SELECTED FINANCIAL DATA

The selected financial data set forth below is extracted from, and should be read in conjunction with the Group's combined financial information during the Track Record Period which are prepared on the assumption that the Group's current corporate structure had been in existence throughout the periods under review and is extracted from, and has been prepared in accordance with the basis set forth in section I of the accountants' report, the text of which is set forth in Appendix I to this prospectus:—

Profit and loss account data

	Year ended 31 December						Five months ended 31 May			
	2001 (audited)		2002 (audited)		2003 (audited)		2003 (unaudited)		2004 (audited)	
	RMB'000	*% of turnover*	*RMB'000*	*% of turnover*	*RMB'000*	*% of turnover*	*RMB'000*	*% of turnover*	*RMB'000*	*% of turnover*
Turnover[1]	84,767	100.0	101,329	100.0	161,508	100.0	47,028	100.0	84,189	100.0
Cost of sales	(34,317)	(40.5)	(40,454)	(40.0)	(92,845)	(57.5)	(25,151)	(53.5)	(52,372)	(62.2)
Gross profit	50,450	59.5	60,875	60.0	68,663	42.5	21,877	46.5	31,817	37.8
Other revenues	1,063	1.3	3,551	3.5	3,271	2.0	1,540	3.3	1,885	2.2
Selling and distribution costs	(15,716)	(18.5)	(10,155)	(10.0)	(11,818)	(7.3)	(4,620)	(9.8)	(7,503)	(8.9)
Administrative expenses	(18,295)	(21.6)	(16,825)	(16.6)	(15,110)	(9.4)	(5,068)	(10.8)	(7,367)	(8.8)
Other operating expenses	(1,293)	(1.5)	(890)	(0.9)	(494)	(0.3)	(98)	(0.2)	(255)	(0.3)
Operating profit	16,209	19.2	36,556	36.0	44,512	27.5	13,631	29.0	18,577	22.0
Finance costs	(857)	(1.0)	(1,127)	(1.1)	(1,951)	(1.2)	(372)	(0.8)	(828)	(0.9)
Share of losses of an associate	(718)	(0.9)	(315)	(0.2)	(43)	—	(23)	0.0	—	—
PROFIT BEFORE TAX	14,634	17.3	35,114	34.7	42,518	26.3	13,236	28.1	17,749	21.1
Taxation	(1,422)	(1.7)	(2,446)	(2.4)	(3,301)	(2.0)	(895)	(1.9)	(2,316)	(2.8)
PROFIT BEFORE MINORITY INTEREST	13,212	15.6	32,668	32.3	39,217	24.3	12,341	26.2	15,433	18.3
Minority Interest	343	0.4	—	—	—	—	—	—	—	—
NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS	13,555	16.0	32,668	32.3	39,217	24.3	12,341	26.2	15,433	18.3
Dividends	—		(20,198)		—		—		—	
Earnings per Share *(RMB cent)*[2]	4.52		10.89		13.07		4.11		5.14	

Notes:—

1. Turnover represents the net invoiced value of goods sold and services rendered during the Track Record Period, after deduction of allowances for returns and trade discounts and net of sales tax and value-added tax.

2. The computation of earnings per Share is based on the Group's combined net profit from ordinary activities attributable to Shareholders for the Track Record Period and on the basis of a total of 300,000,000 Shares in issue and expected to be issued immediately following the completion of the Capitalisation Issue.

Selected balance sheet data

		31 December		**31 May**
	2001	**2002**	**2003**	**2004**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Inventories	36,451	19,693	20,883	33,393
Trade receivables	9,362	36,257	108,016	99,484
Prepayments, deposits and other receivables	15,858	9,547	30,810	38,256
Trade payables	10,103	7,580	20,811	25,728
Notes payable	—	4,492	23,090	22,368
Other payables and accruals	60,815	34,513	32,975	49,460
Short term bank and other loans	11,000	6,000	31,600	36,000
Combined shareholders' equity	17,384	30,269	101,201	116,634

Selected financial ratios

	Note	Year ended 31 December 2001	2002	2003	Five months ended 31 May 2003 (unaudited)	2004
Gross profit margin						
Wireless system solutions		**60%**	**61%**	**59%**	**55%**	**70%**
Wireless transceivers for paging network		60%	63%	67%	54%	—
Realink PHS Intelligent Coverage System		—	—	39%	—	75%
Callnet		—	50%	56%	51%	52%
Wireless Value-added Service Platform		19%	62%	67%	64%	58%
Wireless terminals		**45%**	**41%**	**35%**	**29%**	**31%**
One-way wireless terminal		45%	44%	27%	29%	26%
Fixed wireless terminal		—	30%	36%	29%	19%
Smartphone		—	—	38%	—	36%
Inventory turnover days	1	421	253	80	84	79
Debtors' turnover days	2	42	82	163	187	187
Creditors' turnover days	3	140	136	55	49	55
Effective tax rate	4	9.7%	7.0%	7.8%	6.8%	13%

Notes:—

1. Inventory turnover days = (average of opening and closing balances of inventory/cost of sales) x number of days in the relevant period

2. Debtors turnover days = (average of opening and closing balances of trade receivables/turnover) x number of days in the relevant period

3. Creditor's turnover days = (average of opening and closing balances of trade payables/total purchase) x number of days in the relevant period

4. Effective tax rate = taxation/profit before tax

PRINCIPAL FINANCIAL STATEMENT COMPONENTS

Turnover

The Group's turnover was mainly derived from (1) contractual income for designing, delivering, installing and testing, and provision of maintenance and other after-sales services for wireless system solutions to telecommunication operators and other corporations; and (2) sales income from *Realink PHS Intelligent Coverage System* sold to telecommunication equipment or solution distributors and from wireless terminals sold to telecommunication operators and wireless terminal distributors.

Breakdown of turnover by products and solutions

	For the year ended 31 December						For the five months ended 31 May			
	2001		2002		2003		2003 (unaudited)		2004	
	RMB'000	*% of turnover*	*RMB'000*	*% of turnover*	*RMB'000*	*% of turnover*	*RMB'000*	*% of turnover*	*RMB'000*	*% of turnover*
Wireless system solutions										
Wireless transceivers for paging network	83,363	98.3	73,431	72.5	20,608	12.8	18,029	38.3	—	—
Realink PHS Intelligent Coverage System	—	—	—	—	10,034	6.2	—	—	11,424	13.6
Sub-total for wireless coverage system	83,363	98.3	73,431	72.5	30,642	19.0	18,029	38.3	11,424	13.6
Callnet	—	—	13,343	13.1	11,967	7.4	8,121	17.3	2,448	2.9
Wireless Value-added Service Platform	836	1.0	8,176	8.1	6,190	3.8	5,721	12.2	1,488	1.8
Sub-total for integrated telecom business platform	836	1.0	21,519	21.2	18,157	11.2	13,842	29.5	3,936	4.7
Sub-total	84,199	99.3	94,950	93.7	48,799	30.2	31,871	67.8	15,360	18.3
Wireless terminals										
One-way wireless terminals	568	0.7	4,887	4.8	4,220	2.6	2,927	6.2	39	—
Fixed wireless terminals	—	—	1,492	1.5	89,248	55.3	12,230	26.0	22,538	26.8
Smartphone	—	—	—	—	19,241	11.9	—	—	46,252	54.9
Sub-total	568	0.7	6,379	6.3	112,709	69.8	15,157	32.2	68,829	81.7
Total	84,767	100.0	101,329	100.0	161,508	100.0	47,028	100.0	84,189	100.0

Cost of sales

The Group's cost of sales mainly comprises (i) cost of materials; (ii) direct labor cost, which represents salaries of production and installation staff; (iii) depreciation of production facilities; and (iv) manufacturing overhead such as utilities cost.

Breakdown of cost of sales during Track Record Period

	Year ended 31 December						Five months ended 31 May			
	2001		2002		2003		2003 (unaudited)		2004	
	RMB'000	%	*RMB'000*	%	*RMB'000*	%	*RMB'000*	%	*RMB'000*	%
By components										
Cost of materials	30,535	89.0	37,562	93.0	90,523	97.6	24,342	96.8	51,449	98.2
Direct labor	904	2.6	334	0.8	526	0.5	205	0.8	374	0.7
Depreciation	432	1.3	600	1.4	324	0.3	211	0.8	63	0.2
Manufacturing overhead	2,446	7.1	1,958	4.8	1,472	1.6	393	1.6	486	0.9
Total	34,317	100.0	40,454	100.0	92,845	100.0	25,151	100.0	52,372	100.0
By products and solutions										
Wireless transceivers for paging network	33,332	97.1	26,865	66.4	6,810	7.3	8,313	33.1	—	—
Realink PHS Intelligent Coverage System	—	—	—	—	6,103	6.6	—	—	2,844	5.4
Callnet	—	—	6,672	16.5	5,301	5.7	3,984	15.8	1,170	2.2
Wireless Value-added Service Platform	673	2.0	3,127	7.7	2,060	2.2	2,060	8.2	620	1.2
	34,005	99.1	36,664	90.6	20,274	21.8	14,357	57.1	4,634	8.8
One-way wireless terminal	312	0.9	2,746	6.8	3,074	3.3	2,078	8.3	29	0.1
Fixed wireless terminal	—	—	1,044	2.6	57,542	62.0	8,716	34.6	18,230	34.8
Smartphone	—	—	—	—	11,955	12.9	—	—	29,479	56.3
	312	0.9	3,790	9.4	72,571	78.2	10,794	42.9	47,738	91.2
Total	34,317	100.0	40,454	100.0	92,845	100.0	25,151	100.0	52,372	100.0

During the Track Record Period, cost of materials as a percentage of the total cost of sales increased from approximately 89% in 2001 to approximately 98.2% in the five months ended 31 May 2004. This is mainly due to the increasing use of OEMs for the manufacturing of the Group's wireless terminal products, under which the Group only purchased the raw materials for the OEMs but did not participate in manufacturing.

During the Track Record Period, cost of sales of wireless system solutions as a percentage of the total cost of sales decreased from approximately 99.1% in 2001 to approximately 8.8% in the five months ended 31 May 2004, while that of wireless terminals increased from approximately 0.9% in 2001 to approximately 91.2% in the five months ended 31 May 2004. Such changes are in line with the Group's shift of product mix, whereby wireless terminals gradually replaced wireless system solutions as the Group's major source of turnover.

