

# NetDragon Websoft Inc.

## 網龍網絡有限公司

(incorporated in the Cayman Islands with limited liability)

Stock Code : 777

### Interim Report

# 08





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## FINANCIAL HIGHLIGHTS



- The unaudited consolidated revenue of the Group for the six months ended 30 June 2008 amounted to RMB322.9 million (six months ended 30 June 2007: RMB261.7 million), representing an increase of approximately 23.4% as compared with the same period last year.
- Profit attributable to equity holders of the Company for the six months ended 30 June 2008 amounted to RMB115.3 million (six months ended 30 June 2007: RMB153.8 million), representing a decrease of approximately 25.0% as compared with last corresponding period.
- For the six months ended 30 June 2008, the earnings per share amounted to RMB21.21 cents (six months ended 30 June 2007: RMB38.36 cents).
- The Directors recommend the payment of an interim dividend of HKD0.1 per share for the six months ended 30 June 2008 (six months ended 30 June 2007: Nil).



## FINANCIAL REVIEW

### Revenue

For the six months ended 30 June 2008, the Group recorded an unaudited revenue of approximately RMB322.9 million, representing an increase of approximately 23.4% from approximately RMB261.7 million for the corresponding period in last year. The increase of total revenue was mainly due to the continuing popularity of Conquer Online, Eudemons Online, Zero Online and Tou Ming Zhuang Online.

The following table sets out the breakdown of our revenue by game for the periods indicated:

	Three months ended				Six months ended			
	30 June 2008		31 March 2008		30 June 2008		30 June 2007	
	<i>RMB'000</i>	<i>% of total revenue</i>	<i>RMB'000</i>	<i>% of total revenue</i>	<i>RMB'000</i>	<i>% of total revenue</i>	<i>RMB'000</i>	<i>% of total revenue</i>
<b>Online games</b>								
Conquer Online	<b>36,577</b>	<b>24.8</b>	39,437	22.4	<b>76,014</b>	<b>23.5</b>	61,873	23.6
Eudemons Online	<b>91,492</b>	<b>62.1</b>	105,395	60.0	<b>196,887</b>	<b>61.0</b>	185,040	70.7
Zero Online	<b>14,843</b>	<b>10.1</b>	19,271	11.0	<b>34,114</b>	<b>10.6</b>	14,417	5.5
Tou Ming Zhuang Online	<b>3,782</b>	<b>2.6</b>	11,173	6.4	<b>14,955</b>	<b>4.6</b>	—	—
Heroes of Might and Magic Online	<b>413</b>	<b>0.3</b>	—	—	<b>413</b>	<b>0.1</b>	—	—
Others	<b>234</b>	<b>0.1</b>	280	0.2	<b>514</b>	<b>0.2</b>	419	0.2
<b>Total</b>	<b>147,341</b>	<b>100.0</b>	175,556	100.0	<b>322,897</b>	<b>100.0</b>	261,749	100.0

The revenue derived from Conquer Online for the six months ended 30 June 2008 amounted to approximately RMB76.0 million, representing an increase of approximately 22.9% from approximately RMB61.9 million for the corresponding period in last year. Eudemons Online was launched in late March 2006. Revenue derived from Eudemons Online for the six months ended 30 June 2008 amounted to approximately RMB196.9 million, representing an increase of approximately 6.4% from approximately RMB185.0 million for the corresponding period in last year.

Both Zero Online and Tou Ming Zhuang Online were launched during the year ended 31 December 2007 and contributed revenue of approximately RMB34.1 million and RMB15.0 million to the Group for the six months ended 30 June 2008, respectively.

Heroes of Might and Magic Online was launched in late May 2008 and contributed a revenue of approximately RMB0.4 million from the date of its launch to 30 June 2008.

# MANAGEMENT DISCUSSION AND ANALYSIS



## FINANCIAL REVIEW (Cont'd)

### Revenue (Cont'd)

However, the revenue derived from Conquer Online, Eudemons Online, Zero Online and Tou Ming Zhuang Online for the three months ended 30 June 2008 were decreased by approximately 7.3%, 13.2%, 23.0% and 66.2%, respectively, when compared to the three months ended 31 March 2008. The decrease of revenue was mainly attributable by (i) no major upgrades were launched during the period under review; (ii) the impact of close down of servers for three days due to the earthquake happened in Sichuan Province (“Sichuan”) of the PRC; (iii) decrease of players in Sichuan after earthquake happened; and (iv) the negative impact of commonly known industry problem, “private servers”. The decrease of revenue of Tou Ming Zhuang Online was also caused by the decrease in level of attractiveness and degree of fervor after the same named movie “The Warlords (投名狀)”.

The following table sets out the numbers of PCU and ACU of each game for the periods indicated:

	30 June 2008	Three months ended		
		31 March 2008	30 June 2007	31 March 2007
<b>PCU</b>				
Conquer Online	103,000	99,000	89,000	85,000
Eudemons Online	505,000	479,000	496,000	438,000
Zero Online	71,000	67,000	53,000	—
Tou Ming Zhuang Online	14,000	24,000	—	—
Heroes of Might and Magic Online	4,000	—	—	—
<b>ACU</b>				
Conquer Online	67,000	64,000	64,000	61,000
Eudemons Online	250,000	210,000	274,000	213,000
Zero Online	30,000	30,000	21,000	—
Tou Ming Zhuang Online	6,000	9,000	—	—
Heroes of Might and Magic Online	2,000	—	—	—

Conquer Online was launched in September 2003. The PCU and ACU for Conquer Online was approximately 103,000 and 67,000, respectively for the three months ended 30 June 2008 whereas it recorded a PCU and ACU of approximately 89,000 and 64,000, respectively for the three months ended 30 June 2007, representing an increase of approximately 15.7% and 4.7% on PCU and ACU, respectively.

