The following is the text of a report, prepared for the purpose of inclusion in this prospectus received from the reporting accountants, Grant Thornton, Certified Public Accountants, Hong Kong.

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23 October 2007

The Directors
NetDragon Websoft Inc.
Bear Stearns Asia Limited
First Shanghai Capital Limited

Dear Sirs,

We set out below our report on the financial information regarding NetDragon Websoft Inc. (the "Company") and its subsidiaries (collectively referred to as the "Group") for the years ended 31 December 2005 and 2006 and six months ended 30 June 2007 (the "Relevant Periods") for inclusion in the prospectus of the Company dated 23 October 2007 (the "Prospectus") in connection with the initial listing of the shares of the Company on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

The Company was incorporated in the Cayman Islands on 29 July 2004 as an exempted company with limited liability under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. Pursuant to a group reorganisation (the "Reorganisation") as fully explained in paragraph 1F headed "Group reorganisation" in Appendix V to the Prospectus, the Company has since 18 May 2007 become the ultimate holding company of the subsidiaries now comprising the Group as set out in note 1 of Section II below. Save for the Reorganisation, the Company has not carried out any other business since its date of incorporation.

All companies now comprising the Group have adopted 31 December as their financial year end date. No audited financial statements have been prepared for the Company since its date of incorporation as it has not carried out any business other than the Reorganisation. The statutory financial statements of the subsidiaries established in the People's Republic China (the "PRC") were prepared in accordance with the relevant accounting principles and financial regulations applicable to these PRC subsidiaries. The names of the statutory auditors of these PRC subsidiaries are set out in note 1 of Section II below. No audited financial statements have been prepared for the subsidiary incorporated in Hong Kong as it is newly incorporated. No audited financial statements have been prepared for other subsidiaries since their respective date of incorporation as there is no statutory audit requirement under their jurisdictions of incorporation.

For the purpose of this report we have examined the audited financial statements and, where appropriate, management accounts (the "Underlying Financial Statements") of the companies now comprising the Group for the Relevant Periods and carried out such additional procedures as we consider necessary in accordance with the Auditing Guideline 3.340 "Prospectus and the Reporting Accountant" issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA").

The financial information set out in this report, including the consolidated balance sheets of the Group and the balance sheets of the Company as at 31 December 2005, 31 December 2006 and 30 June 2007, and the consolidated income statements, the consolidated statements of changes in equity and the consolidated cash flow statements of the Group for the Relevant Periods, together with the notes thereto (collectively referred to as the "Financial Information"), have been prepared based on the Underlying Financial Statements following the basis set out in note 1 of Section II below, after making such adjustments as appropriate for the purpose of preparing our report for inclusion in the Prospectus.

The directors of the Company are responsible for the preparation and true and fair presentation of the Financial Information in accordance with Hong Kong Financial Reporting Standards ("HKFRS") issued by the HKICPA. The directors of the respective companies are responsible for the preparation and true and fair presentation of the Underlying Financial Statements. In preparing these financial statements, it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to conduct independent audit procedures on the Financial Information in accordance with Hong Kong Standards on Auditing issued by the HKICPA, to express an opinion on the Financial Information based on our audit, and to report our opinion to you.

In our opinion, the Financial Information set out below gives, for the purpose of this report, a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2005, 31 December 2006 and 30 June 2007 and of the Group's results and cash flows for the years/period then ended.

The unaudited comparative consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement of the Group for the six months ended 30 June 2006 together with the notes thereon (the "Comparative Financial Information") have been extracted from the Group's consolidated financial information for the same period which was prepared by the directors of the Company solely for the purpose of this report. We have reviewed the Comparative Financial Information in accordance with the Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the HKICPA. Our review consisted principally of making enquires of management and applying analytical procedures to the Comparative Financial Information and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the Comparative Financial Information. On the basis of our review which does not constitute an audit, we are not aware of any material modifications that should be made to the Comparative Financial Information.

I. FINANCIAL INFORMATION

CONSOLIDATED INCOME STATEMENTS

		Year ended 31 December		Six months ended 30 June	
	Notes	**2005**	**2006**	**2006**	**2007**
		RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
				(unaudited)	
Revenue - turnover	7	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	7	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	8	(15,464)	(12,835)	(5,463)	(13,137)
Other operating expenses		(8,501)	(15,377)	(5,660)	(13,248)
Operating (loss)/profit	8	(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)	11	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
Dividends	12	—	—	—	79,069
		RMB cents	*RMB cents*	*RMB cents*	*RMB cents*
(Loss)/Earnings per share	13				
- attributable to the equity holders of the Company		(7.29)	10.70	(0.69)	34.79

CONSOLIDATED BALANCE SHEETS

	Notes	At 31 December 2005 RMB'000	At 31 December 2006 RMB'000	At 30 June 2007 RMB'000
ASSETS AND LIABILITIES				
Non-current assets				
Property, plant and equipment	14	13,738	23,211	34,815
Interest in an associate	15	430	—	—
Available-for-sale financial asset	16	4,000	4,000	4,000
Deferred tax assets	24	6,046	201	54
		24,214	27,412	38,869
Current assets				
Investment in trading securities	16	4,599	851	453
Trade and other receivables	17	9,953	40,354	45,513
Amounts due from related parties	23(iii)	5,530	11,357	3,293
Tax recoverable		—	—	3,051
Cash and cash equivalents	18	15,277	66,322	206,406
		35,359	118,884	258,716
Current liabilities				
Trade and other payables	19	17,103	37,910	54,145
Amounts due to related parties	23(iii)	2,156	725	669
Income tax payable		345	2,954	14,112
		19,604	41,589	68,926
Net current assets		15,755	77,295	189,790
Total assets less current liabilities/Net assets		39,969	104,707	228,659
EQUITY				
Share capital	21(b)	1,650	1,650	3,506
Reserves	22(b)	38,319	102,928	224,776
Equity attributable to the equity holders of the Company		39,969	104,578	228,282
Minority interests		—	129	377
Total equity		39,969	104,707	228,659

BALANCE SHEETS

		At 31 December		At 30 June
	Notes	**2005**	**2006**	**2007**
		RMB'000	*RMB'000*	*RMB'000*
ASSETS				
Non-current assets				
Investment in a subsidiary	22(a)	—	—	167,871
Current assets				
Amounts due from related parties	23(iii)	1,453	1,453	—
Amount due from a subsidiary	20	—	—	1,813
		1,453	1,453	1,813
Net assets		1,453	1,453	169,684
EQUITY				
Share capital	21(a)	1,453	1,453	3,506
Reserve	22(a)	—	—	166,178
Total equity		1,453	1,453	169,684

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

	Attributable to the equity holders of the Company									
	Share capital *RMB'000*	Share premium *RMB'000* *(note 22(b)(i))*	Capital contribution *RMB'000*	Capital reserve *RMB'000* *(note 22(b)(ii))*	Statutory reserves *RMB'000* *(note 22(b)(iii))*	Translation reserve *RMB'000*	Retained profits *RMB'000*	Total *RMB'000*	Minority interests *RMB'000*	Total equity *RMB'000*
At 1 January 2005	1,650	16,267	—	11,399	2,676	177	37,156	69,325	29	69,354
Exchange difference arising on translation of overseas operations/Expense recognised directly in equity	—	—	—	—	—	(185)	—	(185)	—	(185)
Loss for the year	—	—	—	—	—	—	(29,171)	(29,171)	(29)	(29,200)
Total recognised income and expense for the year	—	—	—	—	—	(185)	(29,171)	(29,356)	(29)	(29,385)
At 31 December 2005 and 1 January 2006	1,650	16,267	—	11,399	2,676	(8)	7,985	39,969	—	39,969
Exchange difference arising on translation of overseas operations/Expense recognised directly in equity	—	—	—	—	—	(2)	—	(2)	—	(2)
Profit for the year	—	—	—	—	—	—	42,856	42,856	129	42,985
Total recognised income and expense for the year	—	—	—	—	—	(2)	42,856	42,854	129	42,983
Capital received in advance (note 22(b)(i))	—	—	21,755	—	—	—	—	21,755	—	21,755
Appropriations	—	—	—	—	4,092	—	(4,092)	—	—	—
At 31 December 2006 and 1 January 2007	1,650	16,267	21,755	11,399	6,768	(10)	46,749	104,578	129	104,707
Exchange difference arising on translation of overseas operations/Income recognised directly in equity	—	—	—	—	—	175	—	175	—	175
Profit for the period	—	—	—	—	—	—	153,839	153,839	248	154,087

	Attributable to the equity holders of the Company									
	Share capital	Share premium	Capital contribution	Capital reserve	Statutory reserves	Translation reserve	Retained profits	Total	Minority interests	Total equity
	RMB'000	*RMB'000 (note 22(b)(i))*	*RMB'000*	*RMB'000 (note 22(b)(ii))*	*RMB'000 (note 22(b)(iii))*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Total recognised income and expense for the period	—	—	—	—	—	175	153,839	154,014	248	154,262
Issue of shares by the Company (note 21(a)(iv))	—	—	—	360	—	—	—	360	—	360
Issue of shares by a subsidiary (note 21(b) note 22(b)(i))	170	69,984	(21,755)	—	—	—	—	48,399	—	48,399
Dividend declared (note 12)	—	—	—	—	—	—	(79,069)	(79,069)	—	(79,069)
Arising from Shares Swap (note 1)	1,686	—	—	(1,813)	—	127	—	—	—	—
At 30 June 2007	3,506	86,251	—	9,946	6,768	292	121,519	228,282	377	228,659
For the six months ended 30 June 2006 (unaudited)										
At 1 January 2006	1,650	16,267	—	11,399	2,676	(8)	7,985	39,969	—	39,969
Exchange difference arising on translation of overseas operations/Expense recognised directly in equity	—	—	—	—	—	(129)	—	(129)	—	(129)
Loss for the period	—	—	—	—	—	—	(2,780)	(2,780)	—	(2,780)
Total recognised income and expense for the period	—	—	—	—	—	(129)	(2,780)	(2,909)	—	(2,909)
At 30 June 2006	1,650	16,267	—	11,399	2,676	(137)	5,205	37,060	—	37,060