During the Track Record Period, the cost structure for each major product category did not vary significantly. For each of wireless coverage system solutions, integrated telecom business platform and one-way wireless information receivers, amount paid to the OEMs accounted for approximately 89%, 93%, 97.5% and 98.2% of the total cost of sales for each of the three years ended 31 December 2003 and the five months ended 31 May 2004 respectively, while labor cost and other manufacturing overhead accounted for the remaining portion. For fixed wireless terminals, amount paid to the OEMs accounted for approximately 93%, 97.5% and 98.2% of the cost of sales for each of the two years ended 31 December 2003 and the five months ended 31 May 2004 respectively; while for smartphone, amount paid to the OEMs accounted for approximately 97.5% and 97.5% of the cost of sales for the year ended 31 December 2003 and the five months ended 31 May 2004 respectively.

Other revenue

Other revenue mainly represented government grants from 深圳財務局 (Shenzhen Finance Bureau), tax refund, interest income, maintenance income and rental income. The PRC Lawyers confirmed that it is legally permissible for companies to receive and recognise government grants and tax refund as revenue in the PRC.

Breakdown of other revenue during Track Record Period

	Year ended 31 December						**Five months ended 31 May**			
	2001		**2002**		**2003**		**2003 (unaudited)**		**2004**	
	RMB'000	*%*	*RMB'000*	*%*	*RMB'000*	*%*	*RMB'000*	*%*	*RMB'000*	*%*
Gain on disposal of an associate	—	—	—	—	—	—	—	—	1,076	57.1
Rental income	—	—	207	5.8	310	9.5	129	8.4	129	6.8
Interest income	60	5.6	77	2.2	117	3.6	41	2.7	50	2.7
Government grants	—	—	2,529	71.2	—	—	—	—	—	—
Corporate income tax refund	—	—	—	—	559	17.1	—	—	—	—
Value-added tax refund	—	—	—	—	1,251	38.2	1,205	78.2	443	23.5
Maintenance income	550	51.7	379	10.7	733	22.4	165	10.7	56	3.0
Sundry income	453	42.7	359	10.1	301	9.2	—	—	131	6.9
Total	1,063	100	3,551	100	3,271	100	1,540	100	1,885	100

Selling and distribution costs

Selling and distribution costs consisted mainly of the following expenses incurred by the sales and marketing department: (i) staff salaries and welfare; (ii) transportation and travelling expenses; (iii) office expenses such as telephone charges and utilities costs; (iv) entertainment expenses; and (v) others, such as rental and depreciation. During the Track Record Period, staff costs accounted for the largest portion, representing an average of approximately 43% of the total selling and distribution costs.

Breakdown of selling and distribution costs during Track Record Period

	Year ended 31 December						Five months ended 31 May			
	2001		2002		2003		2003 (unaudited)		2004	
	RMB'000	*%*	*RMB'000*	*%*	*RMB'000*	*%*	*RMB'000*	*%*	*RMB'000*	*%*
Staff costs	5,474	34.8	4,344	42.8	6,050	51.2	2,414	52.3	3,485	46.4
Transportation and travelling expenses	4,330	12.9	2,288	22.5	2,523	21.3	916	19.8	1,380	18.4
Office expenses	2,019	27.6	1,030	10.1	726	6.1	313	6.8	1,128	15.0
Entertainment expenses	2,044	13.0	1,043	10.3	1,394	11.8	641	13.9	598	8.0
Others	1,849	11.7	1,450	14.3	1,125	9.6	336	7.2	912	12.2
Total	15,716	100.0	10,155	100.0	11,818	100.0	4,620	100.0	7,503	100.0

Administrative expenses

Administrative expenses consisted mainly of (i) salaries and welfare of staff for administrative personnel and directors' remuneration; (ii) audit, legal and professional fees; (iii) office expenses such as telephone charges and utilities costs; (iv) transportation and travelling expenses; and (v) others such as depreciation and rental, provision for doubtful debts and obsolete and slow-moving inventories, and amortisation of capitalised R&D expenses. During the Track Record Period, staff costs and directors' remuneration accounted for the largest portion, representing an average of approximately 46% of the administrative expenses during the Track Record Period.

Breakdown of administrative expenses during Track Record Period

	Year ended 31 December						Five months ended 31 May			
	2001		2002		2003		2003 (unaudited)		2004	
	RMB'000	*%*	*RMB'000*	*%*	*RMB'000*	*%*	*RMB'000*	*%*	*RMB'000*	*%*
Staff costs and directors' remuneration	7,448	40.7	6,827	40.6	7,713	51.0	2,697	53.2	2,651	36.0
Audit, legal and professional fees	1,609	8.8	922	5.5	1,319	8.7	128	2.5	924	12.5
Office expenses	2,804	15.3	2,244	13.4	2,157	14.3	627	12.4	1,065	14.5
Transportation and travelling expenses	1,409	7.7	1,319	7.8	1,090	7.2	395	7.8	543	7.4
Others	5,025	27.5	5,513	32.7	2,831	18.8	1,221	24.1	2,184	29.6
Total	18,295	100.0	16,825	100.0	15,110	100.0	5,068	100.0	7,367	100.0

Other operating expenses

Other operating expenses represented mainly (i) sales of scraps; (ii) loss on materials and products, being deficiency noted during stocktake; and (iii) others, such as bank charges.

Breakdown of other operating expenses during Track Record Period

	Year ended 31 December						Five months ended 31 May			
	2001		2002		2003		2003 (unaudited)		2004	
	RMB'000	*%*	*RMB'000*	*%*	*RMB'000*	*%*	*RMB'000*	*%*	*RMB'000*	*%*
Sales of scraps	—	—	65	7.3	77	15.7	70	71.4	—	—
Loss on materials and products	1,096	84.8	663	74.5	82	16.7	—	—	141	55.3
Others	197	15.2	162	18.2	335	67.6	28	28.6	114	44.7
Total	1,293	100.0	890	100.0	494	100.0	98	100.0	255	100.0

Finance costs

Finance costs represented interest expenses on bank loans and an amount due to a director and on discounted trade receivables.

Taxation

Tax in Hong Kong

No provision for Hong Kong profits tax has been made as the Group did not generate any assessable profits arising or derived from Hong Kong during the Track Record Period.

Corporate income tax in the PRC

According to the《中華人民共和國外商投資企業和外國企業所得稅法》(Income Tax Law of the PRC for Foreign Investment Enterprises and Foreign Enterprises) and as approved by relevant tax authorities, Yulong Shenzhen, as a WFOE registered in Shenzhen Special Economic Zone, the PRC, is exempted from local corporate income tax and its applicable State corporate income tax rate is 15%. Moreover, according to《政策性減免稅批覆書》(Reply on policy tax exemption and relief) issued by 深圳市地方稅局福田增收分局 (Shenzhen Futian Local Tax Bureau), Yulong Shenzhen is exempted from the State corporate income tax of the PRC for the two years starting from the first profitable year of operation and a 50% relief from the State corporate income tax of the PRC for the following three years. The first profitable year of operation of Yulong Shenzhen is 1996 and therefore Yulong Shenzhen was exempted from the State corporate income tax for the two years ended 31 December 1997 and was entitled to the State corporate income tax rate of 7.5% for the three years ended 31 December 2000. On 20 July 1999, Yulong Shenzhen was accredited as the 深圳市高新技術企業 (Shenzhen Hi-tech Enterprise) by 深圳市科學技術局 (Shenzhen Science and Technology Council). According to《關於深圳宇龍計算機通信科技有限公司企業所得稅減免問題的覆函》(Reply on exemption and relief of corporate income tax of Yulong Shenzhen) issued by 深圳市地方稅務局涉外檢查分局 (Shenzhen Tax Bureau External Affair Department), Yulong Shenzhen was entitled to 50% tax relief from the State corporate income tax of the PRC for another three years starting from 2001. Therefore, the applicable corporate income tax rate for Yulong Shenzhen was 7.5% for the three years ended 31 December 2003. The applicable corporate income tax rate for Yulong Shenzhen is 15% starting from 1 January 2004.

The PRC Lawyers confirmed that Yulong Shenzhen's entitlement to the tax exemption and tax relief as a WFOE in the Shenzhen Special Economic Zone and as a high-tech enterprise during the Track Record Period is in line with the relevant PRC laws and regulations.

Value-added tax ("VAT") in the PRC

Based on《中華人民共和國增值稅暫行條例》(Provisional rules regarding value-added tax in the PRC), for general VAT payers, VAT is levied at 17% on the invoiced value of their domestic sales and is payable by the purchaser. The VAT payers are then required to remit the VAT they collect on their sales to the tax authority, but may deduct such VAT from the VAT they have paid on eligible purchases. However, for small scale VAT payers, which typically are (i) companies mainly engaged in manufacturing or labour intensive business and with turnover of less than RMB1 million; or (ii) companies mainly engaged in wholesale or retail business and with turnover of less than RMB1.8 million, VAT is levied at 6% on the invoiced value of their domestic sales but no deduction is allowed from the VAT they have paid on eligible purchases. VAT payers other than small-scale VAT payers are general VAT payers. Once become a general VAT payer, a company cannot be qualified as a small-scale VAT payer subsequently.

Before 1 May 2002, Yulong Shenzhen was a small-scale VAT payer, and could not deduct the VAT they had paid on eligible purchases. Based on《增值稅一般納稅人申請認定辦法》(Rules on qualification as and application for a general VAT payer) issued by 國家稅務總局 (State Administration of Taxation) and approved by 深圳市福田區國家稅局 (Shenzhen Futian State Tax Bureau) ("Qualification Rules"), Yulong Shenzhen was certified as a general VAT payer from 1 May 2002, and since then may deduct the VAT from the VAT it has paid on eligible purchases from the VAT it has collected. Moreover, according to《關於鼓勵軟件產業和集成電路產業發展和有關稅收政策問題的通知》(Notice on tax policy to encourage the development of software enterprises and integrated electronic enterprises) (the "Notice"), general VAT payers are entitled to refund for the VAT they had paid for more than 3% of the sales in relation to software products. Therefore, starting from 1 May 2002, the Group's sales in relation to software products are effectively only subject to 3% of VAT tax under the Notice by applying for VAT refund from tax bureau based on invoices issued for sales of software, while sales not in relation to software products are subject to 17% VAT.

