directors' securities transactions on terms no less exacting than the required standard of dealings set out in Rules 5.48 to 5.67 of the GEM Listing Rules. Having made specific enquiry with all the Directors, the Directors had complied with the required standard of dealings and the code of conduct for directors' securities transactions during the six months ended 30 June, 2006.

## THE CODE ON CORPORATE GOVERNANCE PRACTICES

During the six months ended 30 June, 2006, the Company has fully complied with the code provisions of the Code on Corporate Governance Practices as set out in Appendix 15 of the GEM Listing Rules.

## SUBSTANTIAL SHAREHOLDERS

So far as was known to the Directors, as at 30 June, 2006, the interest of the persons (not being a Director or chief executive of the Company) in the shares of the Company which were notified to the Company and the Stock Exchange pursuant to the provisions of Divisions 2 and 3 of Part XV of the SFO as recorded in the register required to be kept under section 336 of the SFO were as follows:

**Long positions in Shares**

| Name | Nature of interest | Approximate number of Shares *(million)* | Approximate percentage of total issued ordinary share capital of the Company |
|---|---|---|---|
| China National Computer Software & Information Technology Service Corporation (Hong Kong) Limited ("CS&S (HK)") *(Note 1)* | Beneficial interest | 199.01 | 26.34% |
| Chinasoft National Software and Service Company Limited ("CNSS") *(Note 1)* | Interest of controlled corporation | 199.01 | 26.34% |
| Chinasoft International (Hong Kong) Limited ("Chinasoft (HK)") *(Note 2)* | Interest of persons acting in concert | 199.01 | 26.34% |
| Far East Technology International Limited ("Far East Technology") *(Note 3)* | Beneficial interest | 170.09 | 22.51% |
| International Finance Corporation ("IFC") *(Note 4)* | Beneficial interest | 97.25 | 12.87% |

| Name | Nature of interest | Approximate number of Shares *(million)* | Approximate percentage of total issued ordinary share capital of the Company |
|---|---|---|---|
| Microsoft Corporation ("Microsoft") *(Note 4)* | Beneficial interest | 97.25 | 12.87% |
| Authorative Industries Limited | Beneficial interest | 57.49 | 7.61% |

*Notes:*

1. CNSS is taken to be interested in the Shares in which CS&S (HK) is interested. CNSS holds approximately 99.3% of the total voting rights of CS&S (HK). The number of Shares in which CS&S (HK) is interested includes 23,248,302 Shares which may be issued by the Company to CS&S (HK) pursuant to an acquisition agreement between Chinasoft (HK) and CS&S (HK) dated 28th April 2005 subject to fulfillment of a condition and the exercise of a cash option.

2. Chinasoft (HK) and CS&S (HK) are parties to agreements to acquire interests in the Company which include provisions imposing restrictions with respect to the disposal of interests acquired, and Chinasoft (HK) is taken to be interested in the Shares in which CS&S (HK) is interested pursuant to section 318 of the SFO.

3. Mr. Duncan Chiu, a non-executive Director, is nominated by Far East Technology. Mr. Duncan Chiu is a director of Far East Technology.

4. IFC and Microsoft were each interested in 97,250,000 Shares which could be issued to each of them upon the conversion of the 97,250,000 series A preferred shares of HK$0.05 each in the capital of the Company ("Series A Preferred Shares") allotted and issued to each of them on 6 January 2006. Each of IFC and Microsoft holds 50% of the total 194,500,000 Series A Preferred Shares in issue.

Save as disclosed above, as at 30 June, 2006, no other interest or short position in the Shares or underlying shares of the Company were recorded in the register required to be kept under section 336 of the SFO.

## COMPETING INTERESTS

As at 30 June, 2006, Dr. Cui Hui, an executive Director, was interested in approximately 1.34% of the issued share capital of CNSS. Dr. Cui Hui also served as a director of CNSS. In addition, Madam Tang Min (a non-executive Director) had been appointed as directors of CNSS since August 2000. Although the Directors are of the view that the principal activities of CNSS do not directly compete with those of the Group currently, the Group and CNSS however are both engaged in the provision of information technology outsourcing.

Save as disclosed above, as at 30 June, 2006, none of the Directors or the management shareholders of the Company and their respective associates (as defined under the GEM Listing Rules) had any interest in a business which competed or might compete with the business of the Group.

## AUDIT COMMITTEE

The Company established an audit committee on 2 June, 2003 with written terms of reference in compliance with the requirements as set out in Rules 5.28 to 5.33 of the GEM Listing Rules. The primary duties of the audit committee are to review and to provide supervision over the financial reporting process and internal control system of the Group. The audit committee comprises the three independent non-executive directors, namely Mr. He Ning and Mr. Zeng Zhijie and Dr. Leung Wing Yin Patrick.

The audit committee of the Company has reviewed the Interim results of the Group for the six months ended 30 June, 2006.

## PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

Neither the Company nor any of its subsidiaries have purchased, sold or redeemed any listed securities of the Company during the six months ended 30 June, 2006.

On behalf of the Board
**Dr. Chen Yuhong**
*Managing Director*

2 August, 2006, Beijing, PRC