CONSOLIDATED CASH FLOW STATEMENTS

	Year ended 31 December		Six months ended 30 June	
	2005	**2006**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
			(unaudited)	
Cash flows from operating activities				
(Loss)/Profit before income tax	(30,921)	51,543	(1,280)	172,266
Adjustments for:				
Gain on disposal of an available-for-sale financial asset	(54)	—	—	—
Loss on disposal of an associate	—	2	—	—
Fair value gain on investment in trading securities	—	(383)	(152)	(104)
Interest income	(392)	(614)	(138)	(851)
Depreciation of property, plant and equipment	3,958	4,457	1,934	3,569
Write off of property, plant and equipment	517	795	—	—
Loss on disposal of property, plant and equipment	112	466	8	20
Impairment on trade receivables	2	416	379	347
Foreign exchange differences	443	287	(49)	1,319
	(26,335)	56,969	702	176,566
Increase in trade and other receivables	(3,010)	(30,817)	(6,861)	(5,506)
(Increase)/Decrease in amounts due from related parties	(1,497)	(5,827)	(97)	6,611
Increase in trade and other payables	10,121	20,807	12,557	16,235
Increase/(Decrease) in amounts due to related parties	1,895	(1,431)	(1,968)	(56)
Cash (used in)/generated from operating activities	(18,826)	39,701	4,333	193,850
Income tax paid	(6)	(104)	(1,683)	(9,925)
Net cash (used in)/generated from operating activities	(18,832)	39,597	2,650	183,925

	Year ended 31 December		Six months ended 30 June	
	2005	2006	2006	2007
	RMB'000	*RMB'000*	*RMB'000* *(unaudited)*	*RMB'000*
Cash flows from investing activities				
Interest received	392	614	138	851
Proceed from disposal of an available-for-sale financial assets	630	—	—	—
Proceed from disposal of an associate	—	428	—	—
Proceeds from disposal of property, plant and equipment	243	526	215	10
Net cash (used in)/generated from investment in trading securities	(4,599)	4,131	4,751	502
Investment in an associate	(430)	—	—	—
Purchase of property, plant and equipment	(3,421)	(15,717)	(1,186)	(15,203)
Net cash (used in)/generated from investing activities	(7,185)	(10,018)	3,918	(13,840)
Cash flows from financing activities				
Issue of shares by the Company (note 21(a)(ii)&(iv))	—	—	—	1,813
Issue of shares by a subsidiary (note 22(b)(i))	—	21,755	—	48,399
Dividend paid (note 12)	(3,465)	—	—	(79,069)
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
Cash and cash equivalents at beginning of year/period	45,393	15,277	15,277	66,322
Effect of foreign exchange rate changes	(634)	(289)	(79)	(1,144)
Cash and cash equivalents at end of year/period	15,277	66,322	21,766	206,406

II. NOTES TO THE FINANCIAL INFORMATION

1. Formation of the Group and basis of presentation

The Company was incorporated in the Cayman Islands on 29 July 2004 as an exempted company with limited liability. The registered office of the Company is situated at Scotia Centre, 4th Floor, P.O. Box 2804, George Town, Grand Cayman, Cayman Islands. The Group is principally engaged in online game development and operation and marketing of those online games. At the date of this report, the particulars of the subsidiaries which the Company has direct or indirect interests are set out as follows:

Name	Place and date of incorporation/ establishment and kind of legal entity	Particulars of issued and fully paid share capital/ registered capital	Effective interest held by the Company	Principal activities	Name of the statutory auditors for 2005 and 2006
Interests held directly					
NetDragon Websoft Inc. ("NetDragon (BVI)")	Incorporated on 8 January 2003 in the British Virgin Islands ("BVI"), limited liability company	US$222,203.93	100%	Investment holding	No statutory audit requirements
Interests held indirectly					
福建網龍計算機網絡信息技術有限公司 (Fujian NetDragon Websoft Co., Ltd.*), formerly known as 福州網龍計算機網絡信息技術有限公司 ("NetDragon (Fujian)")	Established on 25 May 1999 in the PRC, limited liability company	RMB10,000,000	99.36%Δ	Operation of online games	福建華興有限責任會計師事務所 (Fujian Huaxing Certified Public Accountants Ltd.)
Fujian TQ Digital Inc (福建天晴數碼有限公司), formerly known as Fujian TQ Digital Ind (福建天晴數碼有限公司) and Fuzhou TQ Digital Ind (福州天晴數碼有限公司) ("TQ Digital")	Established on 28 February 2003 in the PRC, wholly-owned foreign enterprise #	RMB45,000,000	100%	Development of online games and licensing and servicing of the developed games	福建華興有限責任會計師事務所 (Fujian Huaxing Certified Public Accountants Ltd.)
上海天坤數碼科技有限公司 (Shanghai Tiankun Digital Technology Ltd.*) ("NetDragon (Shanghai)")	Established on 20 December 2004 in the PRC, limited liability company	RMB1,000,000	99.36%Δ	Provision of support services to a group company in the PRC	上海驍天誠會計師事務所有限公司 (Shanghai Xiao Tian Cheng Certified Public Accountants Co., Ltd.)
NetDragon Websoft Inc. ("NetDragon (USA)")	Incorporated on 10 July 2003 in the United States of America ("USA"), domestic stock corporation	US$600,000	100%	Provision of support services to a group company in the USA *(note)*	No statutory audit requirements
NetDragon Websoft (Hong Kong) Limited (網龍香港有限公司) ("NetDragon (HK)")	Incorporation on 28 June 2007 in Hong Kong, limited liability company	HK$1	100%	Dormant	Not applicable

Note: NetDragon (USA) was engaged in operation of online games before 1 June 2007.

* for identification purpose only

converted to a wholly-owned foreign enterprise on 28 November 2003

Δ interest existed by virtue of certain contractual arrangements as described in the following paragraphs

The formation of the Group is attributable to the following major events which are part of the Reorganisation:

(i) On 18 May 2007, in consideration for the shareholders of NetDragon (BVI) transferring the entire issued share capital in NetDragon (BVI), the then ultimate holding company of TQ Digital and NetDragon (USA), to the Company, an aggregate of 19,553,727 common shares of US$0.01 each and 2,666,666 preferred shares of US$0.01 of the Company were allotted and issued to the shareholders of NetDragon (BVI) (the "Shares Swap"). The total number of new shares issued by the Company is identical to the total number of shares of NetDragon (BVI) and the total number of shares of the Company in issue on that date.

(ii) On 28 September 2007 and 15 October 2007, TQ Digital entered into certain agreements with NetDragon (Fujian) and the equity holders of NetDragon (Fujian) (the "Structure Contracts") which took effect on 1 January 2007. As a result of the Structure Contracts, NetDragon (Fujian) and its wholly-owned subsidiary, NetDragon (Shanghai), are controlled by TQ Digital and accordingly, the results of NetDragon (Fujian) and NetDragon (Shanghai) are consolidated in the financial statements of the Group in accordance with Hong Kong Accounting Standard 27 "Consolidated and Separate Financial Statements" ("HKAS 27") issued by the HKICPA.

Pursuant to the Structure Contracts, a management committee (the "Management Committee") is set up to oversee the business and operation of the online game business conducted by TQ Digital and NetDragon (Fujian), including supervision of their day-to-day operations, management of manpower resources allocation between TQ Digital and NetDragon (Fujian), supervision of matters related to staff recruitment and training, approval and monitoring of the daily expenditure and payments of NetDragon (Fujian), formulation of the business plan of NetDragon (Fujian) and providing guidance and recommendations to NetDragon (Fujian) in respect of its strategic development, imposing restrictions on certain activities such as disposal or acquisition of assets or rights and creating security interests over NetDragon (Fujian)'s assets or intellectual property to third parties, and procurement of the provision of various services provided by TQ Digital to NetDragon (Fujian) in exchange for fees as further explained in the following paragraph. The Management Committee effectively governs the financial and operating activities of NetDragon (Fujian). Since the Management Committee is ultimately controlled by TQ Digital by virtue of its power to appoint or remove all the members of the Management Committee, TQ Digital is in a position to govern the financial and operating policies of NetDragon (Fujian).

Through certain commercial arrangements (the "Commercial Arrangements") attached to the Structure Contracts, TQ Digital is able to obtain economic benefits from the operation of NetDragon (Fujian). Under the Commercial Arrangements, TQ Digital provides software licenses, technical support service and software development service to NetDragon (Fujian) in return for fees which represent a substantial amount of the revenue generated by NetDragon (Fujian) from the operation of online game business. In addition, according to the Structure Contracts, NetDragon (Fujian) is obliged to maintain its net asset value at the amount not exceeding its net asset value as at 31 December 2006 determined in accordance with the PRC accounting standards or as adjusted based on the accounting principles generally accepted in Hong Kong (approximately RMB15,000,000) and the Management Committee is authorised to review the financial position of NetDragon (Fujian) regularly and to carry out the necessary measures to procure the fulfilment of such obligation by NetDragon (Fujian). As a result of the above arrangements, TQ Digital is entitled to substantially all of the operating profits generated by NetDragon (Fujian).

Despite the lack of shareholding in NetDragon (Fujian), the agreements entered into by TQ Digital and the equity holders of NetDragon (Fujian) confer TQ Digital the power and authority to exercise control over NetDragon (Fujian). Pursuant to the agreements:

- all the equity holders of NetDragon (Fujian) have granted irrevocable proxy to TQ Digital or a nominee designated by TQ Digital (which will likely be a director of TQ Digital) to exercise all their voting right in the capacity of shareholders of NetDragon (Fujian);
- the equity holders of NetDragon (Fujian) have agreed not to enter into any transaction that may materially affect the assets, liabilities, equity or operations of NetDragon (Fujian) without the prior written consent of TQ Digital;
- the equity holders of NetDragon (Fujian) have agreed not to transfer, sell, pledge, dispose of or create any encumbrance on their equity interest in NetDragon (Fujian) without the prior written consent of TQ Digital;
- NetDragon (Fujian) will not distribute any dividend; and
- the equity holders of NetDragon (Fujian) have pledged their equity interest in NetDragon (Fujian) to TQ Digital as a security against its payment obligations and other obligations and covenants under the Structure Contracts.