Eudemons Online was launched in late March 2006 and achieved a PCU and ACU of approximately 505,000 and 250,000, respectively for the three months ended 30 June 2008 whereas it recorded a PCU and ACU of approximately 496,000 and 274,000, respectively for the three months ended 30 June 2007, representing an increase of approximately 1.8% and a decrease of approximately 8.8%, respectively, when compared to the corresponding period in last year.

### FINANCIAL REVIEW (Cont'd)

#### Revenue (Cont'd)

The PCU of Conquer Online and Eudemons Online for the three months ended 30 June 2008 rose by approximately 4.0% and 5.4%, respectively, whereas Conquer Online and Eudemons Online also recorded an increase in ACU for the three months ended 30 June 2008 by approximately 4.7% and 19.0%, respectively, when compared to the three months ended 31 March 2008.

Zero Online was launched in late April 2007 and achieved a PCU and ACU of approximately 71,000 and 30,000, respectively, for the three months ended 30 June 2008 whereas it recorded a PCU and ACU of approximately 53,000 and 21,000, respectively from the date of its launch to 30 June 2007.

The PCU and ACU of Zero Online for the three months ended 30 June 2008 rose by approximately 6.0% and remained steady, respectively, when compared to the three months ended 31 March 2008.

Tou Ming Zhuang Online was launched in late 2007 and its PCU and ACU for the three months ended 30 June 2008 dropped by approximately 41.7% and 33.3%, respectively, when compared to the three months ended 31 March 2008. The decrease in PCU and ACU of Tou Ming Zhuang Online was principally attributable by the decrease in level of attractiveness and degree of fervor after the same named movie "The Warlords (投名状)".

Heroes of Might and Magic Online was launched in late May 2008 and achieved a PCU and ACU of approximately 4,000 and 2,000, respectively from the date of its launch to 30 June 2008.

#### Gross profit

For the six months ended 30 June 2008, the unaudited gross profit reached approximately RMB290.5 million with a gross profit margin of approximately 90.0%, where the audited gross profit and gross profit margin were approximately RMB247.1 million and 94.4%, respectively for the corresponding period in last year. The decrease in the percentage of gross profit margin was mainly due to the decrease in the player usage as demonstrated by the decrease in revenue derived for the three months ended 30 June 2008 as compared with the three months ended 31 March 2008 and the increase in depreciation of servers as a result of the increased number of servers owned by us as compared with the same period in 2007.

#### Other revenue and gains

Other revenue and gains for the six months ended 30 June 2008 increased by approximately 1,086.5% or 10.9 times to approximately RMB15.8 million as compared with the same period in 2007. The increase was mainly due to the increase in interest income earned from the net proceeds of the international placing in connection with the listing of the Company's shares on the GEM of the Stock Exchange.



## FINANCIAL REVIEW (Cont'd)

### Selling and marketing expenses

Selling and marketing expenses for the six months ended 30 June 2008 increased by approximately 45.8% to approximately RMB44.2 million as compared with the same period in 2007. The increase in the amount of selling and marketing expenses was mainly attributable to our continued advertising and promotion expenses for Eudemons Online, Zero Online, Tou Ming Zhuang Online and Heroes of Might and Magic Online. In accordance with the terms of agreement with China Film Group Corporation and Ubisoft Entertainment SA, respectively, the Group has to provided marketing support for promoting the collaboration of Tou Ming Zhuang Online and Heroes of Might and Magic Online. Besides that, the Group has started the marketing and promotional activities of its self-developed game, Way of the Five, before its official launch in late 2008.

Further, the increase in the amount of selling and marketing expenses was also caused by the increase in staff costs due to employing various defensive and counter-attack measures in an attempt to resolve and reduce the negative impact to the online games franchise caused by the commonly known industry problem, “private servers”, by recruiting experienced staff to keep checking, preventing and attacking the private servers activities.

### Administrative expenses

Administrative expenses increased by approximately 220.9% to approximately RMB62.3 million for the six months ended 30 June 2008 as a result of the continuous expansions of our online game business. The increase of administrative expenses for the six months ended 30 June 2008 was mainly attributable by (i) the significant increase of our business development needs including cooperation with different business partners such as cooperation with China Film Group Corporation and Buena Vista Internet Group (“BVIIG”); (ii) our overall expansion for the Company; and (iii) the exchange loss resulted from the appreciation of RMB against USD and HKD for the six months ended 30 June 2008.

## FINANCIAL REVIEW (Cont'd)

### Development costs

Development costs increased by approximately 171.2% to approximately RMB35.6 million for the six months ended 30 June 2008. The increase in development costs was mainly due to expansion of our development team and the increase of compensation for our employees. The numbers of staff in our development team were increased from 309 as at 30 June 2007 to 781 as at 30 June 2008. We also increased the compensation in order to provide a competitive and attractive increment in the basic salary, and we have distributed discretionary bonus for the success of Eudemons Online to further motivate our employees.

The increase in the amount of development costs was also caused by the increase in staff costs due to employing various defensive and counter-attack measures in an attempt to resolve and reduce the negative impact to the online games franchise caused by the commonly known industry problem, “private servers”, by recruiting experienced staff to develop tools and software for keep checking, preventing and attacking the private servers activities.