The following table illustrates the various VAT rates the Group was subject to during the Track Record Period:

	Year ended 31 December			Five months ended 31 May	
	2001	2002	2003	2003 (unaudited)	2004
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
VAT rate					
17%	—	70,988	158,015	45,115	84,189
6%	84,767	21,735	—	—	—
3%	—	8,606	3,493	1,913	—
Total turnover	84,767	101,329	161,508	47,028	84,189

The PRC Lawyers confirmed that based on the Qualification Rules, a small scale VAT payer is not obligated to apply for a general VAT payer status even if its turnover exceeds the relevant thresholds and is entitled to continue to enjoy the benefits of being a small scale VAT payer. Therefore, the PRC Lawyers confirmed that notwithstanding the fact that Yulong Shenzhen's turnover exceeded the relevant thresholds of being a small scale VAT payer before 1 May 2002, Yulong Shenzhen's status as a small-scale VAT payers before 1 May 2002 and as a general VAT payer after 1 May 2002, as well as Yulong Shenzhen's entitlement to VAT refund in relation to sales of software products, are in line with the relevant PRC laws and regulations, and Yulong Shenzhen will not be subject to any tax penalties or legal claims in this regard. The PRC Lawyers further confirmed that Yulong Shenzhen should be qualified for enjoying such benefits so long as it meets the requirement of generating revenue by way of development and sales of software as stipulated by the relevant PRC laws and regulations.

Other

Since its establishment, Yulong Shenzhen has been imposed two tax penalties: (i) in May 1999, Yulong Shenzhen was fined for RMB50,943.40 in relation to delayed payment of VAT of RMB169,811.32, Yulong Shenzhen has fully paid the fine and the VAT; and (ii) in September 2001, Yulong Shenzhen was fined for RMB554.28 in relation to delayed payment of real estate tax of RMB5,542.84, Yulong Shenzhen has fully paid the fine and the real estate tax. The Directors confirmed that other than the above two tax penalties, the Group was not subject to any other tax penalties during the Track Record Period.

PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies applied in the preparation of the Group's accountants' report set forth in Appendix I to this prospectus are set forth in note 2 "Principal accounting policies" thereof. Principal accounting policies are important to the presentation of the Group's financial conditions and results of operations, and require management's most careful, subjective and complex judgement, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Certain estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting the estimates may differ significantly from the management's current judgement. The Directors consider that the following principal accounting policies involve the most significant judgement and estimates in preparation for the Group's financial statements.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group, and when the revenue can be measured reliably, on the following bases:—

(i) for wireless system solutions (other than *Realink PHS Intelligent Coverage System*) sold to telecommunication operators and corporations, revenue is generally recognised by two installments. The first installment of about 40% to 80% of the contract amount is normally recognised when the customer issues a preliminary certification after the installation and testing, while the second installment of the remaining contract amount is normally recognised when the customer issues the final certification after the trial run.

The Group normally provides one-year warranty for its wireless system solutions. At the end of the warranty period, payment for the retention money of about 5% to 10% of the contract amount would be received from the customers. Such retention money would have been already recognised by the Group upon final certification for acceptance by the customer.

(ii) for *Realink PHS Intelligent Coverage System* sold to telecommunication equipment or solution distributors and wireless terminals sold to telecommunication operators and wireless terminal distributors, revenue is typically recognised upon delivery of the products;

(iii) from the rendering of services associated with goods sold, upon completion of such services;

(iv) for rental income, on a time proportion basis over the lease terms;

(v) for interest income, on a time proportion basis taking into account the principal outstanding and the effective interest rate applicable; and

(vi) for government grants and tax refund, on receipt of such grants and refund.

Provision for obsolete and slow-moving inventories

It is the policy of the Group to make specific provision against slow-moving and obsolete inventories. Typically, the Group performs physical count of its inventories and reports to the management on a monthly basis. The management then determines the provision against slow-moving and obsolete inventories and items to be written off based on the information and their experience.

Provision for doubtful debts

The Group adopts the general policy of making general provision equivalent to 50% of the gross amount of receivables due over 1 year and 100% of the gross amount of receivables due over 2 years. It is the Group's policy to access the recoverability of trade receivable from each customer individually on a monthly basis and to make specific provision accordingly, by checking sufficiency against the provision made under the general provision policy. If the specific provision is less than that under the general provision policy, additional provision will be made.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS

The following discussion of the results of the Group's operation should be read in conjunction with the combined financial statement during the Track Record Period as set forth in the accountants' report, the text of which is set forth in Appendix I to this prospectus.

Overview

The Group is a wireless solution and equipment provider in the PRC. The Group's products and solutions can be summarised as follows:—

1. ***Wireless system solutions***

   (1) *Wireless coverage system solutions*

   — Wireless transceivers for paging network

   — *Realink PHS Intelligent Coverage System* (a multiple-channel PHS coverage system)

   (2) *Integrated telecom business platform*

   — *Callnet* (a call center solution)

   — *Wireless Value-added Services Platform* (a back-end support system for provision of wireless voice and data value-added services with management functions)

2. ***Wireless terminals***

   (1) One-way wireless terminals

   (2) Fixed wireless terminals

   (3) Smartphone

During the Track Record Period, the Group achieved continuous growth in turnover and net profit from ordinary activities attributable to Shareholders due to the expansion of the Group's business and launch of new products and solutions to cater for the demand of the growing telecommunication market in the PRC. Turnover grew from approximately RMB84.8 million (approximately HK$80.0 million) in 2001 to approximately RMB161.5 million (approximately HK$152.4 million) in 2003, representing a CAGR of approximately 38%. Net profit attributable to Shareholders grew from approximately RMB13.6 million (approximately HK$12.8 million) in 2001 to approximately RMB39.2 million (approximately HK$37.0 million) in 2003, representing a CAGR of approximately 70.1%. During the five months ended 31 May 2004, the Group's turnover was approximately RMB84.2 million (approximately HK$79.4 million), increased by approximately 79.2% from the same period in 2003. Net profit from ordinary activities attributable to Shareholders was approximately RMB15.4 million (approximately HK$14.5 million), increased by approximately 25.1% from the same period in 2003.

During the Track Record Period, the Group's major source of turnover changed from sales of wireless system solutions to wireless terminals. The contribution from wireless system solutions decreased from approximately 99.3% in 2001 to approximately 18.3% in the five months ended 31 May 2004, while that from wireless terminals increased from approximately 0.7% in 2001 to approximately 81.7% in the five months ended 31 May 2004. As a result, the Group's overall gross profit margin declined from approximately 60% in 2001 to 37.8% in the five months ended 31 May 2004, as the wireless terminals have a lower gross margin than that of the wireless system solutions facing intense pricing pressure and competition. Such change of product mix during the Track Record Period is in line with the shift of investment focus of the telecommunication operators in the PRC from network infrastructure to value-added services and industry applications.

Key factors affecting the results of the Group's operations

The Group's turnover and ability to continue to generate profits are affected by a number of factors, including the following principal factors:—

- Emergence of new technologies in wireless telecommunication;
- Change of regulations for the telecommunication industry in the PRC;
- The Group's R&D capabilities;
- The Group's ability to manage and control operating costs; and
- The Group's effectiveness in competing with other wireless solution and equipment providers.

Prospects and growth strategy

During the Track Record Period, the Group was able to effectively adjust its products and solutions in line with the investment focus of the telecommunication industry in the PRC. As basic infrastructure of the existing telecommunication network in the PRC matures and the competition among telecommunication operators intensifies, the Directors expect that the contribution of wireless system solutions to the Group would either become stable or decrease gradually till the emergence of new technology or standard. On the other hand, given the huge size and population of the PRC, the increasing use of wireless services and requirement for more sophiscated data handling capability of wireless terminals, the Directors envisage the potential of the Group's wireless terminal products based on its proprietary operating system, particularly smartphone, to be substantial. Under the current market condition, the Group expects to derive growth from wireless terminal products, particularly smartphone, while the Group would continue to provide wireless system solutions and relevant services to telecommunication operators in order to gain insight of technological and other developments. The Directors believe that such development will most likely shape the wireless service user behavior, which is one of the important considerations for designing terminal products by the Group. In the long term, the Group expects to continue to generate growth by providing products and solutions in response to the emergence of new technology and the changing requirements of the telecommunication operators and corporate clients by utilising core wireless technologies.

Year ended 31 December 2002 compared to year ended 31 December 2001

Turnover

The Group's turnover increased by approximately 19.5% from approximately RMB84.8 million (approximately HK$80 million) in 2001 to approximately RMB101.3 million (approximately HK$95.6 million) in 2002. The increase was mainly due to the sales of the Group's newly launched solutions under the integrated telecom business platform in 2002. In 2002, the major source of turnover was sales of wireless system solution, representing approximately 93.7% of the Group's turnover.

Turnover from wireless system solutions increased by approximately 12.8% to approximately RMB95 million (approximately HK$89.6 million) in 2002, which was mainly due to:—

(i) sales from the Group's *Callnet* call centre solutions, which was launched in June 2002 and a total of 3 projects were delivered to the provincial branches of the China Unicom Group; and

(ii) substantial increase of sales from *Wireless Value-added Services Platform*, which was only launched in June 2001. In 2002, 11 *Wireless Value-added Services Platform* were delivered, compared to 2 in 2001.

Turnover from wireless terminals increased by approximately 1,023% to approximately RMB6.4 million (approximately HK$6 million) in 2002, accounting for approximately 6.3% of the Group's total turnover in 2002. Such substantial increase was mainly due to:—

(i) substantial increase of approximately RMB4.3 million (approximately HK$4.1 million) from sales of its one-way wireless terminals due to the well-acceptance of the Group's paging information receivers, which was launched in late 2001; and

(ii) sales from the Group's newly-launched fixed wireless terminal products for GSM/GPRS network, which generated sales of approximately RMB1.5 million (approximately HK$1.4 million).

The increase was partly offset by the decrease in sales of the Group's wireless transceivers by approximately 11.9% as a result of the maturing of the paging network in the PRC. During 2002, 58 wireless transceiver solutions were delivered, compared to 107 in 2001.

Cost of sales

Cost of sales increased by approximately 17.9% from approximately RMB34.3 million (approximately HK$32.6 million) in 2001 to approximately RMB40.5 million (approximately HK$38.2 million) in 2002. Such increase was in line with the growth in the Group's turnover. In 2002, cost of materials accounted for approximately 93% of the total cost of sales, compared to approximately 89% in 2001. Such increase was mainly due to the Group's engagement of one OEM in Shenzhen for the production of the Group's wireless terminals. By engaging the OEM, the Group provided materials and components to the OEM, who carried out the manufacturing. As a result, the proportion of cost of materials increased and that of labor cost and manufacturing overhead decreased.