The Structure Contracts taken as a whole allow TQ Digital to govern the financial and operating policies of NetDragon (Fujian) and TQ Digital is able to obtain substantially all economic benefits from the activities conducted by NetDragon (Fujian). Accordingly, the directors of the Company regard NetDragon (Fujian) and NetDragon (Shanghai) as the subsidiaries of the Group as defined under HKAS 27.

As the Company, NetDragon (BVI), TQ Digital, NetDragon (USA), 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 as set out in Accounting Guideline 5 "Merger accounting under common control combination" issued by the HKICPA. As further explained in note 3(a) below, the Financial Information presents the combined results, combined changes in equity, combined cash flows and combined financial positions of the companies now comprising the Group as if the current group structure had been in existence on 1 January 2005, the beginning of the earliest period presented.

As at 31 December 2005 and 2006, the Reorganisation was not yet completed. The share capital of the Group as at 31 December 2005 and 2006 represented the share capital of NetDragon (BVI), being the holding company of TQ Digital and NetDragon (USA) as at those dates as well as the holding company of NetDragon (Fujian) and NetDragon (Shanghai) by virtue of the Structure Contracts. Upon the formation of the Group on 18 May 2007 as a result of the Shares Swap which took effect on the same date, the Company became the holding company of the Group and the share capital in the consolidated balance sheet as at 30 June 2007 represented the share capital of the Company. Minority interests represent the portion of profit or loss and net assets attributable to those equity owners outside the Group during the Relevant Periods.

2. Basis of preparation

The Financial Information has been prepared in accordance with HKFRS which includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Interpretations issued by the HKICPA. It has been prepared under the historical cost convention except for the revaluation of certain financial assets and financial liabilities which are stated at fair value. The measurement bases are fully described in the accounting policies below.

The Group has not issued any financial statements prior to this report since the Company was incorporated on 29 July 2004. The HKICPA issued a number of new and revised HKFRS which are effective during the Relevant Periods and in preparing and presenting the Financial Information, the Group has adopted all these new and revised HKFRS consistently throughout the Relevant Periods.

The Group has not applied the following new and revised HKFRS that have been issued but are not yet effective:

HKFRS 8	Operating Segments[1]
HKAS 23 (revised)	Borrowing costs[1]
HK(IFRIC)-INT 11	HKFRS 2 - Group and Treasury Share Transactions[2]
HK(IFRIC)-INT 12	Service Concession Arrangements[3]
HK(IFRIC)-INT 13	Customer Loyalty Programmes[4]
HK(IFRIC)-INT 14	HKAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction[3]

1 Effective for annual periods beginning on or after 1 January 2009

2 Effective for annual periods beginning on or after 1 March 2007

3 Effective for annual periods beginning on or after 1 January 2008

4 Effective for annual periods beginning on or after 1 July 2008

The Group is in the process of assessing the impact of these new or revised HKFRS and based on a preliminary assessment, these new or revised HKFRS would not have material effect on the Financial Information of the Group.

It should be noted that accounting estimates and assumptions have been used in preparing the Financial Information. Although these estimates are based on management's best knowledge and judgement of current events and actions, actual results may ultimately differ from those estimates and assumptions. The areas where assumptions and estimates are significant to the Financial Information or areas involving higher degree of judgement or complexity are set out in note 4.

3. Significant accounting policies

(a) *Merger accounting*

The net assets of the combining entities or businesses are combined using the existing book values from the controlling parties' perspective. No amount is recognised as consideration for goodwill or excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost at the time of common control combination. The Financial Information includes the results of each of the combining entities or businesses from the date of incorporation/establishment or since the date when the combining entities or businesses first came under the common control, where this is a shorter period, regardless of the date of the common control combination. All significant intra-group transactions, balances and unrealised gains on transactions have been eliminated on combination. Unrealised losses are also eliminated unless the transactions provide evidence of an impairment of the asset transferred.

(b) *Subsidiary*

A subsidiary is an entity (including special purpose entity) over which the Company has power to govern its financial and operating polices, generally accompanying a shareholding of more than one half of the voting rights, so as to obtain benefits from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Purchase method of accounting is used to account for the acquisition of subsidiaries by the Group, except for those acquisitions which qualify as a common control combination, which are accounted for using merger accounting (note 3(a)).

(c) *Associates*

An associate is an entity over which the Group is able to exercise significant influence, generally accompanying a shareholding of between 20% and 50% of the voting rights. An investment in an associate is accounted for in the Financial Information under the equity method of accounting and is initially recorded at cost and adjusted thereafter for the post-acquisition changes in the Group's share of the associate's net assets less any identified impairment losses. The Financial Information include the Group's share of the post-acquisition, post-tax results of the associate for the year.

(d) *Property, plant and equipment*

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment losses.

The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the items of property, plant and equipment have been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in future economic benefits expected to be obtained from the use of the item of property, plant and equipment, and where the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

Depreciation is calculated on a straight-line basis to write off the cost of each item of property, plant and equipment over its estimated useful life, after taking into account its estimated residual value. The principal annual rates used for this purpose is as follows:

Leasehold improvements	shorter of the lease terms and 20%
Computer and office equipment	19% - 20%
Motor vehicles	19%

Useful lives, residual values and depreciation methods are reviewed and adjusted, if appropriate, at each financial year end.

An item of property, plant and equipment is derecognised upon disposal or when no further economic benefits are expected to arise from the continued use of the item. Any gain or loss arising on derecognising the item (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the period the item is derecognised.

(e) *Operating leases*

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Group is the lessee, rentals payable under the operating leases are charged to the income statement on the straight-line basis over the lease terms.

(f) *Foreign currencies*

Items included in the financial statements of each of the group entities are measured using the currency of the primary economic environment in which the group entity operates (i.e. the "functional currency"). The Financial Information is presented in Renminbi ("RMB"), which is the functional and presentation currency of the Company and most of its subsidiaries.

In preparing the financial statements of individual group entity, transactions in currencies other than the group entity's functional currency (i.e. foreign currency) are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are not translated.

For the purpose of preparing the Financial Information, the assets and liabilities of the subsidiaries which functional currency is not RMB are translated into RMB at the exchange rates ruling at the balance sheet date, and their income statements are translated into RMB at the weighted average exchange rates for the year. Foreign exchange gains and losses arising thereon are dealt with in the translation reserve. Such translation differences are recognised in the income statement in the period in which the foreign operation is disposed of.

(g) *Impairment of non-financial assets*

Where an indication of impairment exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount.

An asset's recoverable amount is the higher of its fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Where the carrying amount of an asset/a cash-generating unit exceeds its recoverable amount, the asset/cash-generating unit is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset/cash-generating unit. An impairment loss is charged to the income statement in the period in which it arises.

A previously recognised impairment loss on non-financial assets other than goodwill is reversed only if there has been a change in the estimates used to determine the recoverable amount of that asset/cash-generating unit, provided the increased amount of the asset/cash-generating unit does not exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset/cash-generating unit in prior years. Such reversal is credited to the income statement in the period in which it arises.

(h) *Financial assets*

The Group's financial assets are classified into financial assets at fair value through profit or loss, available-for-sale financial assets and loans and receivables. Management determines the classification of its financial assets at initial recognition depending on the purpose for which the financial assets were acquired and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

All financial assets are recognised when, and only when, the Group becomes a party to the contractual provisions of the instrument. All regular way purchases and sales of financial assets are recognised on trade date. Regular way purchase or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. Derecognition of financial assets occurs when the rights to receive cash flows from the investments expire or are transferred and substantially all of the risks and rewards of ownership have been transferred.

(i) *Financial assets at fair value through profit or loss*

Financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss are classified as financial assets at fair value through profit or loss. Financial assets are treated as held for trading if they are acquired for the purpose of sale in the near term. Financial assets at fair value through profit or loss are subsequently measured at fair value with changes in fair value being charged to the income statement. In the Financial Information, securities held for trading that are categorised as financial assets at fair value through profit or loss are presented as "Investment in trading securities" under current assets in the balance sheet.

(ii) *Loans and receivables*

Loans and receivables including trade and other receivables and amounts due from related parties are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Trade receivables are included in current assets. Other loans and receivables are included in current assets unless they are expected not to be realised within 12 months after the balance sheet date and in such case, they are classified as non-current assets in the balance sheet.

Loans and receivables are subsequently carried at amortised cost using the effective interest method, less any impairment losses. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction cost. Changes in value of loans and receivables through the amortisation process are recognised in the income statement.

(iii) *Available-for-sale financial assets*

Available-for-sale financial assets are non-derivative financial assets that are either designated or not classified in any other categories of financial assets. They are included in non-current assets unless management intends to dispose of the assets within 12 months from the balance sheet date.

After initial recognition, available-for-sale financial assets are measured at fair value. Changes in fair value are recognised as a separate component of equity until they are disposed of or determined to be impaired, at which time the cumulative loss previously recognised in equity is removed from equity and recognised in the income statement.

For available-for-sale equity investment which fair value cannot be measured reliably because (1) the variability in the range of reasonable fair value estimates is significant for that investment and (2) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such investment is stated at cost less any impairment losses.

(i) ***Impairment of financial assets***

The Group assesses at each balance sheet date whether there is objective evidence that a financial assets or a group of financial assets is impaired. If such evidence exists, the impairment loss is measured and recognised as follows:

(i) *Loans and receivables*

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The amount of impairment loss is recognised in the income statement of the period in which the impairment occurs. In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Group will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of loans and receivables is directly reduced by any identified amount of impairment. Impaired debts are derecognised when they are assessed as uncollectible.

If, in subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed to the extent that it does not result in a carrying amount of the financial asset exceeding what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal is recognised in the income statement of the period in which the reversal occurs.