### Other operating expenses

Other operating expenses for the six months ended 30 June 2008 increased by approximately 45.6% to approximately RMB19.3 million as compared with the same period in 2007. The increase in other operating expenses was primarily attributable to the increase in business tax for the intercompany transactions as a result of revenue increase and donation expenses for assistance of recovery due to the earthquake in Sichuan. However, the business tax included in “other operating expenses” is only related to intercompany transactions while the business tax for online game revenue is deducted from the online revenue directly.

### Income tax expenses

The profit before tax for the six months ended 30 June 2008 dropped by 15.9% as compared with the corresponding period in 2007. However, income tax expenses for the six months ended 30 June 2008 still recorded an increase of approximately 62.9% to approximately RMB29.6 million as compared with the corresponding period in 2007. The increase was primarily due to the increase of overall effective tax rate for the six months ended 30 June 2008 as compared with that for the same period in 2007. The EIT tax rate applicable to TQ Digital and NetDragon (Fujian) were 7.5% and 15%, respectively, for the six months ended 30 June 2007, whereas it changed to 18% and 25%, respectively, for the six months ended 30 June 2008.

### Profit for the period

The unaudited profit for the six months ended 30 June 2008 of the Group decreased by approximately 25.2% to approximately RMB115.2 million as compared with the corresponding period in 2007.



# MANAGEMENT DISCUSSION AND ANALYSIS



## BUSINESS REVIEW

As a vertically integrated developer and operator of online games, we continued to execute upon our strategy of strengthening core game development and operating capabilities, with the goal of further availing ourselves of the growing opportunities that the online gaming industry presents in China and abroad. We continuously undertook measures to bolster our core competencies during the quarter, which we believe will enable us to (i) extend the commercial life of existing franchises; (ii) release games and upgrades in a timely and more frequent manner; and (iii) supplement our existing pipeline of games with additional projects for future growth potential.

During the period under review, based upon our strengthening core competencies, we (i) provided upgrades of Conquer Online, Eudemons Online, Zero Online and Tou Ming Zhuang Online to players weekly for free downloads; (ii) officially launched the Traditional Chinese version of the flagship online games of the Group, Eudemons Online and Zero Online, in Hong Kong and Taiwan markets (in association with our business partners in the respective markets); and (iii) officially launched Heroes of Might and Magic Online.

Additionally, to prepare for continued expansion and evolution of our game offerings, the Group has increased its overall staff count to a total of 1,482, of which 781 are members of the development team as at 30 June 2008. This compares with a total of 936 staff as at 31 March 2008, of which 527 were in the development team.

During the month of June 2008, we witnessed a reemergence of what is commonly known in the online gaming industry as “private servers”. Private servers are a vehicle by which unauthorized individuals illegally operate and offer an online game to the general public. In our Group’s case, unauthorized individuals have illegally operated our online games, especially for Eudemons Online franchise on private servers. As this unauthorized activity directly competed with our Group’s operations of online games, both user concurrency levels and revenue generating performance of online games were negatively impacted. The Group responded by employing various defensive and counter-attack measures in an attempt to resolve and reduce the negative impact to the online games franchise.

The shares of the Company were listed on GEM of the Stock Exchange under the stock code of “8288” on 2 November 2007. On 24 June 2008, the Company’s listing was successfully transferred to the Main Board of the Stock Exchange under a new stock code of “777”. Also, the Group’s stock became a constituent stock of the MSCI China Index as from late May 2008.

### LIQUIDITY AND CAPITAL RESOURCES

For the period ended 30 June 2008, we had term deposits with initial term of over three months, cash on hand and at bank deposits of approximately RMB993.2 million (31 December 2007: RMB1,701.4 million).

For the period ended 30 June 2008, the Group had net current assets of approximately RMB1,344.4 million (31 December 2007: RMB1,702.8 million).

Net cash generated from operating activities for the six months ended 30 June 2008 was approximately RMB155.0 million (six months ended 30 June 2007: RMB183.9 million).

Net cash used in investing activities for the six months ended 30 June 2008 was approximately RMB834.7 million (six months ended 30 June 2007: RMB13.8 million). Net cash used in financing activities for the six months ended 30 June 2008 was approximately RMB393.8 million (six months ended 30 June 2007: RMB28.9 million).

As we did not have any interest bearing bank loans, our gearing ratio was zero as at 31 December 2007 and 30 June 2008.

As at 30 June 2008, the Group's total equity amounted to approximately RMB1,445.0 million (31 December 2007: RMB1,769.4 million).

The Board is in the opinion that the Group is in a strong and healthy financial position and has sufficient resources to support its operations and meet its foreseeable capital expenditures.

# MANAGEMENT DISCUSSION AND ANALYSIS



## FOREIGN CURRENCY RISKS

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

## CONTINGENT LIABILITIES

The Group did not have significant contingent liabilities as at 30 June 2008 (31 December 2007: Nil).

## STAFF INFORMATION

For the period under review, the breakdown of the number of employees of the Group is set out below:

	At 30 June	
	2008	2007
Game development	781	309
Game operation and marketing	487	105
Accounting, finance and general administration	214	113
Total	<u>1,482</u>	<u>527</u>

As at 30 June 2008, we had a total of 1,482 employees (30 June 2007: 527), 781 of which are game developers, representing 52.7% of the total number of staff.

The Group keeps a close watch on the levels of employees' remuneration and benefits, and rewards staff according to the results of the Group's operating achievement. Furthermore, the Group also offers training and development opportunities to our employees.

