MANAGEMENT DISCUSSION AND ANALYSIS OF THE TRADING RECORD

Investors should read the following discussion and analysis in conjunction with our audited financial statements, including notes thereto, as set forth in Appendix I "Accountants' report" to this prospectus. The financial statements have been prepared in accordance with HKFRS.

Overview

We are one of the leading online game developers and operators in the PRC as proven by the awards and recognition we and our online games have received. Our portfolio consists of a range of MMORPGs catering to various types of players. Our strong online game development capability enables us to create our own games and to upgrade our existing games in a timely and efficient manner. In addition, our proprietary customer information system tracks players' behaviour and purchasing patterns to allow us to design more appealing game contents. By employing our player-driven development philosophy and our integrated operation model, we have been able to swiftly adapt to trends in the online game market, such as offering online games to players free of charge and then generating revenue through the sale of virtual items. With these strategies and capabilities, we believe we can effectively satisfy our customers' demand and capture the market opportunities to further strengthen our position in the market.

Factors affecting our results of operations and financial condition

The major factors affecting our results of operations and financial condition include the following:

Growth of Internet penetration and online game market

Our results of operations and financial condition are affected by the growth of Internet penetration and online game market. The worldwide as well as the PRC rate of Internet penetration has continuously increased over the past few years and is expected to further increase in the future. As an online game developer and operator based in the PRC, the majority of our revenue is generated from online game operations in the PRC. The growth of Internet penetration in the PRC has facilitated the growth of online game market in the PRC as more and more people could reach online games through the Internet with easier access and lower cost. We believe that the continuing development of Internet value-added services, reduction in Internet access costs, lower PC prices and growth in broadband access will drive the increase in Internet usage as well as the growth of online game market. For more information, please refer to "Industry overview" in this prospectus.

Popularity of our online games

Our financial results are affected by the popularity of our online games.

Popular games attract a large number of customers and generate significant revenue for the game developers and operators. Therefore, the ability to develop and operate popular games is essential to our commercial success.

Revenue generation

We operate our online games under the FTP model. Players can play the games without initial costs, which enables us to quickly attract new players to experience our online games. Our revenue is generated by selling virtual items to be used in the games. Our ability to design virtual items and enhance game features to attract players to increase spending is critical to our revenue generation. However, this model is a recent phenomenon and our future revenues and profits are substantially dependent upon the continued acceptance and use of the FTP model, and our ability to stimulate players' spending on virtual items.

Development capability

In order to maintain our long-term financial and operational success, we must continuously develop new games that are attractive to players, frequently upgrade our existing games to retain players, and constantly enhance the technical and artistic features of our games to meet players' preferences. The success of our games largely depends on our ability to anticipate and respond to the ever changing user demands. Developing games requires substantial investments prior to their launch and needs significant commitments of future resources to sustain their growth.

Technological change

As an online game developer and operator, our financial results and operations in the future are affected by rapid technological change. Advances in game development softwares enhance our game development capability as well as the novelty and complexity of online games. It enables us to offer a wider range of online games and attract more players. However, the introduction of new technologies may require us to upgrade our hardwares and softwares to remain competitive in the industry.

Foreign exchange fluctuation

We offer online games in various language versions, including English, French and Spanish. Our multi-language approach helps generate revenue from the non-Chinese language market of approximately RMB41.6 million, representing approximately 34.1% of our total revenue for the year ended 31 December 2006. Our financial statements are prepared in Renminbi, while a portion of the revenue and expenses are denominated in foreign currencies. It is possible that the value of the Renminbi may fluctuate in value against other currencies. Our results of operations and financial condition may be affected by changes in the exchange rates of the Renminbi against other currencies in which our revenue and expenses are denominated. For more information, please refer to the paragraph headed "Fluctuations in the exchange rate of currencies may adversely affect our business" set out under the section headed "Risk factors" in this prospectus.

Basis of presentation

Our financial information has been prepared as a combination of business under common control. Our financial information presents our results of operations as if we had been in existence in current form as at 1 January 2005. Although we are not the equity holder of NetDragon (Fujian), we ultimately and effectively control the financial and operating activities of NetDragon (Fujian) through a

Management Committee. The Management Committee is established in accordance with the Structure Contracts, which were entered into by TQ Digital, NetDragon (Fujian) and the equity holders of NetDragon (Fujian) to oversee the business and operations of NetDragon (Fujian). We are able to control the Management Committee through the mechanism mentioned in the Structure Contracts. In addition, TQ Digital is entitled to substantially all of the operating profit generated by NetDragon (Fujian). NetDragon (Fujian) is in essence controlled by TQ Digital and accordingly, we regard NetDragon (Fujian) as our subsidiary, notwithstanding the lack of equity ownership. As NetDragon (Shanghai) is a subsidiary of NetDragon (Fujian), NetDragon (Shanghai) is also regarded as our subsidiary. As we, NetDragon (BVI), TQ Digital, NetDragon (USA), NetDragon (HK), NetDragon (Fujian) and NetDragon (Shanghai) were ultimately controlled by the same group of parties before and after the formation of the Group, the financial information is thereby prepared using the principles of merger accounting and presents our combined results, combined changes in equity, combined cash flows and combined financial positions as if the current group structure had been in existence on 1 January 2005, the beginning of the earliest Active Business Pursuit Period presented.

Critical accounting policies and estimates

We prepare financial statements in accordance with HKFRS, which requires us to adopt accounting policies and make estimates and assumptions that our management believes are appropriate in the circumstances for purposes of giving a true and fair view of our results and financial condition. However, different policies, estimates and assumptions in critical areas could lead to materially different results. We continually evaluate these estimates based on our own experience, knowledge and assessment of current business and other conditions, our expectations based on available information and other reasonable assumptions, which together form our basis for making judgments about matters that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, our actual results could differ from those estimates. Some of our accounting policies require a higher degree of judgment than others in their application. We believe the following accounting policies involve the most significant judgments and estimates used in the preparation of our financial statements.

(i) **Merger accounting**

We prepare our financial information using merger accounting. In determining the appropriate accounting method for preparing the Group's financial statement, we have assessed if the formation of the Group is a business combination involving entities under common control and whether such control is transitory.

(ii) **Online game revenue recognition**

In general, we recognise online game revenue based on the actual consumption of the game points. Under the FTP model, the relevant online games are free-to-play but game players can purchase virtual items with game points to enhance their experience in the online games. To acquire game points, game users can credit their game accounts through direct sales channel such as online payment systems or purchase of pre-paid cards. Online game revenue is recognised when the game points are utilised by game players to purchase virtual items.

We account for the amounts received in respect of unactivated pre-paid cards as well as the amounts received in respect of unutilised game points as deferred income in our consolidated balance sheets. The unutilised game points are valid to be used without a definite period. Our pre-paid cards are sold through third party sales distributors and our own distribution network in the PRC. For pre-paid cards which are sold but not yet activated by the ultimate players, the relevant amount received is recognised as deferred income.