(ii) *Available-for-sale financial assets measured at fair value*

If any such evidence exists for available-for-sale financial assets, the cumulative loss, measured as the difference between the asset's acquisition cost and the current fair value less any impairment loss on that asset previously recognised in the income statement, is transferred from equity to the income statement. Impairment losses on equity instruments classified as available-for-sale are not reversed through the income statement.

(iii) *Available-for-sale financial assets measured at cost*

If there is objective evidence that an impairment loss on an unquoted investment that is not carried at fair value has been incurred, the amount of impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed in subsequent periods.

(j) *Cash and cash equivalents*

Cash and cash equivalents consist of cash on hand and at bank, demand deposits with banks, cash deposited with an online payment service provider which can be readily withdrawn and short-term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

(k) *Financial liabilities*

Financial liabilities include trade and other payables as well as amounts due to related parties which are initially stated at fair value and subsequently carried at amortised cost using the effective interest method. Changes in value of financial liabilities through the amortisation process are recognised in the income statement.

(l) *Provisions and contingent liabilities*

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation. When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group, are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(m) *Income tax*

Income tax comprises current and deferred tax. Income tax is recognised in the income statement, or in equity if it relates to items that are recognised in the same or a different period directly in equity.

Current tax assets and liabilities for the current year and prior periods are measured at the amounts expected to be recovered from or paid to the taxation authorities.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised for all deductible temporary differences, unused tax losses available to be carried forward as well as other unused tax credits, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, the unused tax credits and the unused tax losses can be utilised.

Deferred tax assets and liabilities are not recognised if temporary differences arise from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

Deferred tax liabilities in respect of taxable temporary differences associated with an investment in subsidiaries are not recognised where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred asset to be utilised. Conversely, previously unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it is probable that sufficient taxable profits will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax is calculated at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

(n) *Revenue recognition*

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before the revenue is recognised:

(i) The Group sells pre-paid game cards to distributors and online game players. With the pre-paid game cards, online game players can credit their online game accounts with game points which can be used for the consumption of certain online games of the Group or for purchasing virtual products or premium features for the consumption of other online games of the Group which are free-to-play. The game users can also credit their online game accounts by direct payment. Such income received is deferred and recorded as deferred income under current liabilities and would be recognised as revenue (i.e. online game revenue) upon the actual usage of the game points. Revenue recognised in respect of operating the online games is net of any discounts, business tax and other related taxes and charges.

(ii) Game development fee which arises from developing online games for customers is recognised as revenue by reference to the stage of completion of developing the respective online game. As game development fee is non-recurring revenue and developing online games for outsider is not a principal activity of the Group, such fee income is recognised as other revenue.

(iii) Interest income is recognised on a time-proportion basis using the effective interest method.

(iv) Grants from government are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as other revenue and presented as such over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate.

(o) ***Cost of revenue***

Cost of revenue consist primarily of rental and maintenance fees of computer equipment and software, fees in respect of internet services, handling charges for online payment services, manufacturing costs for pre-paid game cards and depreciation, which are recognised in the income statement upon utilisation of the relevant services or when the relevant costs are incurred, as appropriate.

(p) ***Development costs***

Expenditure incurred on projects to develop new products is charged to the income statement as incurred unless the Group can demonstrate the technical feasibility of completing the projects so that the asset generated will be available for use or sale, its intention to complete the projects and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the project and the ability to measure reliably the expenditure during the development. In such case, development expenditure is capitalised and deferred as intangible asset, and is amortised over its estimated useful life.

(q) ***Pension obligations***

In accordance with the rules and regulations in the PRC, the employees of the entities established in the PRC participate in defined contribution retirement benefits plans organised by regional governments. The regional governments undertake to assume the retirement benefit obligations of all existing and future retired employees payable under the retirement benefit obligations of all existing and future retired employees payable under the plan described above. Contributions to these plans are expensed as incurred and other than these monthly contributions, the Group has no further obligation for the payment of retirement benefits of its employees. The assets of these plans are held separately from those of the Group in an independent fund managed by the PRC government.

The Group's contributions to the defined contribution retirement benefit plan are not reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions.

(r) ***Share capital***

Ordinary shares and non-redeemable preferred shares with discretionary dividends are classified as equity. Any transaction costs associated with the issuing of shares are deducted from share premium to the extent they are incremental costs directly attributable to the equity transactions.

(s) ***Dividends***

Dividends proposed by the directors of the group entities are classified as a separate allocation of retained profits within the equity section of the balance sheet, until they have been approved by the then equity holders of the group entities in a general meeting. When these dividends have been approved by the then equity holders and declared, they are recognised as a liability.

(t) ***Related parties***

A party is considered to be related to the Group if:

(i) the party, directly or indirectly through one or more intermediaries, (1) controls, is controlled by, or is under common control within, the Group; (2) has an interest in the Group that gives it significant influence over the Group; or (3) has joint control over the Group;

(ii) the party is a member of the key management personnel of the Group or its parent;

(iii) the party is a close member of the family of any individual referred to in (i) or (ii);

(iv) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (ii) or (iii); or

(v) the party is a post-employment benefit plan for the benefit of the employees of the Group, or of any entity that is a related party of the Group.

4. Critical accounting estimates and judgements

In the process of applying the Group's accounting policies, which are described in note 3, management has made various estimates and judgements which are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Estimates and judgements are continually evaluated. The key source of estimation uncertainty and accounting judgements that result in significant risk of causing a material adjustment to the carrying amount of assets and liabilities in the next financial year or significantly affect the amounts recognised in the Financial Information are discussed below:

(i) ***Online game revenue recognition***

Online game revenue is recognised based on the actual consumption of the relevant game points. Income received in respect of unutilised game points including those arising from unactivated pre-paid game cards is recognised as deferred income. Online game income received is net of discounts given to certain distribution and payment channels. The amount of deferred income arising from unactivated pre-paid game cards is extracted from the accounting system of the Group. As to the amount of deferred income in respect of other unutilised game points, management's estimation is required in determining the average sales value of these unutilised game points as discounts given are different for different sales channels.

In assessing the amount of average sales value for the unutilised game points, management considers the discount rate applicable to each of the distribution and payment channels and the mix of income received via different distribution and payment channels. Based on these factors, management determines an average discount rate which gives rise to the best estimate of the discount given to those unutilised game points at year end. The average sales value of each game point is then determined by factoring the average discount rate to the face value of the game point. If the actual sales value of the unutilised game points differs from management's estimates, the amount of deferred income as well as online game revenue recognised would be affected.

(ii) ***Subsidiary***

As detailed in note 1, NetDragon (Fujian) and NetDragon (Shanghai) are accounted for as subsidiaries as a consequence of the Structure Contracts. Significant judgements have been exercised by the management in assessing and concluding that NetDragon (Fujian) and NetDragon (Shanghai) are subsidiaries of the Group.

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

The Group's management determines the estimated useful lives for the property, plant and equipment of the Group. This estimate is based on the historical experience of the actual useful lives of the relevant assets of similar nature and functions. The estimated useful lives could be different as a result of technical innovations which could affect the related depreciation charges included in the income statement.

(iv) ***Impairment of receivables***

The Group's management determines the provision for impairment of receivables. This estimate is based on the credit history of the customers and other debtors and the current market condition. Management will reassess the provision at each balance sheet date. The Group's estimates may be inaccurate and any changes in estimates would affect profit or loss in future years.

(v) ***Estimates of current and deferred tax***

The Group is subject to taxation in various jurisdictions. Significant judgement is required in determining the amount of provision for taxation and the timing of payment of the related taxation. Where the final tax outcome is different from the amounts that were initially recorded, such differences would impact the income and deferred tax provisions in the period in which such determination were made.

5. Financial risk management and capital management

5.1 Financial risk management

The Group is exposed to a variety of financial risks: market risk (including foreign currency risk, interest rate risk and price risk), credit risk and liquidity risk. The Group's overall risk management focuses on unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. Risk management is carried out by key management under the policies approved by the board of directors. The Group does not have written risk management policies. However, the board of directors meet regularly and co-operate closely with key management to identify and evaluate risks and to formulate strategies to manage financial risks.

(a) *Market risk*

(i) *Foreign currency risk*

The Group mainly operates in the PRC with majority of the business transactions being denominated and settled in RMB. The Group also has operations in the USA and the business transactions conducted there during the Relevant Periods were mainly denominated and settled in US dollars, which is the functional currency of the relevant subsidiary. In the opinion of the management, the Group's exposure to foreign currency risk is minimal.

(ii) *Interest rate risk*

The Group has no external borrowing. The Group is exposed to fair value interest rate risk through the impact of rate changes on interest-bearing financial assets, mainly the cash and cash equivalents. However, the Group's income and operating cash flows are substantially independent of changes in market interest rates. Management considers that the interest rate risk encountered by the Group is currently not significant.

(iii) *Price risk*

The Group is exposed to equity security price risk because of the available-for-sale investment and trading securities held by the Group. However, in the opinion of the management, the Group's exposure to equity security price risk is insignificant. The Group is not exposed to commodity price risk.

(b) *Credit risk*

Credit risk arises from cash and cash equivalents, trade receivables, other receivables and amounts due from related parties. The Group limits its exposure to credit risk by rigorously selecting the counterparties. The Group's exposure to credit risk is summarised as follows:

	At 31 December		**At 30 June**
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Cash and cash equivalents	15,277	66,322	206,406
Trade receivables	1,131	6,200	22,664
Other receivables	2,206	18,837	2,931
Amounts due from related parties	5,530	11,357	3,293

The carrying amount of cash and cash equivalents, trade receivables, other receivables and amounts due from related parties represent the Group's maximum exposure to credit risk.

Credit risk on cash and cash equivalents is mitigated as cash is deposited in banks with high credit rating and reputable online payment service provider. Credit risk on trade receivables, other receivables and amounts due from related parties is minimised as the Group performs ongoing credit evaluation on the financial condition of its debtors and tightly monitors the ageing of the receivable balances. Follow up action is taken in case of overdue balances. In addition, management reviews the recoverable amount of the receivables individually or collectively at each balance sheet date to ensure that adequate impairment losses are made for irrecoverable amounts.