### PROSPECTS

The Group plans to further enhance its core game development capabilities, streamline its integrated mode of operation, expand its product mix and extend the life cycle of our games in the market in order to enhance the Group's revenue generating possibilities. Our management is continuing to spend efforts to further strengthen our core game development capabilities by (i) recruiting experienced game developers to join our game development team; (ii) engineering game development automation software to replace certain manual and repetitive tasks, which should lead to improved efficiency in our game development process; and (iii) purchasing additional computers and software required for increasing the output of our game developers. In addition, we have also invited professionals from different industries and professors to conduct training sessions to further reinforce the technical knowledge and skills of our game development team.

The Group is continuing the development of two 2.5D MMORPGs including Way of the Five and Tian Yuan. We expect the official launch of Way of the Five and Tian Yuan to take place in late 2008. The Group expects to have satisfactory revenue contribution from these games in the future.

Additionally, the Group has signed a content development and distribution agreement with BVIG in January 2008. Based upon this agreement, we expect to develop a co-branded 2.5D MMORPG which will feature certain BVIG intellectual property – such as a pre-determined selection of characters from amongst the Disney® pantheon of animated characters as well as the thematic worlds in which such characters were set – as part of the game's non-player characters and virtual environments. Furthermore, the Group expects to pursue other opportunities to create online games based upon popular third-party intellectual property, as our management believes such a strategy should provide a competitive advantage upon commercialization of our products.

Finally, during the month of July 2008, the private server situation has continued to impact our online games franchise, with user concurrency levels maintaining a negative growth trend. We are continuing to employ defensive and counter-attack measures in an attempt to mitigate the impact to the online games franchise and the Group's financial performance.

### INTERIM DIVIDEND

On the date of this report, the Board has resolved to declare an interim dividend of HKD0.1 per share for the six months ended 30 June 2008 (six months ended 30 June 2007: Nil). The interim dividend will be paid to the shareholders whose names appeared on the register of members of the Company on 8 September 2008. It is expected that the interim dividend warrants will be despatched on or about 16 September 2008.

### CLOSURE OF REGISTER OF MEMBERS

The Register of Members of the Company will be closed from 8 September 2008 to 10 September 2008, both days inclusive, during which period no transfer of shares will be effected. In order to qualify for the interim dividend for the six months ended 30 June 2008, all share transfers accompanied by the relevant share certificates must be lodged with the Company's branch share registrar in Hong Kong, Tricor Investor Services Limited, 26th Floor, Tesbury Centre, 28 Queen's Road East, Wanchai, Hong Kong not later than 4:30 p.m. on 5 September 2008.

## OTHER INFORMATION



### DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 30 June 2008, the interests and short positions of the Directors and chief executive of the Company in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Chp 571 of the Laws of Hong Kong) ("SFO")), which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which they were taken or deemed to have under provisions of the SFO), or which were required to be entered in the register kept by the Company pursuant to Section 352 of the SFO or which were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules"), to be notified to the Company and the Stock Exchange, were as follows:

Name of Director	Name of company	Capacity and nature of interests	Number of shares held or amount of registered capital contributed (Note 1)	Approximate percentage of shareholding
Liu Dejian (Note 2)	The Company	Through controlled corporations	278,959,040(L)	51.64%
Liu Dejian (Note 3)	NetDragon (Fujian)	Beneficial owner	RMB9,886,000(L)	98.86%
Liu Dejian (Note 3)	NetDragon (Shanghai)	Beneficial owner and through a controlled corporation	RMB1,000,000(L)	100.00%
Liu Luyuan (Note 2)	The Company	Through controlled corporations	278,959,040(L)	51.64%
Liu Luyuan (Note 3)	NetDragon (Fujian)	Beneficial owner	RMB9,886,000(L)	98.86%
Liu Luyuan (Note 3)	NetDragon (Shanghai)	Beneficial owner and through a controlled corporation	RMB1,000,000(L)	100.00%
Zheng Hui (Note 2)	The Company	Through controlled corporations	278,959,040(L)	51.64%
Zheng Hui (Note 3)	NetDragon (Fujian)	Beneficial owner	RMB9,886,000(L)	98.86%
Zheng Hui (Note 3)	NetDragon (Shanghai)	Beneficial owner and through a controlled corporation	RMB1,000,000(L)	100.00%
Chen Hongzhan (Note 4)	The Company	Through a controlled corporation	13,000,000(L)	2.41%



### DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES (Cont'd)

*Notes:*

1. The letter "L" denotes the shareholder's long position in the share capital of the relevant member of the Group.
2. Liu Dejian is interested in 95.4% of the issued share capital of DJM Holding Ltd., which in turn is interested in 33.95% of the issued share capital of the Company.

Liu Luyuan is interested in 100% of the issued share capital of Richmedia Holdings Limited, which in turn is interested in 4.88% of the issued share capital of the Company.

Zheng Hui is interested in 4.6% and 100%, respectively, of the issued share capital of DJM Holding Ltd. and Fitter Property Inc., which in turn is interested in 33.95% and 6.57%, respectively, of the issued share capital of the Company. Zheng Hui owns the voting rights in respect of all the issued shares of Flowson Company Limited. Flowson Company Limited is interested in 100% of the issued share capital of Eagle World International Inc., which in turn is interested in 6.24% of the issued share capital of the Company.

Liu Dejian is a brother of Liu Luyuan and a cousin of Zheng Hui who have agreed to act in concert to acquire interests in the shares in the Company. All of Liu Dejian, Liu Luyuan and Zheng Hui are deemed to be interested in 51.64% of the issued share capital of the Company through their direct and deemed shareholding in all of DJM Holding Ltd., Richmedia Holdings Limited, Fitter Property Inc. and Eagle World International Inc.