As to the unutilised game points at period end, we have estimated the average sales value of the unutilised game points in arriving at the relevant amount of deferred income at that period end. In determining the amount of average sales value of the unutilised game points, we consider the discount rate applicable to each of the distribution and payment channels as discounts given to them are varied. In general, more than half of the revenue generated is attributable to the channel of direct sales via online payment systems and discount is not given in respect of this channel. The rest of the revenue is generated via the channels which are given discounts ranging from 15% to 55% in general. We also consider the mix of income received via the channels of direct sales and pre-paid cards sales through distributors. In a year when more income is received from the channel of direct online payment systems where discount is not given, we tend to use a lower average discount rate in determining the amount of deferred income for that year and vice versa. Having considered these factors, we determine an average discount rate which gives rise to the best estimate of the discount given to those unutilised game points at period end. The average sale value of each game point is then determined by factoring the average discount rate to the face value of the game points. If the actual sales value of the unutilised game points is greater than our estimated sales value, the amount of deferred income recognised in the consolidated balance sheets should be larger and the amount of online game revenue recognised in the consolidated income statements should be smaller correspondingly. On the contrary, if the actual sales value of the unutilised game points is smaller than our estimated sales value, the amount of deferred income recognised in the consolidated balance sheets should be smaller and the amount of online game revenue recognised in the consolidated income statements should be larger correspondingly.

Our existing system is able to capture the information necessary in determining the deferred revenue which includes income received from different distribution and payment channels in a given period, the number of game points consumed in a given period and the number of unutilised game points at period end. With reference to the actual sale value of game points sold via different distribution and payment channels in a given period of time, we are able to estimate the average discount rate in a given period and then to determine the amount of deferred income at the period end.

As a result of the above-mentioned factors, our online game revenue and deferred income during the Actual Business Pursuit Period are fairly stated despite the estimates and assumptions underlying the online game revenue recognition policy.

(iii) **Development costs**

We generally recognise development expenditures as expenses as they are incurred. Costs on development project are capitalised and recognised as intangible assets only when we can demonstrate

(i) the technical feasibility of completing the intangible asset so that it will be available for use or sale; (ii) our intention to complete and our ability to use or sell the asset; (iii) how the asset will generate future economic benefits; (iv) the availability of technical and financial resources to complete; and (v) the ability to measure reliably the expenditure during the development.

Determining the level of development costs that warrant capitalisation requires significant management judgement and assumptions regarding the expected future cash flow of the assets, discount rates to be applied and the expected period of benefits. We have expensed all our development costs to date. We will only capitalise our development costs when our management is satisfied that the above conditions for capitalisation are met through sufficiently reliable estimates and judgement, and the reasonableness of which can be demonstrated objectively.

(iv) **Useful lives of property, plant and equipment**

Our property, plant and equipment primarily comprise servers, computers, vehicles and other office equipment. We depreciate these assets using the straight-line method over the estimated useful lives of the assets, taking into account the assets' estimated residual values. We estimate the useful lives based on our management's knowledge on the useful lives of similar assets in the market, and taking into account anticipated technological or other changes. On this basis, we have estimated the useful lives of our servers, computers, vehicles and office equipment to be five years. We review the estimated useful lives and residual values of assets, and adjust them if appropriate, at each balance sheet date.

If technological innovations are to occur more rapidly than anticipated, we may shorten the useful lives or lower the residual value assigned to these assets, which will result in increased depreciation expense in future periods.

(v) **Impairment of receivables**

Trade and other receivables are booked initially at fair value and subsequently measured at amortised cost less any impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that we will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of a debtor, probability that a debtor will enter bankruptcy, and default or delinquency in payment are considered indicators that the trade receivable is impaired. When a receivable is determined uncollectible, it is written off against the allowance account for receivables and the amount of the loss is recognised in the consolidated income statement as part of administrative expenses. We review the provision for impairment, and adjust it if appropriate, at each balance sheet date after conducting aging analysis of the receivables and reviewing credit history of the debtors.

RESULTS OF OPERATIONS

The table below sets out a summary of our audited consolidated financial results during the Active Business Pursuit Period. For more detailed information, please refer to the accountants' report in Appendix I to this prospectus.

	Year ended 31 December		Six months ended 30 June	
	2005	**2006**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000* (*unaudited*)	*RMB'000*
Revenue - turnover	35,119	122,061	26,111	261,749
Cost of revenue	(4,669)	(11,179)	(3,253)	(14,665)
Gross profit	30,450	110,882	22,858	247,084
Other revenue and gains	4,950	5,673	1,715	1,330
Selling and marketing expenses	(25,450)	(13,838)	(5,531)	(30,345)
Administrative expenses	(16,906)	(22,960)	(9,199)	(19,418)
Development costs	(15,464)	(12,835)	(5,463)	(13,137)
Other operating expenses	(8,501)	(15,377)	(5,660)	(13,248)
Operating (loss)/profit	(30,921)	51,545	(1,280)	172,266
Loss on disposal of an associate	—	(2)	—	—
(Loss)/Profit before income tax	(30,921)	51,543	(1,280)	172,266
Income tax credit/(expense)	1,721	(8,558)	(1,500)	(18,179)
(Loss)/Profit for the year/period	(29,200)	42,985	(2,780)	154,087
Attributable to				
Equity holders of the Company	(29,171)	42,856	(2,780)	153,839
Minority interests	(29)	129	—	248
	(29,200)	42,985	(2,780)	154,087

The table below sets out a summary of the percentage of certain of the financial results to our revenue-turnover:

	Year ended 31 December		Six months ended 30 June	
	2005	**2006**	**2006**	**2007**
Revenue - turnover	100.0%	100.0%	100.0%	100.0%
Cost of revenue	(13.3)%	(9.2)%	(12.5)%	(5.6)%
Gross profit	86.7%	90.8%	87.5%	94.4%
Other revenue and gains	14.1%	4.6%	6.6%	0.5%
Selling and marketing expenses	(72.5)%	(11.3)%	(21.2)%	(11.6)%
Administrative expenses	(48.1)%	(18.8)%	(35.2)%	(7.4)%
Development costs	(44.0)%	(10.5)%	(20.9)%	(5.0)%
Other operating expenses	(24.2)%	(12.6)%	(21.7)%	(5.1)%
Operating (loss)/profit	(88.0)%	42.2%	(4.9)%	65.8%
Loss on disposal of an associate	—	—	—	—
(Loss)/Profit before income tax	(88.0)%	42.2%	(4.9)%	65.8%
Income tax credit/(expense)	4.9%	(7.0)%	(5.7)%	(6.9)%
(Loss)/Profit for the year/period	(83.1)%	35.2%	(10.6)%	58.9%
Attributable to				
Equity holders of the Company	(83.0)%	35.1%	(10.6)%	58.8%
Minority interests	(0.1)%	0.1%	—	0.1%
	(83.1)%	35.2%	(10.6)%	58.9%

Six months ended 30 June 2007 compared with six months ended 30 June 2006

Revenue

Our revenue arising from principal activities for the six months ended 30 June 2007 was approximately RMB261.7 million, representing an increase of approximately 902.4% as compared to the same period in 2006. The table below sets out the breakdown of our revenue by game for the periods indicated:

	Six months ended 30 June			
	2006		2007	
	RMB'000	*% of total revenue*	*RMB'000*	*% of total revenue*
Online games				
Eudemons Online	1,203	4.6	185,040	70.7
Conquer Online	24,126	92.4	61,873	23.6
Zero Online	—	—	14,417	5.5
Others	782	3.0	419	0.2
Total revenue	26,111	100.0	261,749	100.0

The increase of our total revenue was mainly due to the continuing popularity of Conquer Online, achieving a PCU and ACU of approximately 89,000 and 63,000, respectively for the six months ended 30 June 2007 whereas it recorded a PCU and ACU of approximately 66,000 and 47,000, respectively for the six months ended 30 June 2006, and the launches of Eudemons Online and Zero Online in March 2006 and late April 2007, respectively. Eudemons Online was launched in late March 2006, and did not generate revenue until April 2006 and achieved a PCU and ACU of approximately 496,000 and 243,000 for the six months ended 30 June 2007. Zero Online was launched in late April 2007 and achieved a PCU and ACU of approximately 53,000 and 21,000 from the date of its launch to 30 June 2007. Revenue derived from Eudemons Online accounted for approximately 70.7% of our revenue for the six months ended 30 June 2007. In addition, the revenue derived from Conquer Online increased by 156.5% to approximately RMB61.9 million for the six months ended 30 June 2007 from RMB24.1 million for the same period in 2006.

Cost of revenue

Our cost of revenue primarily consist of costs directly attributable to the provision of our services, which include fees paid to game operation service providers, server and bandwidth leasing expenses, depreciation of servers, transaction handling fees and other costs. These costs are recognised in the income statement as incurred or upon utilisation of the relevant services, as appropriate.

The following table shows the breakdown of our cost of revenue for the periods indicated:

	Six months ended 30 June	
	2006	**2007**
	RMB'000	*RMB'000*
Fees paid to game operation service providers	233	4,306
Server and bandwidth leasing expenses	1,634	5,576
Depreciation of servers	522	1,448
Transaction handling fees	864	2,962
Others	—	373
	3,253	14,665

Cost of revenue for the six months ended 30 June 2007 was approximately RMB14.7 million, representing an increase of approximately 350.8% from the same period in 2006. The increase in cost of revenue was mainly attributable to (i) the fee paid to game operation service providers, whereas we only started to pay such fees in the last quarter of 2006; (ii) increased server and bandwidth leasing expenses due to the increased number of servers we leased; and (iii) increased transaction handling fees as a result of the increased revenue.

The services provided by the game operation service providers, which are all Independent Third Parties, includes (i) provision of servers for online game operation; (ii) provision of network security; (iii) fixing of any technical problems; (iv) provision of technical and customer services; and (v) provision of promotional and advertising activities. The effective dates of the agreements entered into between the game operation service providers and us varied from May 2006 to January 2007, and accordingly, only a small amount of cost of revenue was recorded for the six months ended 30 June 2006.

The transaction handling fees are service fees charged by our online payment service providers for collecting money on our behalf.

Gross profit

As a result of the above-mentioned factors, our gross profit increased by approximately 981.0% to approximately RMB247.1 million for the six months ended 30 June 2007. Gross profit margin increased from approximately 87.5% for the six months ended 30 June 2006 to approximately 94.4% for the same period in 2007, which was mainly due to the increased player usage.

Other revenue and gains

Other revenue and gains for the six months ended 30 June 2007 decreased by approximately 22.4% to approximately RMB1.3 million compared with the same period in 2006. The decrease was mainly due to that (i) no fee for game development to third parties was generated for the six months ended 30 June 2007; (ii) the government grants received decreased in that period; (iii) we no longer carry out the business in generating advertising income in 2007; and (iv) there was no website transfer transaction in the six months ended 30 June 2007.

Government grants represent subsidies for hi-tech projects. As a hi-tech enterprise conducting hi-tech projects in relation to the development of online games, NetDragon (Fujian) and TQ Digital are eligible for such grants. These grants are non-recurring in nature and are given on project basis. The website transfer in 2006 is a one time transaction and is not expected to repeat in the future.

Selling and marketing expenses

Our selling and marketing expenses primarily consist of staff costs, advertising and promotion expenses and other selling and marketing expenses.

The following table shows the breakdown of selling and marketing expenses for the periods indicated:

	Six months ended 30 June	
	2006	**2007**
	RMB'000	*RMB'000*
Advertising and promotion	2,194	22,613
Staff costs	1,529	3,409
Others	1,808	4,323
	5,531	30,345

Selling and marketing expenses for the six months ended 30 June 2007 increased by approximately 448.6% to approximately RMB30.3 million as compared with the same period in 2006. The increase in the amount of selling and marketing expenses was mainly attributable to our increased advertising and promotion expenses for Eudemons Online and Zero Online, and the increased staff costs as we raised employee compensations. The advertising and promotion expenses for Eudemons Online and Zero Online included advertisements on various online platforms and Internet cafés. The proportion of selling and marketing expenses to the total revenue for each of the six months ended 30 June 2006 and 2007 was approximately 21.2% and 11.6%, respectively.

Administrative expenses

Our administrative expenses consist primarily of staff costs, depreciation, travel and entertainment expenses and other administrative expenses.

The following table shows the breakdown of administrative expenses for the periods indicated:

	Six months ended 30 June	
	2006	**2007**
	RMB'000	*RMB'000*
Staff costs	4,932	9,078
Depreciation	990	1,890
Travel and entertainment expenses	704	2,675
Others	2,573	5,775
	9,199	19,418

Administrative expenses increased by approximately 111.1% to approximately RMB19.4 million for the six months ended 30 June 2007 as a result of the continuous expansion of our online game business. The increase of our staff costs was due to the increase of compensation for employees. The increase in our travel and entertainment expenses and other administrative expenses for the six months ended 30 June 2007 were primarily driven by the significant increase of our business development needs. The proportion of administrative expenses to total revenue for each of the six months ended 30 June 2006 and 2007 was approximately 35.2% and 7.4%, respectively.

Development costs

The following table shows the breakdown of development costs for the year ended 30 June 2006 and 2007:

	Six months ended 30 June	
	2006	**2007**
	RMB'000	*RMB'000*
Staff costs	5,362	12,943
Others	101	194
	5,463	13,137

Our development costs primarily consist of staff costs and other development-related expenses. The increase in our development costs was mainly due to the increase of compensation for our employees. The number of staff in our development team was 279 and 309 for each of the six months ended 30 June 2006 and 2007, respectively. We increased the compensation in order to provide a competitive and attractive increment in the basic salary and distribution of discretionary bonus due to the success of Eudemons Online and to further motivate employees.

Other operating expenses

Our other operating expenses consist primarily of business tax for intercompany transactions and professional fees related to the Listing.