Gross profit

The Group's gross profit increased by approximately 20.6% from approximately RMB50.5 million (approximately HK$47.6 million) in 2001 to approximately RMB60.9 million (approximately HK$57.5 million) in 2002. Gross profit margin increased slightly from approximately 59.5% in 2001 to 60% in 2002. During 2002, the gross profit margin for wireless system solutions and wireless terminal products were approximately 61% and 41% respectively. The higher gross profit margin for the wireless system solutions is due to higher proportion of services and software element of the wireless system solutions as compared to wireless terminal products. Gross profit margin of wireless system solutions increased slightly from approximately 60% in 2001 to approximately 61% in 2002, which was mainly due to the Group's ability to charge a higher price for its newly launched *Callnet*. Gross profit margin of wireless terminals decreased slightly from approximately 45% in 2001 to approximately 41% in 2002, which was mainly due to the increase in cost of materials as mentioned above.

Other revenue

The Group's other revenue increased by approximately 234.1% from approximately RMB1.1 million (approximately HK$1 million) in 2001 to approximately RMB3.6 million (approximately HK$3.4 million) in 2002. Such increase was mainly due to the receipt of government grant from 深圳財務局 (Shenzhen Finance Bureau) by the Group as a high-technology enterprise of approximately RMB2.5 million (approximately HK$2.4 million). There was no such grant received in 2001.

Selling and distribution costs

The Group's selling and distribution costs decreased by approximately 35.4% from approximately RMB15.7 million (approximately HK$14.8 million) in 2001 to approximately RMB10.2 million (approximately HK$9.6 million) in 2002. As a percentage of turnover, the selling and distribution costs decreased from approximately 18% in 2001 to approximately 10% in 2002. Such decrease is principally due to the decrease in headcount of the sales team from 58 in 2001 to 47 in 2002, since major sales and marketing activities in relation to the launch of the *Callnet* call centre solution and the new wireless terminal products were carried out in 2001, while in 2002, the sales and marketing activities reduced as the market had become aware of the product and the solution.

Administrative expenses

The Group's administrative expenses decreased by approximately 8% from approximately RMB18.3 million (approximately HK$17.3 million) in 2001 to approximately RMB16.8 million (approximately HK$15.8 million) in 2002. As a percentage of turnover, the administrative expenses decreased from approximately 21.6% in 2001 to approximately 16.6% in 2002. Such decrease was mainly due to the decrease in staff headcount of the general administration department from 223 in 2001 to 196 in 2002.

Other operating expenses

The Group's other operating expenses decreased by approximately 31.2% from approximately RMB1.3 million (approximately HK$1.2 million) in 2001 to approximately RMB0.9 million (approximately HK$0.8 million) in 2002. As a percentage of turnover, other operating expenses decreased from approximately 1.5% to 0.9% in 2002. Such decrease was mainly due to the decrease in loss on materials and products as a result of the Group's effort in inventory control during 2002.

Finance costs

The Group's finance costs increased by approximately 31.5% from approximately RMB0.9 million (approximately HK$0.8 million) in 2001 to approximately RMB1.1 million (approximately HK$1 million) in 2002. Such increase mainly represented the increase in interest payments for mortgage loans in relation to properties used by the Group as office and R&D centre.

Share of loss of an associate

The amount of share of loss of an associate represented the Group's share of loss in its 30% owned associate Shenzhen Yi Wei Digital Technologies Co,. Ltd. ("Shenzhen Yi Wei"). Shenzhen Yi Wei was mainly engaged in development and design of website and software of online gaming and incurred loss since its establishment in January 2001. Shenzhen Yi Wei became dormant since June 2002. As a result, the Group's share of its loss decreased by approximately 56% from approximately RMB0.7 million (approximately HK$0.67 million) in 2001 to approximately RMB0.3 million (approximately HK$0.28 million) in 2002.

Taxation

As mentioned in the paragraph headed "Principal financial statements components — Taxation", the Group's applicable corporate income tax rate was 7.5% for 2001 and 2002. In 2001, the Group's effective tax rate was approximately 9.7%, the difference from the applicable tax rate was mainly due to the adjustment for expenses not deductible for tax purpose of approximately RMB324,000 (approximately HK$306,000). In 2002, the Group's effective tax rate was approximately 7%, the difference from the applicable tax rate was mainly due to the receipt of government grant of approximately RMB2.5 million, from 深圳財務局 (Shenzhen Finance Bureau) with a tax effect of RMB188,000 (approximately HK$177,000), which was exempted from corporate income tax.

Minority interest

The Group recorded a minority interest of approximately RMB343,000 (approximately HK$324,000) in 2001, which represented the share of the Group's loss for the five months ended 31 May 2001 by Yulong Shenzhen's then minority shareholder, Dickman Enterprises Company Limited. The Group's sales are generally lower during the first quarter of the year, when the telecommunication operators are still in the process of annual budget. Therefore, the Group's revenue for the five months ended 31 May 2001 was not enough to cover its fixed cost and incurred a loss during the period. No minority interest was recorded in 2002 as Dickman Enterprises Company Limited has ceased to be a minority shareholder of Yulong Shenzhen since June 2001. For details of Dickman Enterprises Company Limited, please refer to the paragraph headed "History and development — Shareholding" in the section headed "Business" in this prospectus.

Net profit from ordinary activities attributable to shareholders

The Group's net profit from ordinary activities attributable to shareholders increased by approximately 141% from approximately RMB13.6 million (approximately HK$12.8 million) in 2001 to approximately RMB32.7 million (approximately HK$30.8 million) in 2002. The increase was mainly due to the increase in the Group's turnover in 2002. The Group's net profit margin increased from approximately 16% in 2001 to approximately 32.3% in 2002. The increase was mainly due to the (i) relatively stable gross profit margin in 2002 compared to 2001; and (ii) decrease of selling and distributions expenses and administrative expenses as a percentage of turnover.

Year ended 31 December 2003 compared to year ended 31 December 2002

Turnover

The Group's turnover increased by approximately 59.4% from approximately RMB101.3 million (approximately HK$95.6 million) in 2002 to approximately RMB161.5 million (approximately HK$152.4 million) in 2003. The increase was mainly due to the Group's newly launched *Realink PHS Intelligent Coverage System*, fixed wireless terminals and CDMA1X smartphones for CDMA network. In 2003, the major source of turnover was sales of wireless terminals, representing approximately 69.8% of the Group's turnover.

Turnover from the Group's wireless system solutions decreased by approximately 48.6% to approximately RMB48.8 million (approximately HK$46 million) in 2003, accounted for approximately 30.2% of the Group's turnover in 2003. Such decrease was mainly due to:—

(i) decrease in sales of wireless transceivers for paging network as a result of the maturing of paging network in the PRC. In 2003, 15 wireless transceiver solutions were delivered, compared with 58 such projects in 2002;

(ii) decrease in sales of *Callnet* call centre solution. 3 *Callnet* call centre solutions were delivered in 2003, same as those in 2002, but the average project price of *Callnet* decreased from approximately RMB4.4 million (approximately HK$4.2 million) in 2002 to approximately RMB4 million (approximately HK$3.8 million) in 2003, as a result of the smaller size of projects delivered during the year; and

(iii) decrease in sales of *Wireless Value-added Service Platform*. In 2003, 9 projects were delivered compared with 11 in 2002.

The decrease in turnover from wireless system solutions was partly offset by the sales from the Group's newly launched *Realink PHS Intelligent Coverage System*. In 2003, 6 such projects were delivered.

Sales of wireless terminal products increased substantially by approximately 1,666.9% to approximately RMB112.7 million (approximately HK$106.3 million) in 2003. Such increase was mainly due to:—

(i) substantial increase in sales from the fixed wireless terminals by approximately 58 times due to expanded sales and marketing efforts and launch of fixed wireless terminals for CDMA network; and

(ii) successful launch of the *Coolpad* CDMA1X smartphones in December 2003, which generated sales of approximately RMB19.2 million (approximately HK$18.1 million).

Cost of sales

Cost of sales increased by approximately 129.5% from approximately RMB40.5 million (approximately HK$38.2 million) in 2002 to approximately RMB92.8 million (approximately HK$87.5 million) in 2003. Such increase was in line with the growth in the Group's turnover and shift in product mix. In 2003, raw material accounted for approximately 97.6% of the Group's cost of sales, compared with that of approximately 93% in 2002. Such increase was mainly due to increase of sales of wireless terminals.

Gross profit

Gross profit increased by approximately 12.8% from approximately RMB60.9 million (approximately RMB57.5 million) in 2002 to approximately RMB68.7 million (approximately HK$64.8 million) in 2003. Gross profit margin decreased from approximately 60% in 2002 to approximately 42.5% in 2003. Such decrease was principally due to shift in product mix as explained under the paragraph headed "Turnover" above. The gross profit margin for wireless system solutions of approximately 59% remained higher than that of the wireless terminals of approximately 35%, as there is higher proportion of services and software element of the wireless system solutions than wireless terminal products.

Gross profit margin for wireless system solution decreased slightly from approximately 61% in 2002 to 59% in 2003, as the Group was able to maintain sales price of its wireless system solutions through the launch of the *Realink PHS Intelligent Coverage System* and establishment of its reputation in this field. Gross profit margin for wireless terminals decreased from approximately 41% in 2002 to 35% in 2003, which was mainly due to the pressure on the pricing of one-way wireless terminal products, for which market demand was not particularly strong. Smartphone was newly launched towards the end of 2003. The gross margin of smartphone was around 38%, which was similar to the average gross profit margin of the other wireless terminal products of the Group.

Other revenue

Other revenue decreased slightly by approximately 8% from approximately RMB3.6 million (approximately HK$3.4 million) in 2002 to approximately RMB3.3 million (approximately HK$3.1 million) in 2003. In 2003, the Group received VAT refund of approximately RMB1.3 million (approximately HK$1.2 million) for sales of software products. The Group became eligible for such refund since it became a general VAT payer on 1 May 2002.

Selling and distribution costs

Selling and distribution costs increased by approximately 16.4% from approximately RMB10.2 million (approximately HK$9.6 million) to approximately RMB11.8 million (approximately HK$11.1 million) in 2003. The increase was mainly attributable to the increase in headcount in sales team from 47 to 86 in 2003 in order to carry out the sales and marketing activities in relation to the Group's CDMA fixed wireless terminal products and launch of the *Coolpad* CDMA1X smartphones. Nevertheless, as a percentage of turnover, selling and distribution costs decreased from approximately 10% to approximately 7.3% in 2003, which was mainly due to increase in awareness of importance of control cost. In 2004, the Group implemented a performance assessment system in some departments such as the wireless system solutions department and the sales department which includes operating expenditure as one of the performance measurements.