3. Liu Dejian, Liu Luyuan and Zheng Hui are interested in 96.05%, 2.11% and 0.7%, respectively, of the registered capital of NetDragon (Fujian), which in turn is interested in 99.00% of the registered capital of NetDragon (Shanghai). Zheng Hui is directly beneficially interested in 1% of the registered capital of NetDragon (Shanghai). Liu Dejian is a brother of Liu Luyuan and a cousin of Zheng Hui who have agreed to act in concert to acquire interests in the registered capital of NetDragon (Fujian). All of Liu Dejian, Liu Luyuan and Zheng Hui are deemed to be interested in 98.86% of the registered capital of NetDragon (Fujian) and the entire registered capital of NetDragon (Shanghai) through their deemed shareholding in NetDragon (Fujian) and deemed and direct shareholding in NetDragon (Shanghai).
4. Chen Hongzhan is interested in 99% of the issued share capital of Cristionna Holdings Limited, which in turn is interested in 2.41% of the issued share capital of the Company. Chen Hongzhan is deemed to be interested in 2.41% of the issued share capital of the Company through his shareholding in Cristionna Holdings Limited.

Save as disclosed above, to the best knowledge of the Directors, as at 30 June 2008, none of the Directors and chief executive of the Company had any interest and short positions in any shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they were taken or deemed to have under such provisions of the SFO), or which were required to be entered in the register kept by the Company pursuant to Section 352 of the SFO or which were required, pursuant to the Model Code to be notified to the Company and the Stock Exchange.

## OTHER INFORMATION



### SUBSTANTIAL SHAREHOLDERS' INTERESTS AND OTHER PERSONS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

So far as is known to the Directors, as at 30 June 2008, the following persons (other than a Director or chief executive of the Company) had, or were deemed or taken to have interests or short positions in the shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO or, which were required to be entered in the register kept by the Company under Section 336 of the SFO or who were directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group:

Name	Name of Group member	Capacity and nature of interests	Number of ordinary shares held or amount of registered capital contributed (Note 1)	Approximate percentage of shareholding
DJM Holding Ltd.	The Company	Beneficial owner	183,402,600(L)	33.95%
Fitter Property Inc.	The Company	Beneficial owner	35,498,720(L)	6.57%
Eagle World International Inc. (Note 2)	The Company	Beneficial owner	33,712,920(L)	6.24%
Flowson Company Limited (Note 2)	The Company	Through a controlled corporation	33,712,920(L)	6.24%
IDG Group	The Company	Beneficial owner	78,333,320(L)	14.51%
NetDragon (Fujian)	NetDragon (Shanghai)	Beneficial owner	RMB990,000(L)	99.00%

Notes:

1. The letter "L" denotes the shareholder's long position in the share capital of the relevant member of the Group.
2. Eagle World International Inc. is an investment holding company incorporated on 7 May 2007 in the BVI with limited liability and is owned as to 100% by Flowson Company Limited. Flowson Company Limited is deemed to be interested in 6.24% of the issued share capital of the Company through its shareholding in Eagle World International Inc.

Save as disclosed above, the Directors are not aware of any persons (other than a Director or chief executive of the Company) who had, or were deemed or taken to have interests or short positions in the shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO or, which were required to be entered in the register kept by the Company under Section 336 of the SFO or who were directly or indirectly interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any member of the Group as at 30 June 2008.

### COMPETITION AND CONFLICT OF INTEREST

None of the Director or any of their respective associates, as defined in the Listing Rules, has interest in any business that competes or may compete, either directly or indirectly, with the businesses of the Group, or has any other conflict of interests with the Group as at the date of this report.

### PURCHASE, SALE OR REDEMPTION OF SECURITIES

During the review period, the Company repurchased a total of 15,858,500 shares on the Stock Exchange at an aggregate consideration of HKD193,384,936.66 before expenses. Details of the share repurchase are as follows:

Month of purchase	Number of ordinary shares repurchased	Price per share		Aggregate consideration paid <i>HKD</i>
		Highest	Lowest	
		<i>HKD</i>	<i>HKD</i>	
January 2008	4,159,500	13.50	12.40	54,823,486.66
February 2008	11,699,000	13.00	11.04	138,561,450.00
	<u>15,858,500</u>			<u>193,384,936.66</u>

The repurchased shares were cancelled on delivery of the share certificates during the review period. The nominal value of the cancelled shares was transferred to the capital redemption reserve and the relevant aggregate consideration was paid out from the Company's retained profits.

The repurchase of the Company shares during the review period were effected by the Directors pursuant to the resolutions of the Board meeting on 10 December 2007, with a view to benefit shareholders as a whole by enhancing the net asset value per share and earnings per share of the Company.

Save as disclosed above, neither the Company nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities during the review period.

## OTHER INFORMATION



### COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS

The following is a summary of comparison of the Company's actual business progress with its business objectives as set out in the Prospectus for the period from 1 January 2008 to 30 June 2008.