None of the Group's financial assets are securitised by collateral or other credit enhancements.

(c) *Liquidity risk*

Management of the Group aims at maintaining sufficient level of cash and cash equivalents to finance the Group's operations and expected expansion. The Group's primary cash requirements include payments for operating expenses and additions or upgrades of property, plant and equipment. The Group finances its working capital requirements mainly by the funds generated from operations.

All the financial liabilities of the Group will be settled within 12 months from the respective reporting date. The Group manages liquidity risk by forecasting the amount of cash required and monitoring the working capital of the Group to ensure that all liabilities due and known funding requirements could be met. Based on the assessment of the management, liquidity risk encountered by the Group is minimal.

5.2 Capital management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders, to maintain an optimal capital structure to reduce the cost of capital and to support the Group's stability and growth.

The Group actively and regularly reviews and manages its capital structure to ensure optimal capital structure and shareholder returns, taking into consideration the future capital requirements of the Group. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, issue new shares or return capital to shareholders.

Management regards total equity as capital. The amount of capital as at 31 December 2005, 31 December 2006 and 30 June 2007 amounted to RMB39,969,000, RMB104,707,000 and RMB228,659,000 respectively, which the management considers as optimal having consider the projected capital expenditures and the projected strategic investment opportunities.

5.3 Fair value estimation

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price. The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. The fair value of debt securities is determined using the method of estimated discounted cash flows.

The carrying value of trade and other receivables, trade and other payables and cash equivalents are assumed to approximate their fair values due to the short-term maturity of these balances.

6. Segment information

Based on risks and returns, the directors of the Company consider that the primary reporting format of the Group is by business segment. The directors consider that there is only one business segment, being online game development and operation and marketing of those online games. The disclosures for the primary segment have already been given in this Financial Information and therefore no further information about business segment is presented.

Geographical segment is the secondary reporting format of the Group. In determining the Group's geographical segments, revenue is attributed to the segments based on the location where services are provided and assets and capital expenditure are attributed to the segments based on the location of the assets. Unallocated assets mainly comprise available-for- sale financial assets, deferred tax assets, investment in trading securities, non-operating cash and cash equivalents, amounts due from related parties and amount due from a PRC entity, Guolun Holdings Limited (高能控股有限公司) (note 17 (ii)).

The Group's turnover analysed by geographical markets during the Relevant Periods is presented below:

	Year ended 31 December		**Six months ended 30 June**	
	2005	**2006**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000* *(unaudited)*	*RMB'000*
PRC	14,514	80,413	8,647	208,747
USA	18,332	40,889	17,464	52,582
Others	2,273	759	—	420
	35,119	122,061	26,111	261,749

The carrying amount of segment assets and capital expenditure, which represent additions to property, plant and equipment, analysed by geographical markets is presented below:

	Segment assets		
	At 31 December		**At 30 June**
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
PRC	29,736	75,702	221,522
USA	4,477	9,374	56,560
Unallocated	25,360	61,220	19,503
	59,573	146,296	297,585

	Capital expenditure			
	Year ended 31 December		Six months ended 30 June	
	2005	**2006**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000* *(unaudited)*	*RMB'000*
PRC	3,363	15,605	1,095	15,142
USA	58	112	91	61
	3,421	15,717	1,186	15,203

7. Revenue and gains

	Year ended 31 December		Six months ended 30 June	
	2005	**2006**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000* *(unaudited)*	*RMB'000*
Revenue - turnover				
Online game revenue	35,119	122,061	26,111	261,749
Other revenue and gains				
Game development fee	2,963	2,157	270	—
Government grants	470	590	360	220
Bank interest income	392	614	138	851
Fair value gain on investment in trading securities	—	383	152	104
Others	1,125	1,929	795	155
	4,950	5,673	1,715	1,330
	40,069	127,734	27,826	263,079

Government grants were received from the PRC government for subsidising the Group in conducting projects relating to software or technology development. There are no unfulfilled conditions or contingencies relating to these grants.

8. Operating (loss)/profit

The Group's operating (loss)/profit is arrived at after charging the following items:

	Year ended 31 December		Six months ended 30 June	
	2005	**2006**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000* *(unaudited)*	*RMB'000*
Auditors' remuneration	718	718	366	368
Depreciation of property, plant and equipment	3,958	4,457	1,934	3,569
Operating lease charges on:				
- land and buildings	2,358	2,182	1,000	1,206
- computer equipment	2,927	5,361	1,634	5,264
Development costs (note (i))	15,464	12,835	5,463	13,137
Staff costs (note (ii))	28,808	26,812	11,823	25,430
Net foreign exchange losses	152	212	19	353
Write off of property, plant and equipment	517	795	—	—
Loss on disposal of property, plant and equipment	112	466	8	20
Impairment on trade receivables	2	416	379	347

Notes:

(i) Development costs mainly comprise depreciation of property, plant and equipment of RMB896,000, RMB164,000, RMB90,000 and RMB47,000 for the years ended 31 December 2005 and 2006 and the six months ended 30 June 2006 and 2007, respectively, and staff costs of RMB13,958,000, RMB12,171,000, RMB5,362,000 and RMB12,943,000 for the years ended 31 December 2005 and 2006 and the six months ended 30 June 2006 and 2007, respectively, which are also included in the respective total amounts disclosed separately above for each of these types of expenses for the respective years / periods.

(ii) Breakdown of staff costs, including directors' remuneration, is as follows:

	Year ended 31 December		Six months ended 30 June	
	2005	**2006**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000* *(unaudited)*	*RMB'000*
Wages, salaries and bonus	24,043	22,565	9,790	21,931
Welfare, medical and other benefits	2,177	1,989	946	1,734
Contribution to pension plans	2,588	2,258	1,087	1,765
	28,808	26,812	11,823	25,430

9. Financial results and financial assets and liabilities by category of financial instruments

Financial results by category

Net gains/(losses) from financial assets and financial liabilities by category of financial instruments are set out below:

	Year ended 31 December		Six months ended 30 June	
	2005	2006	2006	2007
	RMB'000	*RMB'000*	*RMB'000* *(unaudited)*	*RMB'000*
Available-for-sale financial asset	54	—	—	—
Financial assets at fair value through profit or loss held for trading	—	383	152	104
Loans and receivables	(2)	(416)	(379)	(347)
Net amounts reported in the consolidated income statements	52	(33)	(227)	(243)

Financial assets by category

The carrying amount of the Group's financial assets by category of financial instruments included in the consolidated balance sheets and the headings in which they are included are as follows:

	At 31 December		At 30 June
	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Non-current assets			
Available-for-sale financial asset	4,000	4,000	4,000
Current assets			
Financial assets at fair value through profit or loss held for trading			
- Investment in trading securities	4,599	851	453
Loans and receivables			
- Trade and other receivables	9,953	40,354	45,513
- Amounts due from related parties	5,530	11,357	3,293
	24,082	56,562	53,259

Financial liabilities by category

The carrying amount of the Group's financial liabilities by category of financial instruments included in the consolidated balance sheets and the headings in which they are included are as follows:

	At 31 December		At 30 June
	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Current liabilities			
Financial liabilities measured at amortised cost			
- Trade and other payables	17,103	37,910	54,145
- Amounts due to related parties	2,156	725	669
	19,259	38,635	54,814

10. Remuneration of directors and five highest paid individuals

(i) *Directors' remuneration*

The aggregate amount of remuneration paid and payable to the directors of the Company by the Group during the Relevant Periods are as follows:

	Year ended 31 December 2005				
	Fees	Salaries and allowances	Discretionary bonus	Contribution to pension plans	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Executive directors					
Mr Liu Dejian	—	303	—	—	303
Mr Liu Luyuan	—	132	—	4	136
Mr Zheng Hui	—	58	—	4	62
Mr Chen Hongzhan	—	173	—	4	177
Non-executive directors					
Mr Lin Dongliang	—	—	—	—	—
Mr Zhu Xinkun	—	—	—	—	—
Independent non-executive directors					
Mr Chao Guowei, Charles	—	—	—	—	—
Mr Lee Kwan Hung	—	—	—	—	—
Mr Liu Sai Keung, Thomas	—	—	—	—	—
	—	666	—	12	678

Year ended 31 December 2006

	Fees	Salaries and allowances	Discretionary bonus	Contribution to pension plans	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Executive directors					
Mr Liu Dejian	—	874	—	—	874
Mr Liu Luyuan	—	131	—	4	135
Mr Zheng Hui	—	65	—	—	65
Mr Chen Hongzhan	—	209	—	4	213
Non-executive directors					
Mr Lin Dongliang	—	—	—	—	—
Mr Zhu Xinkun	—	—	—	—	—
Independent non-executive directors					
Mr Chao Guowei, Charles	—	—	—	—	—
Mr Lee Kwan Hung	—	—	—	—	—
Mr Liu Sai Keung, Thomas	—	—	—	—	—
	—	1,279	—	8	1,287

Six months ended 30 June 2006 (unaudited)

	Fees	Salaries and allowances	Discretionary bonus	Contribution to pension plans	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Executive directors					
Mr Liu Dejian	—	336	—	—	336
Mr Liu Luyuan	—	67	—	3	70
Mr Zheng Hui	—	34	—	—	34
Mr Chen Hongzhan	—	88	—	2	90
Non-executive directors					
Mr Lin Dongliang	—	—	—	—	—
Mr Zhu Xinkun	—	—	—	—	—
Independent non-executive directors					
Mr Chao Guowei, Charles	—	—	—	—	—
Mr Lee Kwan Hung	—	—	—	—	—
Mr Liu Sai Keung, Thomas	—	—	—	—	—
	—	525	—	5	530

	Six months ended 30 June 2007				
	Fees	Salaries and allowances	Discretionary bonus	Contribution to pension plans	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
Executive directors					
Mr Liu Dejian	—	614	—	—	614
Mr Liu Luyuan	—	173	—	2	175
Mr Zheng Hui	—	75	—	2	77
Mr Chen Hongzhan	—	227	—	3	230
Non-executive directors					
Mr Lin Dongliang	—	—	—	—	—
Mr Zhu Xinkun	—	—	—	—	—
Independent non-executive directors					
Mr Chao Guowei, Charles	—	—	—	—	—
Mr Lee Kwan Hung	—	—	—	—	—
Mr Liu Sai Keung, Thomas	—	—	—	—	—
	—	1,089	—	7	1,096

During the Relevant Periods, no emoluments were paid by the Group to any of the directors as an inducement to join or upon joining the Group or as compensation for loss of office and none of the directors has waived or agreed to waive any emoluments.