Administrative expenses

The Group's administrative expenses decreased by approximately 10.2% from approximately RMB16.8 million (approximately HK$15.8 million) to approximately RMB15.1 million (approximately HK$14.2 million) in 2003. As a percentage of turnover, administrative expenses decreased from approximately 16.6% to approximately 9.4% in 2003. The decrease was mainly due to implementation of cost control measures during 2003 as mentioned above.

Other operating expenses

The Group's other operating expenses decreased by approximately 44.5% from approximately RMB0.9 million (approximately HK$0.8 million) to approximately RMB0.5 million (approximately HK$0.46 million) in 2003. As a percentage of turnover, other operating expenses decreased from approximately 0.9% to 0.3% in 2003. The decrease was also mainly due to the implementation of the cost control measures as mentioned above.

Finance costs

The Group's finance costs increased by approximately 73.1% from approximately RMB1.1 million (approximately HK$1 million) to approximately RMB2 million (approximately HK$1.8 million) in 2003. The increase is mainly due to the increase in short-term bank loans used to support the Group's business expansion.

Share of loss of an associate

The amount of share of loss of Shenzhen Yi Wei decreased by approximately 86.3% from approximately RMB315,000 (approximately HK$297,000) to approximately RMB43,000 (approximately HK$40,000) in 2003 as Shenzhen Yi Wei continued to remain dormant during 2003. The loss was mainly due to depreciation of office equipment held by Shenzhen Yi Wei.

Taxation

As mentioned in the paragraph headed "Principal financial statements components — Taxation", the Group's applicable corporate income tax rate was 7.5% for 2002 and 2003. In 2003, the Group's effective tax rate was approximately 7.8%, the difference from the applicable tax rate was mainly due to adjustment for expenses not deductible for tax purpose of approximately RMB112,000 (equivalent to approximately HK$106,000).

Net profit from ordinary activities attributable to shareholders

The Group's net profit from ordinary activities attributable to shareholders increased by approximately 20% from approximately RMB32.7 million (approximately HK$30.8 million) in 2002 to approximately RMB39.2 million (approximately HK$37 million) in 2003. The increase was mainly due to the increase in the Group's turnover in 2003. The Group's net profit margin decreased from approximately 32.3% in 2002 to approximately 24.3% in 2003. The decrease was mainly due to a change of product mix and more products of lower gross margin were sold in 2003.

Five months ended 31 May 2004 compared to five months ended 31 May 2003 (unaudited)

Turnover

The Group's turnover increased by approximately 79% from approximately RMB47 million (approximately HK$44.3 million) for the five months ended 31 May 2003 to approximately RMB84.2 million (approximately HK$79.4 million) for the five months ended 31 May 2004. The increase was mainly due to the substantial increase in sales of the Group's smartphone products.

For the five months ended 31 May 2004, turnover from wireless system solutions decreased by approximately 51.8% to approximately RMB15.4 million (approximately HK$14.5 million). Such decrease was mainly due to:—

(i) the Group did not deliver any wireless transceiver for paging network during the five months ended 31 May 2004 as a result of the maturing of the paging network market in the PRC. During the five months ended 31 May 2003, the Group delivered 9 such projects;

(ii) decrease in sales of *Callnet* call centre solution. For the five months ended 31 May 2004, the Group delivered 1 *Callnet* call centre solution, compared with 2 such projects in the five months ended 31 May 2003; and

(iii) decrease in sales of *Wireless Value-added Service Platform*. For the five months ended 31 May 2004, the Group delivered 5 such projects, compared with 6 in the five months ended 31 May 2003.

The decrease in turnover of wireless system solutions was partly offset by the sales from the Group's *Realink PHS Intelligent Coverage System*. In the five months ended 31 May 2004, the Group delivered 30 *Realink PHS Intelligent Coverage System*, but did not deliver any such project in the five months ended 31 May 2003 as the *Realink PHS Intelligent Coverage System* was launched in December 2003.

Sales of wireless terminals increased substantially by approximately 354.1% to approximately RMB68.8 million (approximately HK$64.9 million) for the five months ended 31 May 2004. Such increase was mainly due to:—

(i) increase in sales of fixed wireless terminal, as the Group launched new models with less functions and of lower prices in response to increasing market competition in the end of 2003, therefore boosting sales; and

(ii) the sales of the Group's CDMA1X smartphones, which was launched in December 2003.

The increase was partly offset by decrease in sales of one-way wireless terminals. The Directors believe that the decrease was resulted from the shrinking paging market of the PRC. In the future, the Group would not put substantial resources in the R&D or marketing of this product. Instead, the Group will only deliver this type of products based on specific order from earlier customers.

Cost of sales

Cost of sales increased by approximately 108.2% from approximately RMB25.2 million (approximately HK$23.7 million) for the five months ended 31 May 2003 to approximately RMB52.4 million (approximately HK$49.4 million) for the five months ended 31 May 2004. Such increase was in line with the Group's increase in turnover, especially that of smartphones, the major raw materials of which, such as LCD, are relatively more expensive.

Gross profit

Gross profit margin decreased from approximately 46.5% for the five months ended 31 May 2003 to approximately 37.8% for the five months ended 31 May 2004, which was mainly due to the increase of turnover from wireless terminals, which in general has a lower profit margin than that of the wireless system solution.

Gross profit margin for wireless system solutions increased from approximately 55% for the five months ended 31 May 2003 to approximately 70% for the five months ended 31 May 2004, mainly due to the increase in the selling price of *Realink PHS Intelligent Coverage System*, which was set at a relatively low price in 2003 as a newly launched product. Gross profit margin for wireless terminals was approximately 31% for the five months ended 31 May 2004, increased from approximately 29% for the five months ended 31 May 2003. Such increase was mainly due to the Group's launch of smartphone product, which has a higher gross profit margin.

Other revenue

Other revenue increased by approximately 22.4% from approximately RMB1.5 million (approximately HK$1.4 million) in the five months ended 31 May 2003 to approximately RMB1.9 million (approximately HK$1.8 million) in the five months ended 31 May 2004. Such increase was mainly due to the gain in the disposal of Shenzhen Yi Wei of approximately RMB1.1 million (approximately HK$1 million) in February 2004.

Selling and distribution costs

Selling and distribution costs increased by approximately 62.4% from approximately RMB4.6 million (approximately HK$4.4 million) in the five months ended 31 May 2003 to approximately RMB7.5 million (approximately HK$7.1 million) in the five months ended 31 May 2004. The increase was mainly due to the increase in the headcount of the sales team from 76 in the five months ended 31 May 2003 to 105 in the five months ended 31 May 2004 due to the promotion activities for the Group's smartphones.

Administrative expenses

Administrative expenses increased by approximately 45.4% from approximately RMB5.1 million (approximately HK$4.8 million) in the five months ended 31 May 2003 to approximately RMB7.4 million (approximately HK$7 million) in the five months ended 31 May 2004. Such increase was mainly due to the expansion of the Group's business as a result of the launch of smartphone in December 2003.

Other operation expenses

Other operation expenses increased by approximately 160.2% from approximately RMB98,000 (approximately HK$92,000) in the five months ended 31 May 2003 to approximately RMB255,000 (approximately HK$241,000) in the five months ended 31 May 2004. Such increase was mainly due to increase in loss on materials and products of approximately RMB141,000 (approximately HK$133,000) during the five months ended 31 May 2004.

Finance costs

Finance costs increased by approximately 122.6% from approximately RMB372,000 (approximately HK$351,000) in the five months ended 31 May 2003 to approximately RMB828,000 (approximately HK$781,000) in the five months ended 31 May 2004. The increase was mainly due to increase in short-term bank loan during the five months ended 31 May 2004 to finance the Group's business expansion.

Taxation

As mentioned in the paragraphs headed "Principal financial statements components — Taxation", the Group's applicable corporate income tax rate was 15% in 2004. During the five months ended 31 May 2004, the Group's effective tax rate was approximately 13%. The difference from the applicable tax rate was mainly due to adjustment for gain on disposal of an associate which was exempted from corporate income tax.

Net profit from ordinary activities attributable to shareholders

The Group's net profit from ordinary activities attributable to shareholders increased by approximately 25.1% from approximately RMB12.3 million (approximately HK$11.6 million) for the five months ended 31 May 2003 to approximately RMB15.4 million (approximately HK$14.5 million) for the five months ended 31 May 2004. The increase was mainly due to the increase in the Group's turnover during the period. The Group's net profit margin decreased from approximately 26.2% for the five months ended 31 May 2003 to approximately 18.3% for the five months ended 31 May 2004. The decrease was mainly due to the decrease in gross profit margin for the five months ended 31 May 2004 compared to the five months ended 31 May 2003 due to change of product mix.

Inventories

Breakdown of inventories during the Track Record Period is set out as follows:—

	31 December			31 May
	2001	2002	2003	2004
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Raw materials	6,037	6,691	10,484	13,509
Work in progress	1,501	2,086	2,652	2,341
Finished goods	28,913	10,916	7,747	17,543
	36,451	19,693	20,883	33,393

All of the inventory balances as at 31 May 2004 had less than 6-months aging. Up to the Latest Practicable Date, all of the inventory balances as at 31 May 2004 and as at 31 December 2003 had been fully used.

In 2001, approximately RMB804,000 (equivalent to approximately HK$758,000) provision was made against obsolete and slow-moving inventories, while no such provision was made in 2002, 2003 and the five months ended 31 May 2004. The Directors confirm that the Group's provision for obsolete and slow-moving inventories are sufficient.

The inventory turnover days in 2001, 2002, 2003 and in the five months ended 31 May 2004 were approximately 421 days, 253 days, 80 days and 79 days, respectively. The decrease of turnover days during the Track Record Period was mainly attributable to the Group's improvement in inventory management and shift of product mix from wireless system solutions products to wireless terminal products.

For wireless system solution, since materials and components are normally purchased at the beginning of a project but used by stages in accordance with the progress of the project, inventory turnover days are relatively long. Therefore, the Group's inventory turnover days were relatively long in 2001 and 2002 when revenue from wireless system solutions accounted for the majority of the Group's turnover. Starting from 2003, inventory turnover days improved significantly as wireless terminals replaced wireless system solutions as the Group's major source of turnover.