	<b>Business objectives as stated in the Prospectus</b>	<b>Actual business progress</b>
Further strengthen our core game development capabilities	<ul style="list-style-type: none"><li>• We will recruit additional experienced game developers to cope with our game development.</li><li>• We intend to set up a 3D graphic centre in Shanghai to upgrade and enhance the features of our existing and newly developed online games and recruit fresh graduates from universities and experienced 3D graphic artists to enhance our artist team and to facilitate the development of our 3D technology in order to expand our online game portfolio.</li><li>• We intend to invite professionals to organise trainings and seminars for our internal training programmes.</li></ul>	<ul style="list-style-type: none"><li>• We have recruited more than 300 game developers to join our game development team.</li><li>• We have set up a 3D graphic department with 6 staff in Shanghai for the six months ended 30 June 2008. The 3D graphic staff includes an experienced expertise, the 1) 3D Art Director, who has extensive online game development experience; 2) several experienced artists. We are going to move to a more spacious office in the coming future in order to further expand the 3D graphic department.</li><li>• We invited professionals from different industries and professors to conduct training sessions and seminars for our employees.</li></ul>



### COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

#### Business objectives as stated in the Prospectus

#### Actual business progress

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>• We will continue to upgrade our computers and game development software.</li> <br/> <li>• We will continue to standardise our game development process to improve efficiency.</li> <br/> <li>• We will integrate our customer information system and ERP system.</li> <br/> <li>• Our team will use the study result on customer information system to form marketing strategies.</li> </ul> | <ul style="list-style-type: none"> <li>• We have purchased new computers and softwares and replaced old computer hardwares and accessories required for our game development.</li> <br/> <li>• We have developed some game development software to replace some manual operation which improved the efficiency on our game development process.</li> <br/> <li>• We have started to integrate our customer information system and ERP system and performing several test run.</li> <br/> <li>• Our team has used the study result on customer information system to form marketing strategies such as making advertisement in the movies.</li> </ul> |
|---|--|

Further enhance our integrated operation model



## OTHER INFORMATION



### COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

	<b>Business objectives as stated in the Prospectus</b>	<b>Actual business progress</b>
Enrich our product portfolio and extend our game life cycles	<ul style="list-style-type: none"><li>• We will launch the Chinese versions of Tian Yuan (previously named as Piao Miao Online) and Heroes of Might and Magic Online.</li><li>• We will rollout upgraded versions of Eudemons Online, Zero Online and Way of the Five (previously named as Happiness Q).</li><li>• We will customise Way of the Five (previously named as Happiness Q) and Tian Yuan (previously named as Piao Miao Online) into the English version.</li><li>• We will customise Zero Online into other language versions.</li><li>• We will recruit additional experienced staff to operate our games</li></ul>	<ul style="list-style-type: none"><li>• The Chinese version of Heroes of Might and Magic Online was launched in late May 2008. We will conduct the closed and open beta testing of the Chinese version of Tian Yuan (previously named as Piao Miao Online) in the fourth quarter of 2008 and first quarter of 2009, respectively.</li><li>• We rollout upgraded versions of Eudemons Online and Zero Online but not for Way of the Five (previously named as Happiness Q)</li><li>• We will customize Way of the Five (previously named as Happiness Q) into English version in early 2009 after the official launch of the Chinese version. We plan to customize Tian Yuan into English version after conducting the open beta testing of the Chinese version in the first quarter of 2009.</li><li>• We have conducted the closed beta testing of the Spanish and Traditional Chinese versions of Zero Online in first half of 2008, respectively. We will conduct the open beta testing for both languages versions of Zero Online in second half of 2008.</li><li>• We have recruited more than 200 additional employees to join our game development team.</li></ul>



## OTHER INFORMATION

### COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

	<b>Business objectives as stated in the Prospectus</b>	<b>Actual business progress</b>
Expand our business through acquisition or cooperation with external parties	<ul style="list-style-type: none"><li>• We intend to acquire PRC or overseas medium size game development studios and game operators specialising in MMORPGs.</li><li>• We intend to establish cooperation partnership with PRC or overseas medium to large size well-known Internet portals.</li><li>• We will evaluate other merger and acquisition opportunities that complement or benefit our business strategies.</li></ul>	<ul style="list-style-type: none"><li>• We were negotiating with several potential PRC medium size game development studios and game operators specializing in MMORPGs to evaluate merger and acquisition possibilities.</li><li>• We have signed a content development and distribution agreement with BVIG in January 2008 and expect to release the Disney Game by early 2009. In the Disney Game, players live in a Disney-themed central world and can interact with selected Disney characters.</li><li>• Our business development team has continued to evaluate acquisition and merger activities that complement or benefit our business strategies.</li></ul>



## OTHER INFORMATION



### COMPARISON OF BUSINESS OBJECTIVES AND ACTUAL BUSINESS PROGRESS (Cont'd)

	<b>Business objectives as stated in the Prospectus</b>	<b>Actual business progress</b>
Strengthen our corporate image and promote our games	<ul style="list-style-type: none"><li>• We will continue to engage marketing consultants to formulate marketing strategies to promote our corporate image and our games.</li><li>• We will continue the cooperation with well-known Internet portals for game promotion and corporate image advertisement</li><li>• We will continue to participate in game industry events.</li><li>• We will engage a number of advertising agents to place advertisements in various media, including newspapers and magazines.</li></ul>	<ul style="list-style-type: none"><li>• We continued to engage Effort Ogilvy (Fujian) Advertising Co. Ltd to formulate marketing strategies to promote our games.</li><li>• We have engaged well-known Internet portals such as those operated by SINA, Baidu and Tencent for corporate image advertisement and game promotion.</li><li>• We were participating in the 2007 China Game Industry Conference in January 2008 and received several awards in the conference as well.</li><li>• We have engaged a number of advertising agents to place advertisements in various media.</li></ul>

### COMPARISON BETWEEN PROPOSED APPLICATIONS AND ACTUAL APPLICATIONS OF NET PROCEEDS RAISED FROM THE PLACING OF THE COMPANY'S SHARES ON GEM

<b>Business Objectives</b>	<b>Proposed applications for the period from 1 January 2008 to 30 June 2008, as set out in the Listing documents</b>	<b>Actual amount of proceeds used for the period from 1 January 2008 to 30 June 2008</b>
	HKD million	HKD million
Further strengthen our core game development capabilities	29.4	23.7
Further enhance our integrated operation model	1.5	—
Enrich our product portfolio and extend our game life cycles	10.3	6.2
Expand our business through acquisition or cooperation with external parties	63.2	—
Strengthen our corporate image and promote our games	27.4	15.1
	<hr/>	<hr/>
Total	131.8	45.0
	<hr/> <hr/>	<hr/> <hr/>

### SHARE OPTION SCHEME

Pursuant to the resolution of the shareholders of the Company dated 12 June 2008, the Company adopted a new share option scheme (the “Main Board Share Option Scheme”) to replace the then existing share option scheme (the “GEM Share Option Scheme”). As at the date of this report, no options has been granted under the GEM Share Option Scheme or the Main Board Share Option Scheme.