The following table shows the breakdown of other operating expenses for the periods indicated:

	Six months ended 30 June	
	2006	**2007**
	RMB'000	*RMB'000*
Business tax (intercompany transactions)	445	6,609
Professional fees related to the Listing	4,057	6,359
Others	1,158	280
	5,660	13,248

Other operating expenses for the six months ended 30 June 2007 increased by approximately 134.1% to approximately RMB13.2 million as compared with the same period in 2006. The increase in other operating expenses was mainly attributable to the increase in business tax for intercompany transactions as a result of our revenue increase, and the increase in our professional fees relating to the Listing. We are required to pay business tax not only for intercompany transactions but for all online game revenue. However, the business tax included in "other operating expenses" is only related to intercompany transactions, and the business tax for online game revenue is deducted from the gross revenue directly. Business tax is neither costs of revenue, nor selling and marketing expenses, nor administrative expenses, nor development costs. Business tax is also not an income tax in nature. Accordingly, they are classified as "other operating expenses". As required by the relevant accounting standard, professional fees not directly attributable to equity transaction including costs related to stock market listing are recognised as expenses in the period they incur.

Operating (loss)/profit

As a result of the above-mentioned factors, our profitability improved from an operating loss of approximately RMB1.3 million for the six months ended 30 June 2006 to an operating profit of approximately RMB172.3 million for the same period in 2007. The increase in operating income resulted from the increasing popularity of our online games and the fact that our revenue increased at a substantially higher rate than that of our operating expenses.

(Loss)/Profit before income tax

(Loss)/Profit before income tax for each of the six months ended 30 June 2006 and 2007 are approximately the same as the operating (loss)/profit for the same periods.

Income tax credit/(expense)

Despite the Group reported a loss before income tax amounted to RMB1.3 million for the six months ended 30 June 2006, the amount of income tax expense was RMB1.5 million for the period concerned. It was mainly due to NetDragon (USA) derived assessable income in the USA for the six months ended 30 June 2006 while NetDragon (BVI) and TQ Digital were loss making for the period concerned. Our income tax expense increased by 1,111.9% to RMB18.2 million for the six months ended 30 June 2007. The increase was primarily due to that we had profit before tax of RMB172.3 million for the six months of 2007 as compared with a loss before tax of RMB1.3 million for the same period in 2006.

(Loss)/Profit for the period

As a result of the overall effect from the above-mentioned factors, our profit for the six months ended 30 June 2007 turned around to approximately RMB154.1 million as compared with loss of approximately RMB2.8 million for the same period in 2006. The net profit margin for the six months ended 30 June 2007 was 58.9%.

Year ended 31 December 2006 compared with year ended 31 December 2005

Revenue

Our revenue arising from principal activities for the year ended 31 December 2006 was approximately RMB122.1 million, representing an increase of approximately 247.6% as compared to approximately RMB35.1 million for the year ended 31 December 2005. The table below sets out the breakdown of our online game revenue for the periods indicated:

	Year ended 31 December			
	2005		2006	
	RMB'000	*% of total revenue*	*RMB'000*	*% of total revenue*
Online games				
Eudemons Online	—	—	69,489	56.9
Conquer Online	32,338	92.1	51,112	41.9
Others	2,781	7.9	1,460	1.2
Total revenue	35,119	100.0	122,061	100.0

The increase in our revenue for the year ended 31 December 2006 was mainly due to the popularity of Eudemons Online, which was launched in March 2006. Eudemons Online achieved a PCU and ACU of approximately 325,000 and 70,000, respectively for the year ended 31 December 2006. Revenue derived from Eudemons Online accounted for approximately 56.9% of our revenue for the year ended 31 December 2006. In addition, the 58.1% increase in revenue derived from Conquer Online added to the revenue growth for the year ended 31 December 2006. Conquer Online achieved a PCU and ACU of approximately 82,000 and 52,000, respectively for the year ended 31 December 2006 whereas it recorded a PCU and ACU of approximately 47,000 and 27,000, respectively for the year ended 31 December 2005. Revenue derived from Conquer Online accounted for approximately 92.1% and 41.9%, respectively, of our revenue for the year ended 31 December 2005 and 2006.

Cost of revenue

The following table shows the breakdown of our cost of revenue for the years ended 31 December 2005 and 2006:

	Year ended 31 December	
	2005	**2006**
	RMB'000	*RMB'000*
Fees paid to game operation service providers	—	2,521
Server and bandwidth leasing expenses	2,927	5,360
Depreciation of servers	1,008	1,088
Transaction handling fees	734	2,210
	4,669	11,179

Cost of revenue for the year ended 31 December 2006 was approximately RMB11.2 million, representing an increase of approximately 139.4% as compared to the year ended 31 December 2005. The increase in cost of revenue was mainly attributable to (i) fees paid to game operation service providers for the year ended 31 December 2006 pursuant to an agreement entered between us and the game operation service provider in relation to the operation of Eudemons Online and Conquer Online; (ii) increase in our server and bandwidth leasing expenses due to the increased number of servers we leased; and (iii) transaction handling fees primarily as a result of the increased revenue.

The services provided by the game operation service providers, which are all Independent Third Parties, includes (i) provision of servers for online game operation; (ii) provision of network security; (iii) fixing of any technical problems; (iv) provision of technical and customer services; and (v) provision of promotional and advertising activities. The effective dates of the agreements entered into between the game operation service providers and us varied from May 2006 to January 2007, and accordingly, no cost of revenue was recorded for the year ended 31 December 2005.

The transaction handling fees are service fees charged by our online payment service providers for collecting money on our behalf.

Gross profit

As a result of the above-mentioned factors, gross profit increased by approximately 264.1% to approximately RMB110.9 million in the year ended 31 December 2006. Gross profit margin increased from approximately 86.7% for the year ended 31 December 2005 to approximately 90.8% for the year ended 31 December 2006 mainly due to the increased player usage, which in turn led to higher consumption of our virtual items and brought higher revenue. As our cost of server leasing expense is charged per server unit rather than per online game player, higher gross profit was generated as a result.

Other revenue and gains

Other revenue and gains for the year ended 31 December 2006 increased by approximately 14.6% to approximately RMB5.7 million as compared with the year ended 31 December 2005. The increase in other revenue and gains was mainly attributable to gain on investments and increases in our interest income offset by a decrease in game development fee income for the year ended 31 December 2006. The game development fee income was generated from our development of an online game for Guangdong Digital Communications Network Company Limited (廣東數據通信網絡有限公司), an Independent Third Party.

Selling and marketing expenses

The following table shows the breakdown of selling and marketing expenses for the years ended 31 December 2005 and 31 December 2006:

	Year ended 31 December	
	2005	**2006**
	RMB'000	*RMB'000*
Advertising and promotion	10,425	6,204
Staff costs	6,290	3,279
Others	8,735	4,355
	25,450	13,838

Selling and marketing expenses for the year ended 31 December 2006 decreased by approximately 45.6% to approximately RMB13.8 million as compared with the year ended 31 December 2005. The decrease in selling and marketing expenses was mainly attributable to our effort to focus on the development and operation of MMORPGs for the year ended 31 December 2006 instead of spreading our resources in developing each of MMORPGs, casual games and online portal for the year ended 31 December 2005. As a result, advertising and promotion expenses and staff related costs on non-MMORPG business was discontinued in 2006. The number of staff relating to selling and marketing were 247 and 88 for each of the year ended 31 December 2005 and 2006, respectively. The proportions of selling and marketing expenses to the total revenue for the year ended 31 December 2005 and 2006 were approximately 72.5% and 11.3%, respectively.