Trade receivables

An aging analysis of the trade receivables based on invoice date is as follows:—

	31 December			31 May
	2001	**2002**	**2003**	**2004**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Within 3 months				
Wireless system solutions	2,783	11,970	8,339	6,667
Wireless terminals	103	2,398	37,247	20,877
4–6 months				
Wireless system solutions	3,173	9,927	1,979	9,025
Wireless terminals	295	259	22,909	31,621
7–12 months				
Wireless system solutions	2,362	10,441	24,617	15,334
Wireless terminals	—	4	11,808	14,940
1–2 years				
Wireless system solutions	1,292	2,212	1,496	1,496
Wireless terminals	—	304	738	543
More than 2 years				
Wireless system solutions	2,738	3,853	3,529	3,620
Wireless terminals	—	—	150	150
Sub-total	12,746	41,368	112,812	104,273
Less: provision for doubtful debts	(3,384)	(5,111)	(4,796)	(4,789)
Total	9,362	36,257	108,016	99,484
Subsequent settlement up to 30 September 2004	12,737	40,188	104,404	59,299

The increase of trade receivable during the Track Record Period was mainly due to the increase of the Group's turnover and the extended credit term give to one of the Group's largest customers, the China Unicom Group. As at 31 December 2001, 2002, 2003 and 31 May 2004, trade receivables from the China Unicom Group represented approximately 65%, 41%, 56% and 55% of the total trade receivables, respectively.

Aging analysis of trade receivables due from the China Unicom Group

	As at 31 December							
	2001		2002		2003		31 May 2004	
		As % of total trade receivable		As % of total trade receivable		As % of total trade receivable		As % of total trade receivable
	RMB'000		*RMB'000*		*RMB'000*		*RMB'000*	
Within 3 months								
Wireless system solutions	1,384	11%	4,298	10%	—	—	1,032	1%
Wireless terminals	—	—	1,840	4%	16,552	15%	8,578	8%
4–6 months								
Wireless system solutions	2,684	21%	8,176	20%	926	1%	4,372	4%
Wireless terminals	—	—	10	—	19,721	17%	23,273	22%
7–12 months								
Wireless system solutions	1,986	16%	656	2%	12,190	11%	5,232	5%
Wireless terminals	—	—	—	—	11,808	10%	12,229	12%
1–2 years								
Wireless system solutions	188	1%	459	1%	320	—	806	1%
Wireless terminals	—	—	—	—	—	—	35	—
More than 2 years								
Wireless system solutions	2,091	16%	1,512	4%	2,167	2%	1,645	2%
Wireless terminals	—	—	—	—	—	—	23	—
Sub-total	8,333	65%	16,951	41%	63,684	56%	57,225	55%
Less: provision for doubtful debts	(2,185)		(1,742)		(2,327)		(2,048)	
Total	6,148		15,209		61,357		55,177	
Subsequent settlement up to 30 September 2004	8,333		16,951		60,224		26,685	

Aging analysis

Generally, credit terms of three months are granted to the Group's customers. However, in 2003, after considering the substantial percentage of the sales to the China Unicom Group, its strong financial background, leading market position and the resulting strong bargaining power, the Group extended the credit terms to the China Unicom Group for both wireless system solutions and wireless terminal products to around six months. Notwithstanding such extended credit terms, the payment by the China Unicom Group was further delayed, causing some of the trade receivables to be overdue for seven months and above. As at 31 December 2003 and 31 May 2004, trade receivables from the China Unicom Group accounted for approximately 63% and 55% of the trade receivables overdue for seven months and above, respectively. The remaining of the trade receivables overdue for seven months and above as at 31 December 2003 and 31 May 2004 mainly consisted of those from other telecommunication operator and large-scale State-owned enterprises. The Directors understand that the relatively slow settlement was mainly due to additional time required by the internal procedures of the aforesaid customers (including the China Unicom Group).

During the five months ended 31 May 2004, most of the Group's wireless terminals, especially smartphones, were sold to wireless terminal distributors. The breakdown of the Group's sales by customer type is set out under the paragraphs headed "Customers" in the section headed "Business" in this prospectus. Settlements from these distributors were generally in line with the Group's credit policy and therefore trade receivables of less than 3 months decreased. Trade receivables of 4 to 6 months as at 31 May 2004 were mainly related to the sale of fixed wireless terminal, which was launched in December 2003, to the China Unicom Group between December 2003 and January 2004. As a result, trade receivables of 4 to 6 months as at 31 May 2004 increased.

During the Track Record Period, the prolonged repayment by the customers negatively impacted on the operating cash flow of the Group. Further details about the Group's cash flow position during the Track Record Period are elaborated under the paragraph headed "Liquidity, financial resources and capital structure — Cash flows — Operating activities" in this section.

Debtors' turnover days

During 2001, 2002, 2003 and the five months ended 31 May 2004, the Group's overall debtors' turnover days were approximately 42 days, 82 days, 163 days and 187 days, respectively. The increase in debtors' turnover days during the Track Record Period was mainly due to the slow-down of settlement from one of the Group's then largest customers, the China Unicom Group, and the overall delay in settlement from the Group's other customers, comprising members of other telecommunication operators and large-scale State-owned enterprises ("Other Customers"). The Directors understand that they took additional time under their internal procedures to process and obtain clearance for the payment. Debtors' turnover days for Other Customers was approximately 39 days, 89 days, 186 days and 94 days for each of the three years ended 31 December 2003 and 31 May 2004, respectively; while trade receivables from Other Customers accounted for approximately 86%, 88%, 74% and 44% of the trade receivables of more than 90 days excluding those from the China Unicom Group as at 31 December 2001, 2002, 2003 and 31 May 2004, respectively.

In 2003, debtors' turnover days increased substantially to approximately 163 days, which was mainly due to (i) the Group extended credit term to China Unicom to six months for both wireless system solutions and wireless terminal products in light of the substantial percentage of the Group's sales to the China Unicom Group and its strong bargaining position; (ii) the outbreak of the severe acute respiratory syndrome; and (iii) the continued prolonged settlement from the China Unicom Group and Other Customers. For the five months ended 31 May 2004, the Group's debtors' turnover days further increased to approximately 187 days. The Directors understand that telecommunication operators such as the China Unicom Group and State-owned enterprises normally spend the first quarter of the year for finalisation of annual budget and planning. As a result, settlement from these companies during the first half of the year is slow as compared to full year of 2003.

The Directors confirmed that at present, the Group does not intend to shorten the credit term granted to the China Unicom Group in light of the Group substantial sales to China Unicom Group and China Unicom's bargaining position. The Directors consider that solution/equipment providers such as the Group need to work with its customers to achieve mutually beneficial position instead of maintaining a strong stand in negotiation, especially in the case of dealing with major telecommunication operators such as China Unicom. The Directors consider that the extended credit term to the telecommunication operators is in line with market practice.

Notwithstanding the above, the Directors confirm that in light of the relatively long debtors' turnover days during the Track Record Period, the Group has made an effort to increase sales to telecommunication equipment and terminal distributors, whose settlement period is generally shorter than those from the telecommunication operators and large-scale State-owned enterprises. Moreover, in early 2004, the Group has strengthened the debt collection process whereby the result and efficiency of trade receivables recovery became one of the factors for evaluation of performance of the Group's sales staff. As a result, up to 30 September 2004, approximately 43% of the Group's trade receivable balances as at 31 May 2004 has been settled.

By assessing the recoverability of individual accounts and in accordance with the Group's general provision policy based on the age of the trade receivables, provisions of doubtful debts were made against balance of gross amount of trade receivables as at each period end as follows:—

Provision for doubtful debts during the Track Record Period

	31 December			31 May
	2001	**2002**	**2003**	**2004**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
As at 1 January	2,596	3,384	5,111	4,796
Increase/(decrease) during the year	788	1,727	(315)	(7)
As at 31 December/ 31 May	3,384	5,111	4,796	4,789

As at 31 May 2004, the Group's provision for doubtful debts was approximately RMB4.8 million (equivalent to approximately HK$4.5 million). In view of the fact that (i) the China Unicom Group is not in dispute with the Group about the amount of trade receivables; and (ii) the Group has not experienced any default in payment during the Track Record Period, the Directors consider that the Group's provision for doubtful debts is sufficient. Up to 30 September 2004, approximately RMB59.3 million (approximately HK$52.2 million) of the trade receivable outstanding as at 31 May 2004 was settled.

Subsequent settlement of trade receivables

	Within 3 months	4–6 months	7–12 months	1–2 years	More than 2 years	Total
Balance as at 31 May 2004 (before provision)	27,544	40,646	30,274	2,039	3,770	104,273
Subsequent settlement up to 30 September 2004	(5,968)	(26,578)	(21,621)	(1,832)	(3,300)	(59,299)
Balance outstanding as at 30 September 2004 (before provision)	21,576	14,068	8,653	207	470	44,974

Prepayments, deposits and other receivables

During the Track Record Period, prepayments, deposits and other receivables mainly consists of (i) prepayment to suppliers; (ii) advance to sales staff for business trip and operation, and advance to representative office and sales liaison points for office maintenance and purchase of daily necessities; (iii) product samples borrowed by sales staff for promotion activities and exhibitions, which are to be returned to the Group after the promotions and exhibitions; and (iv) other prepayments.

	Year ended 31 December			31 May
	2001	**2002**	**2003**	**2004**
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Prepayment to suppliers	10,067	5,007	17,902	18,666
Advance to sales staff and sales liaison points	3,160	1,688	6,605	8,561
Sample borrowed by sales staff	1,625	1,908	2,390	3,342
Others	1,006	944	3,913	7,687
Total	15,858	9,547	30,810	38,256

The increase in 2003 was mainly due to (i) the prepayments for the materials and components of fixed wireless terminals and smartphones, which was in line with the increase in turnover; and (ii) increase in advance to staff and sales liaison points as a result of the increasing promotion activities in relation to the Group's fixed wireless terminals and smartphones. The increase in 2004 was mainly due to increase in other prepayments in relation to listing expenses.

Trade payables

As at 31 December 2001, 2002, 2003 and 31 May 2004, the Group's trade payable amounted to approximately RMB10.1 million (approximately HK$9.5 million), RMB7.6 million (approximately HK$7.2 million), RMB20.8 million (approximately HK$19.6 million) and RMB25.7 million (approximately HK$24.2 million) respectively.