### COMPLIANCE WITH CODE ON CORPORATE GOVERNANCE PRACTICES

The Company applied the principles and complied with all the code provisions as set out in the Code on Corporate Governance Practices contained in Appendix 14 to the Listing Rules since the commencement of trading of its shares on the Main Board on 24 June 2008.

## OTHER INFORMATION



### MODEL CODE OF CONDUCT FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted a code of conduct regarding securities transactions by Directors on terms no less exacting than the required standard of dealings as set out in the Model Code of the Listing Rules. Having made specific enquiry of all Directors, the Directors have complied with the required standard of dealings and the code of conduct regarding securities transactions by the Directors since the commencement of trading of the shares of the Company on Main Board on 24 June 2008.

### AUDIT COMMITTEE

In compliance with Rules 3.21 and 3.22 of the Listing Rules, the Company established an audit committee with written terms of reference. The primary duties of the audit committee are to review and supervise our financial reporting process and internal control systems of the Group. The audit committee comprises three members, Chao Guowei, Charles, Lee Kwan Hung and Liu Sai Keung, Thomas who are the independent non-executive Directors. Chao Guowei, Charles is the chairman of the audit committee.

The Group's unaudited consolidated results for the six months ended 30 June 2008 have been reviewed by the audit committee, which was of the opinion that the preparation of such results complied with the applicable accounting standards and requirements and that adequate disclosures have been made.

By Order of the Board  
**NetDragon Websoft Inc.**  
**Liu Dejian**  
*Chairman*

Hong Kong, 22 August 2008





Member of Grant Thornton International Ltd

**To the Board of Directors of NetDragon Websoft Inc.**

網龍網絡有限公司

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

## INTRODUCTION

We have reviewed the interim financial statements of NetDragon Websoft Inc. and its subsidiaries (collectively, the “Group”) set out on pages 24 to 44, which comprise the condensed consolidated balance sheet as at 30 June 2008 and the related condensed consolidated income statement, condensed consolidated statement of changes in equity and condensed consolidated cash flow statement for the six-month period then ended, and other explanatory notes. The Rules Governing the Listing of Securities on the Main Board of The Stock Exchange of Hong Kong Limited require the preparation of a report on interim financial statements to be in compliance with the relevant provisions thereof and Hong Kong Accounting Standard 34 “Interim Financial Reporting” issued by the Hong Kong Institute of Certified Public Accountants (the “HKICPA”). The directors are responsible for the preparation and presentation of this interim financial statements in accordance with Hong Kong Accounting Standard 34.

Our responsibility is to express a conclusion on this interim financial statements based on our review and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## SCOPE OF REVIEW

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the HKICPA. A review of interim financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

## CONCLUSION

Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements is not prepared, in all material respects, in accordance with Hong Kong Accounting Standard 34.

### Grant Thornton

*Certified Public Accountants*

13/F Gloucester Tower

The Landmark

15 Queen’s Road Central

Hong Kong

22 August 2008

# CONDENSED CONSOLIDATED INCOME STATEMENT

For the six months ended 30 June 2008



		Six months ended 30 June	
		2008	2007
		(Unaudited)	(Audited)
		<i>RMB'000</i>	<i>RMB'000</i>
	Notes		
<b>Revenue</b>	4	<b>322,897</b>	261,749
Cost of revenue		<b>(32,401)</b>	(14,665)
<b>Gross profit</b>		<b>290,496</b>	247,084
Other revenue and gains	4	<b>15,781</b>	1,330
Selling and marketing expenses		<b>(44,240)</b>	(30,345)
Administrative expenses		<b>(62,313)</b>	(19,418)
Development costs		<b>(35,630)</b>	(13,137)
Other operating expenses		<b>(19,295)</b>	(13,248)
<b>Profit before income tax</b>	5	<b>144,799</b>	172,266
Income tax expense	6	<b>(29,606)</b>	(18,179)
<b>Profit for the period</b>		<b>115,193</b>	154,087
Attributable to			
Equity holders of the Company		<b>115,305</b>	153,839
Minority interests		<b>(112)</b>	248
		<b>115,193</b>	154,087
<b>Dividends</b>	7	<b>47,496</b>	79,069
		<i>RMB cents</i>	<i>RMB cents</i> (Restated)
<b>Earnings per share</b>	8		
– Basic		<b>21.21</b>	38.36
– Diluted		<b>N/A</b>	N/A