Administrative expenses

The following table shows the breakdown of administrative expenses for the years ended 31 December 2005 and 2006:

	Year ended 31 December	
	2005	**2006**
	RMB'000	*RMB'000*
Staff costs	8,560	11,362
Depreciation	1,509	2,636
Travel and entertainment expenses	529	2,885
Others	6,308	6,077
	16,906	22,960

Administrative expenses increased by approximately 35.8% to approximately RMB23.0 million for the year ended 31 December 2006. The increase of our staff costs was due to the increase of compensation for employees. The proportions of administrative expenses to total revenue for the year ended 31 December 2005 and 2006 were approximately 48.1% and 18.8%, respectively. We have increased the compensation for most of the staff, in particular the senior staff in administrative departments, for the year ended 2006. The staff costs of senior management under the administrative departments are classified as administrative expenses.

Development costs

The following table shows the breakdown of development costs for the years ended 31 December 2005 and 2006:

	Year ended 31 December	
	2005	**2006**
	RMB'000	*RMB'000*
Staff costs	13,958	12,171
Others	1,506	664
	15,464	12,835

The decrease in staff costs related to development was primarily due to our effort to focus on the development of MMORPGs in 2006 instead of the diversified development directions in MMORPGs, casual games and online portals in the year ended 31 December 2005 offset by an increase in overall compensation to our staff. Under our previous diversified development directions which commenced in early 2004, we believed that the result of such strategy was not satisfactory which was attributable to our loss for the year ended 31 December 2005. As such, we have decided to focus our resources on the development of MMORPGs since 2005.

Other operating expenses

The following table shows the breakdown of other operating expenses for the years ended 31 December 2005 and 2006:

	Year ended 31 December	
	2005	**2006**
	RMB'000	*RMB'000*
Business tax (intercompany transactions)	321	2,439
Professional fees related to the Listing	4,985	8,113
Write-off of and loss on property, plant and equipment	629	1,261
Others	2,566	3,564
	8,501	15,377

Other operating expenses for the year ended 31 December 2006 increased by approximately 80.9% to approximately RMB15.4 million as compared with the year ended 31 December 2005. The increase in other operating expenses was mainly attributable to an increase in business tax for intercompany transactions which was driven by our increase in revenue for the year ended 31 December 2006. We also recorded professional fees related to the Listing of about RMB8.1 million as the preliminary expenses for our preparation of the Listing for the year ended 31 December 2006. In addition, we disposed of the unutilised and outdated computers which accounted for the write-off and loss on disposal of property, plant and equipment.

Operating (loss)/profit

As a result of the above-mentioned factors, profitability was improved from an operating loss of approximately RMB30.9 million for the year ended 31 December 2005 to an operating profit of approximately RMB51.5 million for the year ended 31 December 2006. The increase in operating profit was attributable to an increase in gross profit by approximately 264.1%, as well as a decrease in selling and marketing expenses by approximately 45.6%. The improvement in operation for the year ended 31 December 2006 was resulted from the increasing popularity of our online games.

Loss on disposal of an associate

Loss on disposal of an associate is only incurred for the year ended 31 December 2006. Loss on disposal of an associate of approximately RMB2,000 was resulted from the dissolution of Fuzhou Yikairui Network & Infotech Company Limited (福州易凱瑞網絡信息技術有限公司) with consideration of approximately RMB428,000 on 4 August 2006. The dissolution of Fuzhou Yikairui Network & Infotech Company Limited (福州易凱瑞網絡信息技術有限公司) had been completed and there is no actual or contingent liability for the dissolution of that associate.

(Loss)/Profit before income tax

As a result of the above-mentioned factors, profit before income tax for the year ended 31 December 2006 increased to approximately RMB51.5 million as compared with the loss before income tax of approximately RMB30.9 million for the year ended 31 December 2005.

Income tax credit/(expense)

Income tax expense was RMB8.6 million for the year ended 31 December 2006. This increase was primarily due to a turnaround in profit before income tax for the year ended 31 December 2006 as compared with the loss before income tax for the year ended 31 December 2005.

(Loss)/Profit for the year

As a result of the overall effect from the above-mentioned factors, profit for the year ended 31 December 2006 turned around to approximately RMB43.0 million as compared with a loss of approximately RMB29.2 million for the year ended 31 December 2005. The net profit margin for the year ended 31 December 2006 was approximately 35.2%.

ANALYSIS FOR SELECTED BALANCE SHEET ITEMS

Debtor's turnover period

Debtor's turnover period is calculated by dividing the amount of trade receivables as at the respective period end and revenue for the relevant period times the number of days in the relevant period. We generally request debtors to pay in advance or within a credit period of 30 to 45 days. The credit periods granted to debtors in different distribution and payment channels vary based on their reputation. For each of the year ended 31 December 2005 and 2006 and the six months ended 30 June 2007, debtor's turnover period for us was approximately 12 days, 19 days and 16 days, respectively. The increase in debtor's turnover period in the year ended 31 December 2006 was primarily due to the increase in the revenue generated from distribution partners and telecommunication voice service and mobile SMS service providers with credit period ranging from 30 to 45 days we granted. The online game revenue generated from them for each of the years ended 31 December 2005 and 2006 were approximately RMB6.6 million and RMB23.0 million, respectively. The popularity and wide coverage of the distribution partners' platforms provide players more convenient channels to play our games. It leads to the substantial increase in the revenue generated from distribution partners. As to the increase in the revenue generated from telecommunication voice service and mobile SMS service providers, it was mainly attributable to the popularity of Eudemons Online and increase in revenue derived from Conquer Online during the year. The decrease in debtor's turnover period for the six months ended 30 June 2007 was due to the improvement of outstanding debt collection during the period. Due to the increase of debtor's turnover period in the year ended 31 December 2006, we negotiated with some of the online payment service providers and successfully shorten the credit period for less than 30 days during the six months period 30 June 2007. It was proved by the decrease in the outstanding balances over 60 days for the year ended 31 December 2006 in comparing with the six months ended 30 June 2007. The outstanding balances over 60 days for the year ended 31 December 2006 and the six months ended 30 June 2007 were RMB403,000 and RMB381,000 respectively.

As of 31 December 2005 and 2006 and 30 June 2007, we had trade receivables amounted to approximately RMB1.1 million, RMB6.2 million and RMB22.7 million, respectively, representing approximately 3.2%, 5.2% and 8.8% of our current assets and approximately 1.9%, 4.2% and 7.6% of our total assets, respectively.