(ii) ***Five highest paid individuals***

The five highest paid individuals consisted of two, one, one and two directors for the years ended 31 December 2005 and 2006 and the six months ended 30 June 2006 and 2007, respectively, details of whose remuneration are set out above. Details of the remuneration of the remaining three, four, four and three highest paid individuals for the years ended 31 December 2005 and 2006 and the six months ended 30 June 2006 and 2007, respectively, are as follows:

	Year ended 31 December		Six months ended 30 June	
	2005	2006	2006	2007
	RMB'000	*RMB'000*	*RMB'000* (*unaudited*)	*RMB'000*
Salaries and allowances	1,251	2,244	1,015	1,046
Discretionary bonus	—	—	—	—
Contribution to pension plans	—	—	—	—
	1,251	2,244	1,015	1,046

The remuneration paid to each of the above non-director individuals during the Relevant Periods fell within the band of nil to RMB1,000,000.

11. Income tax (credit)/expense

The major components of income tax (credit)/expense for the Relevant Periods are as follows:

	Year ended 31 December		Six months ended 30 June	
	2005	**2006**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000* *(unaudited)*	*RMB'000*
Current tax				
- PRC (note (i))	—	1,446	—	17,875
- USA (note (ii))	356	1,267	852	157
	356	2,713	852	18,032
Deferred income tax (note 24)	(2,077)	5,845	648	147
Income tax (credit)/expense	(1,721)	8,558	1,500	18,179

Notes:

(i) PRC enterprise income tax ("EIT") is calculated at the applicable rates in accordance with the relevant laws and regulations in the PRC.

TQ Digital is a foreign-invested enterprise and was approved to be a hi-tech enterprise located in high technology development zone on 29 July 2005. 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, TQ Digital is entitled to a preferential income tax rate of 15%. The qualification of hi-tech enterprise is subject to review once every two years and TQ Digital continued to be recognised as a hi-tech enterprise on 16 August 2007. On 25 December 2003, TQ Digital was approved to be a software enterprise. 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 is entitled to tax benefits of tax exemption for two years starting from the first year of profitable operations after offsetting prior year tax losses, followed by 50% tax reduction for three years. 2003 was the first profitable year for TQ Digital. Accordingly, the EIT tax rate applicable to TQ Digital during the Relevant Periods was 7.5%.

NetDragon (Fujian) continued to be recognised as a hi-tech enterprise located in high technology industrial development zone on 9 November 2004. 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) as mentioned in the previous paragraph, NetDragon (Fujian) was entitled to paying EIT at the reduced tax rate of 15% for 2005 and 2006. Pursuant to a notice issued by a government authority (福建省科學技術廳) on 16 August 2007, NetDragon (Fujian) continued to be recognised as a hi-tech enterprise and is thereby subject to EIT tax rate of 15% for the period ended 30 June 2007.

NetDragon (Shanghai) is subject to EIT tax rate of 33%.

No provision for EIT has been made for the year ended 31 December 2005 and six months ended 30 June 2006 as TQ Digital, NetDragon (Fujian) and NetDragon (Shanghai) either did not derive assessable income in the PRC or had tax loss available for offsetting against the assessable income derived in the PRC in the relevant year.

(ii) The USA income tax rates applicable to the Group are 34% for federal income tax and 8.84% for state income tax.

(iii) The Group is not subject to any taxation under the jurisdiction of the Cayman Islands and BVI during the Relevant Periods. Provision for Hong Kong profits tax is not made as the Group does not derive any assessable profits in Hong Kong during the Relevant Periods.

A reconciliation of income tax (credit)/expense and accounting profit/(loss) at applicable tax rates is as follows:

	Year ended 31 December		**Six months ended 30 June**	
	2005	**2006**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000* *(unaudited)*	*RMB'000*
(Loss)/Profit before income tax	(30,921)	51,543	(1,280)	172,266
Tax calculated at domestic tax rates applicable to profits in the respective jurisdictions	(3,848)	8,426	455	26,096
Tax exemptions	—	(2,790)	—	(9,861)
Tax effect of non-taxable income	(35)	(81)	(24)	(15)
Tax effect of non-deductible expenses	2,194	2,917	1,146	2,004
Others	(32)	86	(77)	(45)
Income tax (credit)/expense	(1,721)	8,558	1,500	18,179

12. Dividends

Dividends were paid or declared by the Company and NetDragon (BVI) during the Relevant Periods:

(a) Part of the dividend declared by NetDragon (BVI) in respect of year 2004 amounting to RMB3,465,000 was paid to the then equity holders in 2005.

(b) On 3 February 2007, NetDragon (BVI) declared a special dividend of RMB44,839,000 to its then equity holders.

(c) On 20 June 2007, NetDragon (BVI) declared a special dividend of RMB34,230,000 to the Company. On the same date, the Company declared the same amount of dividend to its equity holders who are effectively the then equity holders of NetDragon (BVI).

The rates of dividends and the number of shares ranking for dividends are not presented as such information is not meaningful having regard to the purpose of this report.

13. (Loss)/Earnings per share

The calculation of (loss)/earnings per share attributable to the equity holders of the Company is calculated based on consolidated (loss)/profit attributable to the equity holders of the Company of each of the Relevant Periods and the weighted average number of 400,407,860, 400,407,860, 400,407,860 and 442,220,015 shares for the years ended 31 December 2005 and 2006 and the six months ended 30 June 2006 and 30 June 2007, respectively, assuming the capitalisation issue of the Company as detailed in note 28(iii) occurred as at 1 January 2005.

14. Property, plant and equipment

	Leasehold improvements	Computer and office equipment	Motor vehicles	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Cost:				
At 1 January 2005	892	17,019	956	18,867
Additions	13	3,273	135	3,421
Disposals	—	(1,082)	(337)	(1,419)
At 31 December 2005 and 1 January 2006	905	19,210	754	20,869
Additions	680	13,698	1,339	15,717
Disposals	—	(4,098)	(619)	(4,717)
At 31 December 2006 and 1 January 2007	1,585	28,810	1,474	31,869
Additions	318	13,013	1,872	15,203
Disposals	—	(46)	—	(46)
At 30 June 2007	1,903	41,777	3,346	47,026
Accumulated depreciation:				
At 1 January 2005	239	3,258	223	3,720
Charge for the year	169	3,635	154	3,958
Disposals	—	(360)	(187)	(547)
At 31 December 2005 and 1 January 2006	408	6,533	190	7,131
Charge for the year	262	4,059	136	4,457
Disposals	—	(2,624)	(306)	(2,930)
At 31 December 2006 and 1 January 2007	670	7,968	20	8,658
Charge for the period	165	3,149	255	3,569
Disposals	—	(16)	—	(16)
At 30 June 2007	835	11,101	275	12,211
Net carrying amount:				
At 31 December 2005	497	12,677	564	13,738
At 31 December 2006	915	20,842	1,454	23,211
At 30 June 2007	1,068	30,676	3,071	34,815

15. Interest in an associate

	At 31 December		At 30 June
	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Unlisted equity investment, at cost	430	—	—

The associate has not carried out any business activity since its incorporation in 2005 and it was dissolved in 2006. Particulars of the associate at 31 December 2005 are as follows:

Name	Particulars of issued capital	Place of incorporation	Percentage of interest held by the Group	Principal activity
福州易凱瑞網路資訊技術有限公司	RMB1,000,000	PRC	43%	Dormant

The following table illustrates the summarised financial information of the associate extracted from its management accounts for the year ended 31 December 2005:

	RMB'000
Assets	1,000
Liabilities	—
Revenue	—
Profit	—

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

	At 31 December		At 30 June
	2005	2006	2007
	RMB'000	*RMB'000*	*RMB'000*
Unlisted equity investment — PRC	4,000	4,000	4,000
Unlisted debt securities — USA	4,599	851	453
	8,599	4,851	4,453
Represented by:			
Available-for-sale financial asset	4,000	4,000	4,000
Investment in trading securities	4,599	851	453
	8,599	4,851	4,453

The unlisted equity investment represents 9.5% interest in 福建楊振華 851生物科技股份有限公司 which was established in the PRC. The entity is a related party to the Group because Mr Liu Dejian and Mr Zheng Hui, directors of the Company, are directors of the entity and Ms Lin Yun, a beneficial owner of the Company, has equity interest in the entity. The unlisted debt securities represent bonds and certificate of deposits issued by U.S. corporations.

The available-for-sale financial asset is denominated in RMB while the trading securities are denominated in US$.

The available-for-sale financial asset is stated at cost less impairment because the directors are of the opinion that its fair value cannot be measured reliably.

The fair values of the unlisted trading securities which are classified as held for trading are determined by discounting their expected future cash flows at market rate.

The debt securities bear interest at fixed rates ranging from 4.0% to 4.5% as at 31 December 2005 and 4.2% to 4.5% as at 31 December 2006 and 30 June 2007. The debt securities as at 31 December 2005 matured between 7 April 2006 and 21 September 2007 while the debt securities as at 31 December 2006 and 30 June 2007 matured between 10 May 2007 and 21 September 2007.