During 2001, 2002, 2003 and the five months ended 31 May 2004, creditors' turnover days were approximately 140 days, 136 days, 55 days and 55 days respectively. The decrease of creditors' turnover days during the Track Record Period was mainly due to the more stringent control in relation to the purchase of raw materials for the Group's fixed wireless terminals and smartphones, such as LCDs.

Notes payable

Notes payable represented mainly bank draft against acceptance (承兑滙票) in relation to the purchase of materials and components for the Group's wireless terminal products. As at 31 December 2002, 2003 and 31 May 2004, notes payable amounted approximately RMB4.5 million (approximately HK$4.2 million), RMB23.1 million (approximately HK$21.8 million) and RMB22.4 million (approximately HK$21.1 million) respectively. There was no notes payable as at 31 December 2001. Most of the Group's notes payable carried a payment term of about 90 days. The substantial increase in notes payable in 2003 was in line with the substantial increase in sales of fixed wireless terminals and launch of smartphones, for which payments of materials and components were mainly settled by bank draft against acceptance. Balance of notes payable as at 31 May 2004 was similar to that of 31 December 2003.

Short term bank loans

As at 31 December 2001, 2002, 2003 and 31 May 2004, the Group's short term bank loans amounted to approximately RMB11 million (approximately HK$10.4 million), RMB6 million (approximately HK$5.7 million), RMB31.6 million (approximately HK$29.8 million) and RMB36 million (approximately HK$34.0 million) respectively. The significant increase in 2003 was used mainly to finance purchase of materials and components for manufacturing of fixed wireless terminals and smartphones for which prepayments are normally required by the suppliers. The increase in 2004 was due to the need of the Group to finance the purchase of materials and components for smartphones for which prepayments are normally required by the suppliers.

Other payables and accruals

Breakdown of other payable and accruals during the Track Record Period is:

	31 December			31 May
	2001	2002	2003	2004
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
Prepayment from customers				
— wireless system solution	54,291	20,140	2,121	974
— wireless terminal	458	1,751	317	7,883
VAT payable	(1,661)	4,663	19,630	28,231
Accrued subcontracting fee	—	—	1,284	1,903
Accrued salary	1,781	1,160	1,626	1,820
Amount due to Dickman Enterprises Company Limited *(Note)*	3,179	3,179	3,179	3,179
Others	2,767	3,620	4,818	5,470
Total	60,815	34,513	32,975	49,460

Note: Dickman Enterprises Company Limited was a minority shareholder of Yulong Shenzhen prior to June 2001. The amount due to this company represents the consideration to be collected by it. For details regarding Dickman Enterprises Company Limited, please refer to the paragraph headed "History and development — Shareholding" in the section headed "Business" in this prospectus.

The decrease of prepayment from customers during the Track Record Period was in line with the decrease in turnover of wireless system solutions. Prepayment from customers increased from RMB2.4 million (approximately HK$2.3 million) in 2003 to RMB8.9 million (approximately HK$8.4 million) in 2004, mainly because more prepayment from customers were required for the sales of smartphones. VAT payable also increased during the Track Record Period, which was in line with the Group's overall increase in turnover during the Track Record Period.

PROFIT FORECAST

The Directors forecast that, in the absence of unforeseen circumstances and based on the audited results of the Group for the five months ended 31 May 2004, the unaudited results of the Group for the five months ended 31 October 2004 and a forecast of the results of the Group for the remaining two months ending 31 December 2004 and on the basis that the current Group structure had been in existence throughout the whole financial year ending 31 December 2004, the consolidated profit after taxation but before extraordinary items of the Group for the year ending 31 December 2004 will not be less than RMB46.0 million (approximately HK$43.4 million). The Directors are not aware of any extraordinary items which have arisen or are likely to arise during the year ending 31 December 2004.

On the basis of the above profit forecast and on the basis of 400,000,000 Shares to be in issue immediately after completion of the Capitalisation Issue and Share Offer but takes no account of (i) any Shares which may be issued upon the exercise of the Over-allotment Option; (ii) any Shares which may be issued upon the exercise of any options which may be granted under the Share Option Scheme; and (iii) any Shares which may be allotted and issued or repurchased by the Company pursuant to the general mandates referred to in Appendix VI to this prospectus, the forecast earnings per Share on a fully diluted basis will be approximately RMB11.5 cents (approximately HK10.9 cents), representing a prospective price/earnings multiple on a fully diluted basis of approximately 7.3 times and 8 times respectively, based on the indicative Offer Price range between HK$0.79 and HK$0.87 per Share. Please refer to Appendix II to this prospectus for further details.

The texts of letters from Ernst & Young, the reporting accountants, and from the Sponsor in respect of the profit forecast are set forth in Appendix III to this prospectus.

INDEBTEDNESS

Borrowings

As at 30 September 2004, the Group had outstanding borrowings of RMB30 million (approximately HK$28 million), comprising secured short-term bank loans of RMB10 million (approximately HK$9.4 million) and unsecured short-term bank loans of approximately RMB20 million (approximately HK$18.9 million).

Securities and guarantees

As at 30 September 2004, the Group's outstanding short-term bank borrowing of RMB10 million (approximately HK$9.4 million) were secured by the office building and investment property of Yulong Shenzhen with a net book value of approximately RMB13 million (approximately HK$12.3 million) and RMB2 million (approximately HK$1.9 million), respectively as at 30 September 2004.

Contingent liabilities

As at 30 September 2004, the Group had RMB0.8 million (approximately HK$0.7 million) trade receivable discounted with recourse. The receivables belonged to Yulong Shenzhen, a subsidiary of the Company.

Commitment

The Group leases certain of its warehouses premises and office building premises under operating lease arrangements for a lease term of 51 months and 12 months, respectively. As at 30 September 2004, the commitment in relation to such operating lease arrangement was approximately RMB0.3 million (approximately HK$0.28 million).

Disclaimers

Save as aforesaid or as otherwise disclosed herein, and apart from intra-group liabilities, the Group did not have outstanding mortgages, charges, debentures, loan capital, bank overdrafts, loans, debt securities or other similar indebtedness, finance leases or hire purchase commitments, liabilities under acceptances or acceptance credits or any guarantees or other material contingent liabilities outstanding at the close of business on 30 September 2004.

The Directors confirm that there have been no material changes in the Group's indebtedness and contingent liabilities since 30 September 2004.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

Cash flows

During the Track Record Period, the Group has financed its working capital primarily through internally generated cash flows, bank borrowings and shareholder's loan. Cash generated from operations, when not needed for working capital requirements, is held principally in the form of short-term deposits with banks.

The following summarises the Group's cash flow during the Track Record Period:—

	Year ended 31 December			31 May	
	2001	2002	2003	2003 (unaudited)	2004
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
New cash inflow/ (outflow) from operating activities	(2,890)	24,825	(13,714)	(9,004)	23,454
Net cash inflow/(outflow) from investing activities	(3,488)	(2,353)	(32,394)	(1,764)	3,932
Net cash inflow/(outflow) from financing activities	8,443	(25,910)	55,364	8,428	3,572
Increase/(decrease) in cash and cash equivalents	2,065	(3,438)	9,256	(2,340)	30,957
Cash and cash equivalent as at 1 January	10,830	12,895	9,457	9,457	18,713
Cash and cash equivalent as at 31 December/31 May	12,895	9,457	18,713	7,117	49,670

Operating activities

In 2001, the Group had a net cash outflow from operating activities of approximately RMB2.9 million (approximately HK$2.7 million), compared with profit before tax of approximately RMB14.6 million (approximately HK$13.8 million). The difference was mainly due to decrease in accrued liabilities and other payables of approximately RMB29.2 million (approximately HK$27.5 million), which was mainly due to decrease in prepayment from the customers of wireless system solutions and was partly offset by adjustment for non-cash items such as depreciation, and decrease in inventories of approximately RMB5.4 million (approximately HK$5.1 million).

In 2002, the Group had a net cash inflow from operating activities of approximately RMB24.8 million (approximately HK$23.4 million), compared with profit before tax of approximately RMB35.1 million (approximately HK$33.1 million). The difference was mainly due to (i) decrease in accrued liabilities and other payables of approximately RMB27 million (approximately HK$25.5 million), as a result of the decrease in advance from the Group's customers for wireless coverage systems; (ii) increase in trade receivables of approximately RMB28.6 million (approximately HK$27 million); and was partly offset by (i) decrease in inventories of approximately RMB16.8 million (approximately HK$15.8 million); (ii) increase in amount due from related companies of approximately RMB14.3 million (approximately HK$13.5 million); and (iii) increase in net amounts due to Directors of approximately RMB6.2 million (approximately HK$5.8 million).

In 2003, the Group had net cash outflow from operating activities of approximately RMB13.7 million (approximately HK$12.9 million), compared with profit before tax of approximately RMB42.5 million (approximately HK$40.1 million). The difference was mainly due to (i) increase in trade receivables of approximately RMB71.4 million (approximately HK$67.4 million), as a result of the slow settlement from the Group's major customer, China Unicom Group; and (ii) increase in prepayments, deposit and other receivables of approximately RMB21.1 million (approximately HK$19.9 million), as the Group was required to pay for deposits for the purchase of raw materials for its fixed wireless terminals and smartphones; and was partly offset by increase in trade and notes payables of approximately RMB31.8 million (approximately HK$30 million) in relation to the purchase of the raw materials for the production of the Group's fixed wireless terminals and smartphones.

For the five months ended 31 May 2004, the Group had net cash inflow from operating activities of approximately RMB23.5 million (approximately HK$22.2 million), compared with profit before tax of approximately RMB17.7 million (approximately HK$17.7 million). The difference was mainly due to increase in accrued liabilities and other payables of approximately RMB16.5 million (approximately HK$15.6 million), mainly as a result of increase in VAT payables; and was partly offset by increase in inventories of approximately RMB12.5 million (approximately HK$11.8 million), mainly represents inventories of smartphones for sales in the second half of the year.

In the future, the Directors expect the cashflow from operating activities to continue to improve as a result of: (1) increase in sales to telecommunication equipment or solution distributors in the PRC, which have a shorter credit term than those of the telecommunication operators; (2) improved relationship with suppliers of raw materials and components of fixed wireless terminals and smartphones, for whom less prepayment are expected to be required; and (3) the strengthening of the debt collection process.