Creditor's turnover period

Our suppliers are mainly game operation service providers and online payment service providers. Normally, we settle their billing on an advanced or monthly basis. Creditor's turnover period is calculated by dividing the amount of trade payables as at the period end and cost of revenue for the relevant period times the number of days in the relevant period. For the year ended 31 December 2005 and 2006 and the six months ended 30 June 2007, creditor's turnover period for us was approximately 8 days, 3 days and 3 days, respectively.

Return on equity

Return on equity for the year ended 31 December 2006 and the six months ended 30 June 2007 was approximately 41.1% and 67.4%, respectively, as compared with that of a net loss for the year ended 31 December 2005 and the six months ended 30 June 2006.

Return on total assets

Return on total assets for the year ended 31 December 2006 and the six months ended 30 June 2007 was approximately 29.4% and 51.8%, respectively, as compared with that of a net loss for the year ended 31 December 2005 and the six months ended 30 June 2006.

Deferred income

As at 31 December 2005, 2006 and 30 June 2007, we had deferred income of approximately RMB2.4 million, RMB8.6 million and RMB11.9 million, respectively.

The amount of sales arising from unactivated pre-paid game cards are approximately RMB1.8 million, RMB1.1 million and RMB0.9 million for each of the two years ended 31 December 2006 and the six months ended 30 June 2007, respectively.

Cash and cash equivalents

As at 31 December 2005, 2006 and 30 June 2007, we had cash on hand and at bank of approximately RMB14.0 million, RMB60.8 million and RMB171.4 million, respectively. In addition, as at 31 December 2005, 2006 and 30 June 2007, we had cash deposited with an online payment service provider of approximately RMB1.3 million, RMB5.5 million and RMB35.0 million, all in the form of U.S. dollars, respectively. Cash deposited with that online payment service provider can be readily withdrawn by us. The accounts maintained with this online payment service provider were held by the directors of NetDragon (USA) on our behalf for the exclusive use of accepting online payments from customers. We note that such online payment service provider did not offer business accounts to NetDragon (USA) at the time when NetDragon (USA) first commenced its business operation on such provider's platform. To accommodate that restriction, the directors of NetDragon (USA) decided to open personal accounts at that online payment service provider on trust for NetDragon (USA) to facilitate our business growth. As at the Latest Practicable Date, we have set up a corporate account at that online payment service provider which is owned by and under the name of NetDragon (USA). The personal accounts previously set up by the directors of the NetDragon (USA) are no longer used by NetDragon (USA). We further confirm that all the funds deposited with such online payment service provider, of approximately RMB35.0 million in the form of U.S. dollars, have been transferred from those personal accounts to our corporate account when we ceased to use those personal accounts.

Available-for-sale financial asset/Investment in trading securities

Our investment objective is to identify potential targets which can maximise the investment return within reasonable and prudent level of risk. In assessing a potential target for investment, we consider its relative competitive position in its market, revenues, profitability as well as size of operations. Once we have made an investment, we regularly review the performance of investment and would consider disposing of an investment if we believe this would be in our best interests. For instance, we would dispose of an investment if we consider that there is deterioration in the operational or financial performance of an investee.

In recent years, we have spent majority of our time and resources in operating, managing and developing our online game business and we plan to focus on these principal activities in the coming years. Accordingly, we have minimised our investment activity during the Active Business Pursuit Period and the percentage of investment in debt and equity securities to net assets has reduced from 21.5% as at 31 December 2005 to 4.6% as at 31 December 2006 and further reduced to 1.9% as at 30 June 2007. To reduce the risk associated to investment, we mainly invest in low risk market such as bond market.

Our available-for-sale financial asset as at the end of each of the Active Business Pursuit Period represents a 9.5% equity interest in Fujian Yang Zhenhua 851 Bio Science Co., Ltd (福建楊振華851生物科技股份有限公司), a PRC established entity which is principally engaged in processing of healthcare products. The entity is a related party because Liu Dejian and Zheng Hui, our Directors, are directors of the entity and Lin Yun, a beneficial owner of the Company, has equity interest in the entity. We intend to hold the investment for long-term in view of its investment potential. Despite the difference in business natures, we consider that the health food product market in the PRC is fast growing with potential investment value and accordingly, we have retained our investment in Fujian Yang Zhenhua 851 Bio Science Co., Ltd (福建楊振華851生物科技股份有限公司) since 2000. We currently have no intention to dispose the investment even though it is not our principal activity. Our unlisted debt securities represent bonds and certificate of deposits issued by US corporations with maturity period ranged from six months to 24 months in general. The balance of unlisted debt securities reduced from RMB4.6 million as at 31 December 2005 to RMB0.9 million as at 31 December 2006 and

RMB0.5 million as at 30 June 2007 as certain bonds and certificate of deposits were disposed or matured. As mentioned in the previous paragraphs, we plan to focus on our principal activities in respect of online game business and accordingly, we have no plan to further invest in debt securities after the maturity of the remaining bonds and certificate of deposits.

Deferred tax assets

At 31 December 2006, we had deferred tax asset of approximately RMB0.1 million (2005: RMB5.1 million) arising from tax losses. The decrease was mainly due to utilisation of tax losses by TQ Digital, NetDragon (Fujian) and NetDragon (Shanghai) during the year.

TAX

We operate in the PRC and the USA, and are subject to the PRC enterprise income tax and the US income tax.

Certain of our affiliates and subsidiaries enjoy preferential tax treatments, in the form of reduced tax rates and/or tax holidays, provided by the PRC government or its local authorities or bureaus. TQ Digital is a foreign-invested enterprise located in the high technology industrial development zone approved by the State Council. Pursuant to the Circular on Some Preferential Policies for the Enterprise Income Tax (關於企業所得稅若干優惠政策的通知) issued by the Ministry of Finance (財政部) and the State Administration of Taxation (國家稅務總局) on 29 March 1994, hi-tech enterprises in the high technology industrial development zone approved by the State Council are entitled to paying the income tax at the reduced tax rate of 15%. The qualification of hi-tech enterprises are subject to review once every two years. TQ Digital has been recognised as a high-tech enterprise on 29 July 2005 and 16 August 2007 and thus is entitled to a preferential enterprise income tax of 15%.

TQ Digital was recognised as a software enterprise on 25 December 2003. Pursuant to the Circular on the Tax Policies for Encouraging the Development of Software and Integrated Circuit Industries (關於鼓勵軟件產業和集成電路產業發展有關稅收政策問題的通知) issued by the Ministry of Finance (財政部), the State Administration of Taxation (國家稅務總局) and the General Administration of Customs (海關總署) on 22 September 2000, TQ Digital can enjoy tax benefits of tax exemption for two years and a reduction in tax payable for three succeeding years. It was exempted from paying the enterprise income tax between 2003 and 2004 and has been entitled to paying the enterprise income tax at the reduced tax rate of 7.5% from 2005 to 2007.

NetDragon (Fujian) continued to be recognised as a hi-tech enterprise on 9 November 2004 and 16 August 2007. As NetDragon (Fujian) is located in the state-level high technology industrial development zone, it was entitled to paying the enterprise income tax at the reduced tax rate of 15% between 2005 and 2006. NetDragon (Fujian) was suspended to be qualified as a hi-tech enterprise during the review in 2006 though it finally obtained the qualification on 16 August 2007. As such, we consider the tax rate of enterprise income tax applicable to NetDragon (Fujian) for the year ending 31 December 2007 is 15%.