17. Trade and other receivables

	At 31 December		**At 30 June**
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Trade receivables (note (i))	1,131	6,200	22,664
Other receivables (note (ii))	2,206	18,837	2,931
Deposits and prepayments	6,616	15,317	19,918
	9,953	40,354	45,513

Notes:

(i) The ageing analysis of trade receivables as at 31 December 2005, 31 December 2006 and 30 June 2007, based on the invoice date, is as follows:

	At 31 December		At 30 June
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Outstanding balances with ages:			
— 30 days or below	970	5,764	21,110
— 31 - 60 days*	32	33	1,173
— 61 - 90 days*	22	24	20
— 91 - 180 days*	27	162	56
— 181 - 365 days*	80	144	99
— Over 365 days*	—	73	206
	1,131	6,200	22,664

* past due but not impaired

The Group allows an average credit period ranged from 30 days to 45 days to its trade debtors but the trade debtors usually settle the outstanding balance within 30 days from the billing date.

(ii) Included in other receivables as at 31 December 2006 was a balance of RMB14,500,000 placed with a PRC entity, Guolun Holdings Limited (高能控股有限公司), for providing asset management services to the Group pursuant to an agreement signed on 12 December 2006 (the "Asset Management Agreement"). On 27 May 2007, TQ Digital entered into an agreement with Mr Liu Dejian, one of the executive directors and beneficial owner of the Company, to dispose its rights underlying the Asset Management Agreement at a consideration of RMB14.5 million. The director is required to settle the consideration within 30 days from the date of the agreement. The balance was settled by the director 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.

(iii) Trade and other receivables are interest-free and unsecured. The directors consider that the carrying amounts of trade and other receivables approximate their fair values.

(iv) Included in trade and other receivables are the following amounts denominated in a currency other than RMB:

	At 31 December		At 30 June
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
US Dollars	1,121	2,125	2,831

18. Cash and cash equivalents

	At 31 December		At 30 June
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Cash on hand and at bank	14,018	60,810	171,402
Cash deposited with an online payment service provider (note (i))	1,259	5,512	35,004
	15,277	66,322	206,406

Notes:

(i) Cash deposited with the online payment service provider could be readily withdrawn by the Group. The accounts maintained with this online payment service provider were held on trust by the directors of NetDragon (USA) on behalf of the Group for the exclusive use of accepting online payment from customers. Subsequent to the Relevant Periods, the Group has set up a corporate account with the online payment service provider which is owned by and under the name of NetDragon (USA) and all the funds held by the directors of NetDragon (USA) on behalf of NetDragon (USA) have been transferred to the corporate account.

(ii) As at 31 December 2005 and 2006 and 30 June 2007, cash and cash equivalents of the Group denominated in RMB amounted to RMB7,164,000, RMB23,553,000 and RMB144,095,000 respectively. The conversion of RMB into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC government.

(iii) Cash deposited with banks bear interest at effective interest rates ranging from 0.6% to 3.7% per annum during the Relevant Periods. Cash deposited with the online payment service provider bears interest at effective interest rates ranging from 2.5% to 4.7% per annum during the Relevant Periods.

(iv) Included in cash and cash equivalents in the consolidated balance sheets are the following amounts denominated in a currency other than RMB:

	At 31 December		At 30 June
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
US Dollars	8,113	42,769	62,311

(v) The directors consider that the carrying amounts of cash equivalents approximate their fair values.

19. Trade and other payables

	At 31 December 2005	At 31 December 2006	At 30 June 2007
	RMB'000	*RMB'000*	*RMB'000*
Trade payables (note (i))	107	83	229
Accrued staff costs	4,674	5,515	6,041
Value added tax payables and other tax payables	3,061	9,794	14,068
Other payables and accrued charges	6,878	13,925	21,907
Deferred income	2,383	8,593	11,900
	17,103	37,910	54,145

Notes:

(i) The ageing analysis of trade payables as at 31 December 2005, 31 December 2006 and 30 June 2007, based on the invoice date, is as follows:

	At 31 December 2005	At 31 December 2006	At 30 June 2007
	RMB'000	*RMB'000*	*RMB'000*
Outstanding balances with ages:			
— Within 90 days	26	1	146
— 91 - 180 days	—	—	—
— 181 - 365 days	1	1	—
— Over 365 days	80	81	83
	107	83	229

(ii) The directors consider that the carrying amounts of trade and other payables approximate their fair values.

(iii) Included in trade and other payables are the following amounts denominated in a currency other than RMB:

	At 31 December 2005	At 31 December 2006	At 30 June 2007
	RMB'000	*RMB'000*	*RMB'000*
US Dollars	7,769	17,845	18,348

20. Amount due from a subsidiary

The amount due is unsecured, interest free and repayable on demand. The directors consider that the carrying amount of the balance approximates its fair value.

21. Share capital

(a) Company

	Share capital				
	Number of common shares of US$0.01 each	**Number of preferred shares of US$0.01 each**	**Total number of shares of US$0.01 each**	**Nominal value**	
				US$	*RMB'000*
Authorised:					
At the date of incorporation and at 31 December 2005 and 2006 (note (i))	50,000,000	3,000,000	53,000,000	530,000	4,388
Increase in authorised share capital (note (iii))	450,000,000	27,000,000	477,000,000	4,770,000	36,740
At 30 June 2007	500,000,000	30,000,000	530,000,000	5,300,000	41,128
Issued:					
At the date of incorporation (note (i))	1	—	1	—	—
Issue of new shares (note (ii))	14,878,936	2,666,666	17,545,602	175,456	1,453
At 31 December 2005 and 2006	14,878,937	2,666,666	17,545,603	175,456	1,453
Issue of new shares (note (iv))	4,674,790	—	4,674,790	46,748	360
Issue of new shares (note (v))	19,553,727	2,666,666	22,220,393	222,204	1,693
At 30 June 2007	39,107,454	5,333,332	44,440,786	444,408	3,506

Notes:

(i) The Company was incorporated on 29 July 2004 with an authorised share capital of US$530,000 divided into 50,000,000 common shares of US$0.01 each and 3,000,000 preferred shares of US$0.01 each. Upon incorporation, one common share was allotted and issued at par to a shareholder.

(ii) On 15 December 2004, 14,878,936 common shares of US$0.01 each and 2,666,666 preferred shares of US$0.01 each were issued and allotted at par value.

(iii) On 1 March 2007, the authorised share capital of the Company was increased from US$530,000 divided into 50,000,000 common shares of US$0.01 each and 3,000,000 preferred shares of US$0.01 each to US$5,300,000 divided into 500,000,000 common shares of US$0.01 each and 30,000,000 preferred shares of US$0.01 each by issuing additional 450,000,000 common shares of US$0.01 each and 27,000,000 preferred shares of US$0.01 each.

(iv) On 26 March 2007, an aggregate of 4,674,790 common shares of US$0.01 each were allotted and issued at par by the Company.

(v) On 18 May 2007, an aggregate of 19,553,727 common shares of US$0.01 each and 2,666,666 preferred shares of US$0.01 were allotted and issued at par by the Company pursuant to the Shares Swap as detailed in note 1.

(b) **Group**

For the purpose of this report, the share capital of the Group as at 31 December 2005 and 2006 represented the paid up capital of NetDragon (BVI). Upon the formation of the Group on 18 May 2007 as a result of the Shares Swap which took place on the same date, the Company becomes the holding company of the Group and the share capital of the Group as at 30 June 2007 represented the share capital of the Company.

22. Reserves

(a) Company

The reserve of the Company represents contributed surplus which is the difference between the investment cost of NetDragon (BVI) and the nominal value of the shares issued by the Company pursuant to the Shares Swap as detailed in note 1.

(b) Group

(i) *Share premium*

On 10 January 2007, an aggregate of 2,200,000 common shares of US$0.01 each of NetDragon (BVI) were allotted and issued at a consideration of US$4.14 per share to the new investors of NetDragon (BVI), giving rise to additional share capital to the Group (the share capital of the Group before the Shares Swap taking place on 18 May 2007 represented the share capital of NetDragon (BVI)) of US$22,000 (equivalent to approximately RMB170,000) and share premium of US$9,086,000 (equivalent to approximately RMB69,984,000). As at 31 December 2006, capital of approximately RMB21,755,000 was received in advance from certain of the new investors.

Under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands (the "Companies Law"), the share premium account can be applied by the Company subject to the provisions, if any, of its memorandum and articles of association in (a) paying distributions or dividends to members; (b) paying up unissued shares of the Company to be issued to members as fully paid bonus shares; (c) the redemption and repurchases of shares (subject to the provisions of section 37 of the Companies Law); (d) writing-off the preliminary expenses of the Company; (e) writing-off the expenses of, or the commission paid or discount allowed on, any issue of share or debentures of the Company; and (f) providing for the premium payable on redemption or purchase of any shares or debentures of the Company. No distribution or dividend may be paid to members out of the share premium account unless immediately following the date on which the distribution or dividend is proposed to be paid, the Company will be able to pay its debts as they fall due in the ordinary course of business.

(ii) *Capital reserve*

Capital reserve arose on combining the results and financial positions of the companies now comprising the Group using merger accounting and following the presentation basis as explained in note 1.

As mentioned in note 1, the Group does not have equity interest in NetDragon (Fujian) and NetDragon (Shanghai) and their results and financial positions are consolidated with that of the Group by virtue of the Structure Contracts. The combined capital of NetDragon (Fujian) and NetDragon (Shanghai) less the amount of capital of NetDragon (Fujian) shared by the minority shareholders is thereby included in capital reserve of the Group.

As at 31 December 2005 and 2006, the Shares Swap had not yet taken place and the share capital of the Company was included in capital reserve of the Group. As at 30 June 2007, the Shares Swap had already taken place and accordingly, the amount of capital reserve of the Group as at 30 June 2007 was reduced to RMB9,946,000 which only included the combined capital of NetDragon (Fujian) and NetDragon (Shanghai) less the amount of the capital of NetDragon (Fujian) shared by the minority shareholders.