Investing activities

During the Track Record Period, the Group's major investing activities included purchase of fixed assets and expenditure on research and development. The Group had a net cash outflow from investing activities of approximately RMB3.5 million (approximately HK$3.3 million), RMB2.4 million (approximately HK$2.3 million) and RMB32.4 million (approximately HK$30.6 million) for each of the three years ended 31 December 2003 and a net cash inflow of approximately RMB3.9 million (approximately HK$3.7 million) for the five months ended 31 May 2004. The significant increase in net cash outflow from investing activities in 2003 was mainly due to the payment for the Group's purchase of office in Shenzhen, the PRC. The Group had a net cash inflow for the five months ended 31 May 2004 as a result of a decrease in pledged time deposit of RMB8.3 million (approximately HK$7.8 million).

Financing activities

The Group had a net cash inflow from financing activities of approximately RMB8.4 million (approximately HK$7.9 million), RMB55.4 million (approximately HK$52.3 million) and RMB3.6 million (approximately HK$3.4 million) for each of the two years ended 31 December 2001 and 2003 and the five months ended 31 May 2004. For the year ended 31 December 2002, the Group had net cash outflow of approximately RMB25.9 million (approximately HK$24.4 million) mainly due to the Group's repayment of bank loans of RMB18 million (approximately HK$17 million) and dividend payment of approximately RMB20.2 million (approximately HK$19.1 million). In 2003, the cash flow from financing activities significantly improved due to the issuance of shares to JATF and borrowing of new bank loans.

Net current assets

As at 30 September 2004, being the latest practicable date for the purpose of this statement, the Group's net current assets was approximately RMB100.7 million (approximately HK$94.1 million), comprising the following:—

	30 September 2004 *RMB'000*
CURRENT ASSETS	
Inventories	36,440
Trade receivables	100,463
Prepayments, deposits and other receivables	72,436
Due from a director	646
Cash and bank balances	33,797
	243,782
CURRENT LIABILITIES	
Trade payables	33,010
Notes payables	5,670
Tax payable	27,930
Other payables and accruals	46,269
Short-term bank and other loans	30,000
Due to related companies	170
	143,049
NET CURRENT ASSETS	100,733

Financial resources and capital structure

During the Track Record Periods, the Group generally financed its operations through internally generated cash flows, bank borrowings and shareholders' loans and equity.

The debt to equity ratio (net debts/shareholders' equity) of the Group was approximately 29%, 56% and 10% as at 31 December 2001, 2002 and 2003, respectively. The increase in 2002 was mainly due to the increase in bank loans. The decrease in 2003 was mainly due to the increase in the Group's shareholders' equity of approximately RMB70.9 million (approximately HK$66.9 million) as a result of profit attributable to shareholders for 2003 and investment by JATF during the year. The Group has a net cash balance of approximately RMB13.6 million (approximately HK$12.9 million) as at 31 May 2004.

The Group's gearing ratio (total debts/total assets) was approximately 17%, 25%, 17% and 14% as at 31 December 2001, 2002, 2003 and 31 May 2004, respectively. The increase of the gearing ratio in 2002 to approximately 25% was mainly due to increase in amount due from the Directors of approximately RMB17.8 million (approximately HK$16.8 million) in 2002. The decrease in 2003 to approximately 17% was mainly due to the increase in total assets as a result of the increase in trade receivable of approximately RMB71.8 million (approximately HK$67.7 million) in 2003. As at 31 May 2004, gearing ratio further decreased to approximately 14% mainly as a result of the increase in total assets during the five months ended 31 May 2004.

Following the completion of the Share Offer, the Directors expect to fund the capital and operating requirements through internally generated cash flows, net proceeds from the New Issue, cash on hand, and, if necessary, additional bank borrowings.

Director's opinion of the working capital

The Directors are of the opinion that, taking into account the financial resources available to the Group, including internally generated fund and the estimated net proceeds from the New Issue, the Group has sufficient working capital to meet its present requirements for at least the next twelve months from the date of this prospectus.

Foreign exchange

The expenditure of the Group are mainly in Renminbi and the assets and liabilities of the Group are also denominated in Renminbi. Taking into account the Group's operational and capital requirements, the Directors do not consider the Group is significantly exposed to any foreign currency risk.

DIVIDEND

For the year ended 31 December 2002, members of the Group declared dividends of approximately RMB20.2 million (approximately HK$19.1 million). Such dividend was declared and approved after the respective balance sheet date and was recognised in the periods in which it was approved by shareholders in general meetings. Save for the above, no other dividend was declared by any member of the Group during the Track Record Period.

Such dividend should not be regarded as an indication of the dividend policy to be adopted by the Company following the listing of the Shares on the Main Board. The amount of dividends to be declared by the Group will be subject to the discretion of the Directors and will depend upon the earnings of the Group, its financial condition, cash requirements and availability and such other factors as the Directors may deem relevant.

Based on《關於外滙指定銀行辦理利潤、股息、紅利滙出有關問題的通知》(Notice in relation to the distribution of profit, dividend and bonus in foreign currencies by designated banks), in order for foreign investment enterprises or overseas listed companies to repatriate dividend by converting RMB into foreign currencies to foreign investors or shareholders, the following documents must be submitted to the banks designated to handle conversion of RMB into foreign currencies (the "Banks"): (1) tax filing and tax clearance issued by relevant tax bureaus; (2) audited annual report, including the profit and dividend; (3) board resolution in relation to the declaration of dividends; (4) foreign currencies registration; and (5) verification report on capital injection issued by the accountants. The Banks will then handle the conversion and remittance after verification of such documents.

DISTRIBUTABLE RESERVES

As at 31 May 2004, being the date to which the Group's latest audited financial statements were made up, the Group had reserves available for distribution of approximately RMB82 million (approximately HK$77.4 million).

UNAUDITED ADJUSTED NET TANGIBLE ASSETS

The following statement of the Group's unaudited adjusted net tangible assets is based on the Group's audited combined net assets as at 31 May 2004 as shown in the accountants' report, the text of which is set forth in Appendix I to this prospectus, adjusted as follows:—

	Audited combined net tangible assets of the Group as at 31 May 2004 *(note 1)* *RMB$'000*	**Estimated net proceeds from the New Issue (assuming that the Over-allotment Option is not exercised)** *RMB$'000*	**Unaudited adjusted net tangible assets** *RMB$'000*	**Unaudited adjusted net tangible assets value per Share** *(note 2)*
Based on the Offer Price of HK$0.79 per Share	108,284	70,800	179,084	RMB44.8 cents
Based on the Offer Price of HK$0.87 per Share	108,284	79,100	187,384	RMB46.9 cents

Note:—

1. Audited combined net tangible assets of the Group was calculated by deducting the product development cost of approximately RMB8,350,000 from the Group's net assets of approximately RMB116,634,000 as at 31 May 2004.

2. The unaudited adjusted net tangible asset value per Share is arrived at after the adjustments referred to in this section and on the basis of 400,000,000 Shares in issue and to be issued as mentioned herein but takes no account of any Shares which may be issued upon the exercise of the Over-allotment Option and any options that may be granted under the Share Option Scheme or which may be allotted and issued or purchased by the Company pursuant to the general mandates for the allotment and issue or purchase of Shares described under "Written resolutions of all the shareholders of the Company passed on 21 November 2004" in Appendix VI to this prospectus.

3. The Group did not incorporate any revaluation surplus or deficit in its financial statements. It is the Group's accounting policy to state its fixed assets at cost less accumulated depreciation and any impairment loss in accordance with the Statement of Standard Accounting Practice No. 17, rather than at revalued amounts. The impairment reviews performed by the Company as at 31 May 2004 did not indicate the need to book any impairment loss for its fixed assets. There was a revaluation surplus of the Group's land and building of approximately RMB4.4 million (approximately HK$4.2 million) as at 31 May 2004. Had the revaluation surplus been incorporated in the Group's financial statements, there would be an increase in the annual depreciation charge of the buildings of approximately RMB0.2 million (approximately HK$0.19 million).

PROPERTY INTERESTS

Particulars of the Group's property interests are set out in Appendix IV to this prospectus.

Property interests held by the Group in the PRC

The Group holds 7 industrial units, comprising a total gross floor area of approximately 3,802 sq.m., in High Tech Plaza, Tian An Cyberpark, Che Gongmiao, Futian District, Shenzhen, Guangdong Province. Portion of the property is occupied by the Group as the headquarter and for research and training center, warehouse and ancillary office use whilst the remaining portion is currently leased to an Independent Third Party. The Group maintained only part of its testing and simple assembly works in these units, and contracting out most of the manufacturing process. Apart from the abovementioned, the Group does not own or lease any production plants.

The Group holds 12 residential units, comprising a total gross floor area of approximately 885 sq.m., in Taoyuan Village, Longzhu Avenue, Nansan District, Shenzhen, Guangdong Province as staff quarters. These 12 residential units are in the nature of Public Community Housing which are not allowed to be transferred. No value is assigned to the property. The Directors consider the 12 residential units are not crucial to the Group's operations.

The Group has obtained Real Estate Title Certificates for all the abovementioned properties.

Property interests leased by the Group in the PRC

The Group leases 2 office units, comprising a total gross floor area of approximately 446 sq.m., on Level 8 East, Tairan Industrial Zone, Futian District, Shenzhen, Guangdong Province as office.

The Group leases 1 office unit, comprising a gross floor area of 58.93 sq.m., on Level 4, Zhongshui Building, 31 Wenfeng Alley, Xidan, Xicheng District, Beijing as office.

Property valuation

DTZ Debenham Tie Leung Limited, an independent valuer, has undertaken a valuation of the Group's property interests as at 30 September 2004 at RMB23,500,000. The full text of the letter, summary of valuations and valuation certificates with regard to such property interests are set forth in Appendix IV to this prospectus.

The statement below shows the reconciliation of leasehold land and buildings from the audited combined financial statements as at 31 May 2004 to the unaudited combined management accounts as at 30 September 2004:

	RMB'000
Net book value as at 31 May 2004	
— Buildings	16,830
— Investment property	2,274
	19,104
Depreciation from 1 June 2004 to 30 September 2004	(328)
Net book value as at 30 September 2004	18,776
Valuation surplus	4,724
Valuation as at 30 September 2004	23,500

NO MATERIAL ADVERSE CHANGE

The Directors confirm that there has been no material adverse change in the financial or trading positions or prospects of the Company or its subsidiaries since 31 May 2004, the date on which latest audited combined financial statements of the Company and its subsidiaries were made up.

DISCLOSURE UNDER RULE 13.13 TO RULE 13.19 OF THE LISTING RULES

The Directors have confirmed that they were not aware of any circumstance which would give rise to a disclosure obligation under rule 13.13 to rule 13.19 of the Listing Rules.