NetDragon (Shanghai) currently pays the PRC enterprise income tax at the tax rate of 33%.

The Tenth National People's Congress enacted a new Enterprise Income Tax Law on 16 March 2007, which provides for a unified income tax rate of 25% to both domestic enterprises and foreign-invested enterprises. The new tax law will become effective on 1 January 2008. As a result, the tax rate for domestic enterprises will be reduced to 25% from the previous 33%, whereas the tax rate for foreign-invested enterprises that have enjoyed preferential tax treatment, such as TQ Digital, will be increased to 25% upon the expiration of their preferential tax treatment.

NetDragon (USA), as a U.S. corporation, is subject to U.S. federal income tax at graduated rates on its net income (i.e., gross income less allowable deductions) at graduated rates that are generally 34% but that may be as high as 35%. To the extent that NetDragon (USA) pays tax to government other than that of the United States or one of the fifty States or the District of Columbia, it may be entitled to claim a credit for such tax against its U.S. federal income tax liability.

NetDragon (USA) is also subject to California State income tax at a rate of 8.84% on its net income.

TQ Digital, in addition to engaging in the development of online games, has also been providing access to users of online game, Conquer Online, in English language since 1 January 2007 and access to users of other non-Chinese language games since 1 June 2007. The fees attributable to such operations are generally not subject to any US tax.

LIQUIDITY AND CAPITAL RESOURCES

We have historically met our working capital and other capital requirements principally from cash provided by our operations and cash at hand, while raising the remainder of our capital requirements through advances from shareholders.

As of 31 December 2005 and 2006 and 30 June 2007, we had net current assets of RMB15.8 million, RMB77.3 million and RMB189.8 million, respectively. As of 31 August 2007, being the latest practicable date for the purpose of this statement, we had net current assets of RMB255.9 million. The current assets primarily comprised trade and other receivables, and cash and cash equivalents. The current liabilities primarily comprised trade and other payables, and income tax payable.

Included in other receivables as at 31 December 2006 was a balance of RMB14.5 million which was paid to a PRC entity, Guolun Holdings Limited (高能控股有限公司), an Independent Third Party, which provided us asset management services pursuant to an agreement signed in December 2006 (the "Asset Management Agreement"). In order to seek a higher return for our investors by capturing the fast growth of the PRC stock markets, we entered into the Asset Management Agreement with Guolun Holdings Limited (高能控股有限公司). Pursuant to the Asset Management Agreement, Guolun Holdings Limited (高能控股有限公司) would assist us to manage and invest a total amount of RMB14.5 million in the PRC stock market. We settled the payment of the RMB14.5 million under the Asset Management Agreement in December 2006. In view of the fluctuation of the stock markets in the PRC and to avoid disruption of the investment in the PRC stock market to our business after the Listing, TQ Digital entered into an agreement with Liu Dejian, one of our executive Directors and beneficial owner, on 27 May 2007 to dispose its rights underlying the Asset Management Agreement at a consideration of RMB14.5 million, representing our contribution under the Asset Management Agreement. Our consideration has been settled on 13 June 2007 and 13 August 2007. Guolun Holdings Limited (高能控股有限公司) has not utilised any amounts under the Asset Management Agreement to purchase any investments during the term of the Asset Management Agreement between Guolun Holdings Limited (高能控股有限公司) and us. We consider that the transactions are fair and reasonable, and on an arm's length basis. There is no previous relationship between Guolun Holdings Limited (高能控股有限公司) and us or the Directors, save as to this transaction.

Cash flows

The following table sets forth certain information regarding our consolidated cash flows for the periods indicated:

	Year ended 31 December		**Six months ended 30 June**	
	2005	**2006**	**2006**	**2007**
	(RMB'000)	*(RMB'000)*	*(RMB'000)* *(unaudited)*	*(RMB'000)*
Net cash (used in)/generated from operating activities	(18,832)	39,597	2,650	183,925
Net cash (used in)/generated from investing activities	(7,185)	(10,018)	3,918	(13,840)
Net cash (used in)/generated from financing activities	(3,465)	21,755	—	(28,857)
Net (decrease)/ increase in cash and cash equivalents	(29,482)	51,334	6,568	141,228

Net cash generated from operating activities

The net cash generated from operating activities for the six months ended 30 June 2007 increased to approximately RMB183.9 million from approximately RMB2.7 million for the same period in 2006. The increase in net cash generated from operating activities was mainly attributable to our increased profit before income tax for the six months ended 30 June 2007 from a loss for the same period in 2006.

The net cash generated from operating activities for the year ended 31 December 2006 amounted to approximately RMB39.6 million as compared with net cash used in operating activities of approximately RMB18.8 million in the year ended 31 December 2005. The increase in net cash generated from operating activities was mainly attributable to the change in loss before income tax of approximately RMB30.9 million for the year ended 31 December 2005 to a profit before income tax of approximately RMB51.5 million for the year ended 31 December 2006.

Net cash used in investing activities

Net cash used in investing activities amounted to approximately RMB13.8 million for the six months ended 30 June 2007, representing an increase of approximately 453.2% as compared to the same period in 2006. The increase was mainly due to our acquisition of property, plant and equipment, including servers, computers and vehicles purchased to manage our expanded operations.

Net cash used in investing activities amounted to approximately RMB10.0 million for the year ended 31 December 2006, representing an increase of approximately 39.4% as compared to the year ended 31 December 2005. The increase in net cash flow used in investing activities for the year ended 31 December 2006 was mainly due to an increase in the purchase of property, plant and equipment, including server purchases to cope with the increased demand of our online games.

Cash flows from financing activities

Net cash used in financing activities was approximately RMB28.9 million in the six months ended 30 June 2007, which was dividends paid to our shareholders offset by issuance of new shares. There were no financing activities in the same period in 2006.

Net cash generated from financing activities was approximately RMB21.8 million for the year ended 31 December 2006, while the net cash used in financing activities for the year ended 31 December 2005 was approximately RMB3.5 million, which was for the 2004 dividend paid by NetDragon (BVI) in 2005.

Capital resources

We generally finance our operations through internally generated cash flows. Following completion of the International Placing, our Directors expect to fund our capital and operating requirements through internally generated cash flows, the net proceeds from the International Placing and cash on hand. Our Directors believe that on a long-term basis, our liquidity will be funded from operations and, if necessary, additional equity financing or bank borrowings.

Gearing ratio is defined as total debt (interest bearing banking loans) over total assets. As we did not have any interest bearing banking loans, our gearing ratio was zero during the Active Business Pursuit Period.

Capital expenditures and commitments

Our capital expenditures were RMB3.4 million, RMB15.7 million and RMB15.2 million for the year ended 31 December 2005 and 2006 and the six months ended 30 June 2007, respectively, and were primarily attributable to the purchase of servers and computer equipment.