(iii) *Statutory reserves*

In accordance with the relevant laws and regulations in the PRC and the articles of association of NetDragon (Fujian), NetDragon (Fujian) is required to appropriate 10% and 5%-10% of its profit after tax after setting off the accumulated losses brought forward from prior years, as determined in accordance with PRC accounting regulations, to the statutory surplus reserve (the "SSR") and the statutory public welfare fund reserve (the "SPWF") respectively. When the balance of SSR reaches 50% of the registered capital of NetDragon (Fujian), any further appropriation is optional. The SSR may be used to make good previous years' losses, if any, and may be converted to increase paid-up capital of the respective entities, provided the remaining balance after the capitalisation is not less than 25% of the registered capital. The SPWF could be used for capital expenditure on staff welfare facilities.

No allocation to the SPWF is required for NetDragon (Fujian) from 1 January 2006 due to the revised laws and regulations in the PRC. The unutilised SPWF of NetDragon (Fujian) as at 31 December 2005 was transferred to SSR in 2006.

In accordance with the relevant laws and regulations concerning foreign investment enterprise established in the PRC and the articles of association of TQ Digital, TQ Digital is also required to appropriate certain portion of its profits after tax after setting off the accumulated losses brought forward from prior years, as determined in accordance with PRC accounting regulations, to reserve fund and staff's and workers' bonus and welfare fund. The amount of appropriation is determined by the board of directors of TQ Digital except for the appropriation of 10% of the net profit to the reserve fund which is mandatory until the accumulated total of the fund reaches 50% of registered capital of TQ Digital. The usage of reserve fund and staff's and workers' bonus and welfare fund are similar to that of SSR and SPWF respectively.

The above reserves cannot be used for purposes other than those for which they are created and are non-distributable as cash dividends.

(c) Distributable reserve

The amount of reserve available for distribution to the equity shareholders of the Company was nil, nil, and RMB166,178,000 respectively as at 31 December 2005, 31 December 2006 and 30 June 2007.

23. Related party transactions

Except as disclosed elsewhere in this report, the Group and Company have the following transactions with the following related parties during the Relevant Periods:

(i) Name of and relationship with the related parties

Name of related parties	**Relationship**
Mr Liu Dejian	Executive director and beneficial owner of the Company
Mr Liu Luyuan	Executive director and beneficial owner of the Company
Mr Liu Ming	A close family member of Mr Liu Dejian
Mr Zheng Hui	Executive director and beneficial owner of the Company
Mr Chen Hongzhan	Executive director and beneficial owner of the Company
Ms Lin Yun	Beneficial owner of the Company and key management
Mr Wu Chak Man	Beneficial owner of the Company and key management
Mr Chen Feng	Beneficial owner of the Company and key management
Mr Wu Jialiang	Beneficial owner of the Company and key management
福建楊振華 851 生物工程技術研究開發有限公司	Mr Liu Dejian has equity interest in this entity
福州天亮網絡技術有限公司	Mr Zheng Hui, Mr Wu Jialiang and Mr Chen Hongzhan have equity interests in this entity
Beso Biological Research Inc.	This entity is wholly owned by a close family member of Mr Liu Dejian and Mr Liu Luyuan
DJM Holding Ltd.	A shareholder of the Company in which Mr Liu Dejian has equity interest
Richmedia Holdings Limited	A shareholder of the Company in which Mr Liu Luyuan has equity interest
IDG Technology Venture Investments, L.P.	A shareholder of the Company

(ii) Significant related party transactions during the Relevant Periods

	Year ended 31 December		Six months ended 30 June	
	2005	**2006**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000* *(unaudited)*	*RMB'000*
Rentals paid to:				
— 福建楊振華 851 生物工程技術研究開發有限公司	310	285	140	135
— Beso Biological Research Inc.	257	265	126	124
After-sales service fee paid to:				
— 福州天亮網絡技術有限公司	—	550	—	1,926
Technical service fee paid to:				
— 福州天亮網絡技術有限公司	—	168	—	511

The directors consider that all related party transactions were carried out in the ordinary course of business and on terms agreed between the parties.

(iii) Amounts due from/to related parties as at 31 December 2005, 31 December 2006 and 30 June 2007

Group

	At 1 January	At 31 December		At 30 June
	2005	**2005**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Amounts due from related parties:				
— 福建楊振華 851 生物工程技術研究開發有限公司 *(note)*	—	—	6,891	2,482
— DJM Holding Ltd. *(note)*	961	961	961	—
— Richmedia Holdings Limited *(note)*	107	107	107	—
— IDG Technology Venture Investments, L.P.	221	221	221	—
— Mr Liu Dejian *(note)*	—	—	—	442
— Mr Zheng Hui *(note)*	1,585	3,243	2,361	—
— Mr Liu Luyuan *(note)*	15	57	57	57
— Mr Wu Chak Man	1,115	912	—	—
— Mr Chen Hongzhan *(note)*	—	—	300	312
— Mr Wu Jialiang	—	—	430	—
— Mr Chen Feng	29	29	29	—
	4,033	5,530	11,357	3,293

Note:

Maximum amount due from these related parties during the Relevant Periods are as follows:

	Year ended 31 December 2005	Year ended 31 December 2006	Six months ended 30 June 2007
	RMB'000	*RMB'000*	*RMB'000*
福建楊振華 851 生物工程技術研究開發有限公司	—	6,891	6,891
DJM Holding Ltd.	961	961	961
Richmedia Holdings Limited	107	107	107
Mr Liu Dejian	—	—	442
Mr Zheng Hui	3,243	3,243	2,361
Mr Liu Luyuan	57	57	57
Mr Chen Hongzhan	—	300	312

	At 31 December 2005	At 31 December 2006	At 30 June 2007
	RMB'000	*RMB'000*	*RMB'000*
Amounts due to related parties:			
— 福建楊振華 851 生物工程技術研究開發有限公司	2,006	—	—
— 福州天亮網路技術有限公司	—	574	557
— Mr Liu Dejian	58	58	—
— Mr Liu Ming	8	9	1
— Ms Lin Yun	84	84	84
— Mr Zheng Hui	—	—	27
	2,156	725	669

Company

	At 1 January 2005	At 31 December 2005	At 31 December 2006	At 30 June 2007
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Amounts due from related parties:				
— DJM Holding Ltd. *(note)*	961	961	961	—
— Richmedia Holdings Limited *(note)*	107	107	107	—
— IDG Technology Venture Investments, L.P.	221	221	221	—
— Mr Zheng Hui *(note)*	135	135	135	—
— Mr Chen Feng	29	29	29	—
	1,453	1,453	1,453	—

Note:

Maximum amount due from these related parties during the Relevant Periods are as follows:

	Year ended 31 December		Six months ended 30 June
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
DJM Holding Ltd.	961	961	961
Richmedia Holdings Limited	107	107	107
Mr Zheng Hui	135	135	135

The balances are unsecured, interest-free and have no fixed term of repayment. The directors consider that the carrying amounts of the balances approximate their fair values.

All the balances due from related parties were fully settled on or before 17 October 2007.

(iv) Key management remuneration

	Year ended 31 December		Six months ended 30 June	
	2005	**2006**	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000* *(unaudited)*	*RMB'000*
Salaries, allowances and other short-term employee benefits	1,670	2,758	1,218	2,034
Contribution to pension plans	14	14	13	13
	1,684	2,772	1,231	2,047

24. Deferred tax assets

The following are the deferred tax assets recognised by the Group and the movements thereon during the Relevant Periods are as follows:

	Tax losses	Development costs	Total
	RMB'000	*RMB'000*	*RMB'000*
A1 1 January 2005	3,090	879	3,969
Credited to consolidated income statement (note 11)	2,023	54	2,077
At 31 December 2005 and 1 January 2006	5,113	933	6,046
Charged to consolidated income statement (note 11)	(4,966)	(879)	(5,845)
At 31 December 2006 and 1 January 2007	147	54	201
Charged to consolidated income statement (note 11)	(147)	—	(147)
At 30 June 2007	—	54	54

The Company had no deferred tax assets/liabilities as at 31 December 2005, 31 December 2006 and 30 June 2007.

25. Capital commitments

At the balance sheet dates, the Group had the following capital commitments:

	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 Company had no capital commitments as at 31 December 2005, 31 December 2006 and 30 June 2007.

26. Operating lease commitments

The Group leases its office premises and certain property, plant and equipment under operating lease arrangements. At the balance sheet dates, the Group had committed to make the following future minimum lease payments in respect of non-cancellable operating leases falling due as follows:

	At 31 December		At 30 June
	2005	**2006**	**2007**
	RMB'000	*RMB'000*	*RMB'000*
Land and buildings			
Within one year	1,899	1,872	2,166
In the second to fifth years	1,888	655	3,085
After five years	—	—	51
	3,787	2,527	5,302
Computer equipment			
Within one year	—	754	1,446
Total			
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

The Company had no operating lease commitments as at 31 December 2005, 31 December 2006 and 30 June 2007.

27. Contingent liabilities

The Group and the Company did not have significant contingent liabilities as at 31 December 2005, 31 December 2006 and 30 June 2007.

28. Subsequent events

Save as disclosed elsewhere in this report, the following significant events have taken place subsequent to 30 June 2007 and up to the date of this report:

(i) On 15 October 2007, the total number of preferred shares of the Company outstanding of 5,333,332 shares of US$0.01 each were converted into 5,333,332 common shares of US$0.01 each.

(ii) on 15 October 2007, the authorised share capital of the Company decreased from US$5,300,000 to US$5,000,000 by the cancellation of 30,000,000 preferred shares and then the authorised share capital of the Company increased from US$5,000,000 to US$10,000,000 by the creation of 500,000,000 shares of US$0.01 each.

(iii) Pursuant to the written resolutions of the Company passed on 15 October 2007, 399,967,074 shares of the Company will be allotted and issued, credited as fully paid at par of US$0.01 each to the then shareholder of the Company, by the capitalisation of the sum of US$3,999,671 from the share premium account. Such allotment and capitalisation were conditional on the share premium account being credited as a result of the new shares issued in connection with the listing of the Company's shares on the Stock Exchange.

Save as aforesaid, no other significant event took place subsequent to 30 June 2007.

29. Subsequent financial statements

No audited financial statements have been prepared by the Group, Company or any of its subsidiaries in respect of any period subsequent to 30 June 2007.

Yours faithfully,
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