The following table sets out our capital commitments as of the dates indicated:

	At 31 December		At 30 June
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Contracted, but not provided for:			
- acquisition of property, plant and equipment	—	2,471	5,529

The following table sets out our operating lease commitments as of the dates indicated:

	At 31 December		At 30 June
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Within one year	1,899	2,626	3,612
In the second to fifth years	1,888	655	3,085
After five years	—	—	51
	3,787	3,281	6,748

Indebtedness

Borrowings

As at the close of business on 31 August 2007, being the latest practicable date for the purpose of the indebtedness statement prior to the printing of this prospectus, we had no outstanding borrowings.

Contingent liabilities

As at the close of business on 31 August 2007, we did not have any material contingent liabilities or guarantees.

Off-balance sheet arrangements

As at the close of business on 31 August 2007, we do not have any material off-balance sheet arrangements.

Disclaimer

Save as aforesaid or as otherwise disclosed herein and apart from any intra-group liabilities and normal trade payables, the Group did not have any outstanding bank overdrafts, loans or other similar indebtedness, debentures or other loan capital (issued or agreed to be issued), mortgages, charges, hire purchase or finance lease commitments, guarantees or other material contingent liabilities at the close of business on 31 August 2007.

No material changes

Except as noted above, our Directors have confirmed that there have been no material change in the Group's indebtedness since 31 August 2007.

Directors' opinion on sufficiency of working capital

Our Directors are of the opinion that, taking into account the internally generated resources of the Group and the estimated net proceeds from the International Placing, we have sufficient working capital for our foreseeable capital requirements for at least the next 12 months from the date of this prospectus. We may, however, require additional cash resources due to changes in business conditions or other future developments, including any investments or acquisitions we may decide to pursue.

Foreign currency exposure

Our present operations are carried out in the USA and the PRC. All our receipts and payments in relation to the operations are principally denominated in RMB and US$. In this respect, our Directors consider there is no significant currency mismatch in our operational cashflows and we are not exposed to any significant foreign currency exchange risk in our operation.

DISCLOSURE UNDER RULES 17.15 TO 17.21 OF THE GEM LISTING RULES

Our Directors have confirmed that, as at the Latest Practicable Date, our Directors were not aware of any circumstance which would give rise to a disclosure requirement under Rules 17.15 to 17.21 of the GEM Listing Rules.

DIVIDEND AND DIVIDEND POLICY

We declared approximately RMB44.8 million and RMB34.2 million dividends to our existing shareholders on 3 February 2007 and 20 June 2007, respectively. The declaration and the amount of special dividends are in the sole discretion of our Directors, subject to such factors similar to our general dividend policy as disclosed below. We had retained earnings and cash and cash equivalents of approximately RMB121.5 million and RMB206.4 million, respectively, as at 30 June 2007. Even if NetDragon (Fujian) and NetDragon (Shanghai) are excluded, we would still have retained earnings and cash and cash equivalents of approximately RMB75.0 million and RMB106.9 million, respectively, as at 30 June 2007. On this basis, we believe that we have sufficient retained profits for the special dividends declared on 3 February 2007 and 30 June 2007, respectively.

Upon Listing, we may not distribute dividends exceeding the lower of our distributable reserves as determined under PRC GAAP and those under the HKFRS.

We are a holding company incorporated in the Cayman Islands and conduct our core business operations through our PRC operating subsidiaries. As a result, our profits available for dividend distribution are dependent on the profits available for distribution from our PRC subsidiaries. The PRC laws permit payment of dividends only out of net income as determined in accordance with PRC accounting standards and regulations. Determination of net income under PRC accounting standards and regulations may differ from determination under the HKFRS in significant aspects, such as the use of different principles for recognition of revenues and expenses. Our PRC subsidiaries are required to set aside at least 10% of their net income each year to fund the designated statutory reserve fund in connection with certain mandatory social welfare programs. Such statutory reserve fund is not distributable as cash dividends. As a result, our primary source of funds for dividend payments is subject to these and other legal restrictions and uncertainties.

The declaration and the amount of dividends are in the sole discretion of our Directors, subject to our results of operations, financial condition, capital requirements and any other factors which the Board may deem relevant.

DISTRIBUTABLE RESERVES

Our profit after tax can be distributed as dividends only after our PRC subsidiaries make appropriate contributions to the statutory reserve fund. As of 30 June 2007, the Company had approximately RMB166.2 million distributable reserves.

UNAUDITED PRO FORMA NET TANGIBLE ASSETS

The following is the unaudited pro forma net tangible assets of our Group which has been prepared based on the audited consolidated net tangible assets of our Group attributable to the equity holders of the Company as at 30 June 2007, as shown in the accountants' report, the text of which is set forth in Appendix I to this prospectus, after giving effect to the pro forma adjustments described in the notes thereto. A narrative description of the pro forma adjustments of the International Placing that are (i) directly attributable to the transaction; (ii) expected to have a continuing impact on the Group; and (iii) factually supportable, are summarised in the accompanying notes.

	Audited consolidated net tangible assets of the Group attributable to the equity holders of the Company as at 30 June 2007	**Estimated net proceeds from the International Placing**	**Unaudited pro forma net tangible assets**	**Unaudited pro forma net tangible assets per Share**
	HK$'000	*HK$'000*	*HK$'000*	*HK$*
	(Note 1)			
Based on 95,600,000 Placing Shares at the Placing Price of HK$13.18 per Share, being the upper price of the price range *(Note 2)*	223,716	1,173,908	1,397,624	2.59
Based on 95,600,000 Placing Shares at the Placing Price of HK$11.18 per Share, being the lower price of the price range *(Note 3)*	223,716	990,356	1,214,072	2.25

Notes:

1. The audited consolidated net tangible assets of the Group attributable to the equity holders of the Company as at 30 June 2007 of RMB228,282,000 are translated into Hong Kong Dollars at the exchange rate of HK$1 to RMB0.98.

2. The estimated net proceeds from the International Placing are based on the Placing Price of HK$13.18 per Placing Share, after deduction of the estimated underwriting fees and related expenses in connection with the International Placing.

3. The estimated net proceeds from the International Placing are based on the Placing Price of HK$11.18 per Placing Share, after deduction of the estimated underwriting fees and related expenses in connection with the International Placing.

4. The calculation of the unaudited pro forma net tangible assets of the Group per Share is based on 540,007,860 Shares in issue after the completion of the International Placing. It has not taken into account any Shares which may fall to be issued upon the exercise of Over-allotment Option or the exercise of the options which may be granted under the Share Option Scheme as detailed in section headed "Share Option Scheme" in Appendix V to this prospectus or any Shares which may be allotted and issued or repurchased by the Company pursuant to the mandates referred to in the paragraph headed "Written resolutions of all the Shareholders passed on 15 October 2007" in the section headed "Further information about the Company" in Appendix V to this prospectus.

NO MATERIAL ADVERSE CHANGE

We confirm that there has been no material adverse change in our financial or trading position of the Company or its subsidiaries since 30 June 2007 (being the date to which our latest audited consolidated financial statements were prepared).