# CONDENSED CONSOLIDATED BALANCE SHEET

As at 30 June 2008

	Notes	At 30 June 2008 (Unaudited) RMB'000	At 31 December 2007 (Audited) RMB'000
<b>ASSETS AND LIABILITIES</b>			
<b>Non-current assets</b>			
Property, plant and equipment	9	85,667	61,344
Land use rights		4,344	1,174
Intangible asset		6,253	—
Long-term prepaid expense		277	—
Available-for-sale financial asset		4,000	4,000
Deferred tax assets		54	54
		<u>100,595</u>	<u>66,572</u>
<b>Current assets</b>			
Trade and other receivables	10	82,357	67,295
Financial assets at fair value through profit or loss	11	341,409	—
Derivative financial instruments	12	425	—
Amounts due from related parties		—	8,832
Tax recoverable		332	581
Term deposits with initial term of over three months		498,918	50,000
Cash and cash equivalents	13	494,237	1,651,380
		<u>1,417,678</u>	<u>1,778,088</u>
<b>Current liabilities</b>			
Trade and other payables	14	43,385	45,262
Amounts due to related parties		—	76
Income tax payable		29,932	29,940
		<u>73,317</u>	<u>75,278</u>
<b>Net current assets</b>		<u>1,344,361</u>	<u>1,702,810</u>
<b>Total assets less current liabilities/Net assets</b>		<u>1,444,956</u>	<u>1,769,382</u>

# CONDENSED CONSOLIDATED BALANCE SHEET

As at 30 June 2008



		<b>At 30 June 2008 (Unaudited) RMB'000</b>	At 31 December 2007 (Audited) RMB'000
	<i>Notes</i>		
<b>EQUITY</b>			
Share capital	15	<b>40,082</b>	41,219
Reserves		<b>1,404,874</b>	1,728,051
		<hr/>	<hr/>
Equity attributable to equity holders of the Company		<b>1,444,956</b>	1,769,270
Minority interests		—	112
		<hr/>	<hr/>
<b>Total equity</b>		<b>1,444,956</b>	1,769,382
		<hr/> <hr/>	<hr/> <hr/>

# CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the six months ended 30 June 2008

## Attributable to equity holders of the Company

	Attributable to equity holders of the Company											
	Share capital	Share premium	Capital contribution	Capital redemption reserve	Capital reserve	Statutory reserves	Translation reserve	Dividend reserve	Retained profits	Minority interests	Total equity	
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
<b>At 1 January 2007</b>	1,453	16,267	21,755	—	11,596	6,768	(10)	—	46,749	104,578	129	104,707
Exchange difference arising on translation of overseas operations /												
Income recognised directly in equity	—	—	—	—	—	—	175	—	—	175	—	175
Profit for the period	—	—	—	—	—	—	—	—	153,839	153,839	248	154,087
Total recognised income and expense for the period	—	—	—	—	—	—	175	—	153,839	154,014	248	154,262
Issue of shares by a subsidiary	—	69,984	(21,755)	—	170	—	—	—	—	48,399	—	48,399
Issue of shares by the Company	2,053	—	—	—	(1,820)	—	127	—	—	360	—	360
Dividends declared (note 7)	—	—	—	—	—	—	—	—	(79,069)	(79,069)	—	(79,069)
<b>At 30 June 2007 (audited)</b>	<b>3,506</b>	<b>86,251</b>	<b>—</b>	<b>—</b>	<b>9,946</b>	<b>6,768</b>	<b>292</b>	<b>—</b>	<b>121,519</b>	<b>228,282</b>	<b>377</b>	<b>228,659</b>
<b>At 1 January 2008</b>	41,219	1,379,483	—	8	9,946	61,216	(10,680)	216,093	71,985	1,769,270	112	1,769,382
Exchange difference arising on translation of overseas operations /												
Expense recognised directly in equity	—	—	—	—	—	—	(45,801)	—	—	(45,801)	—	(45,801)
Profit for the period	—	—	—	—	—	—	—	—	115,305	115,305	(112)	115,193
Total recognised income and expense for the period	—	—	—	—	—	—	(45,801)	—	115,305	69,504	(112)	69,392
Repurchase and cancellation of shares	(1,137)	(176,588)	—	1,137	—	—	—	—	(1,137)	(177,725)	—	(177,725)
Dividend paid	—	—	—	—	—	—	—	(216,093)	—	(216,093)	—	(216,093)
Interim dividend declared (note 7)	—	—	—	—	—	—	—	47,496	(47,496)	—	—	—
<b>At 30 June 2008 (unaudited)</b>	<b>40,082</b>	<b>1,202,895</b>	<b>—</b>	<b>1,145</b>	<b>9,946</b>	<b>61,216</b>	<b>(56,481)</b>	<b>47,496</b>	<b>138,657</b>	<b>1,444,956</b>	<b>—</b>	<b>1,444,956</b>



# CONDENSED CONSOLIDATED CASH FLOW STATEMENT

For the six months ended 30 June 2008



	Six months ended 30 June	
	2008 (Unaudited) RMB'000	2007 (Audited) RMB'000
<b>Net cash generated from operating activities</b>	<b>154,960</b>	183,925
<b>Cash flows from investing activities</b>		
Interest received	5,113	851
Dividend received from available-for-sale financial asset	176	—
Increase in term deposits with initial term of over three months	(448,918)	—
Additions to land use rights	(3,210)	—
Additions to property, plant and equipment	(39,705)	(15,203)
Additions to intangible asset	(7,037)	—
Additions to long-term prepaid expense	(347)	—
Additions to financial assets at fair value through profit or loss	(340,800)	—
Proceeds from disposals of property, plant and equipment	—	10
Net cash generated from investment in trading securities	—	502
<b>Net cash used in investing activities</b>	<b>(834,728)</b>	(13,840)
<b>Cash flows from financing activities</b>		
Dividends paid	(216,093)	(79,069)
Payment for repurchase of shares	(177,725)	—
Proceeds from shares issued by the Company	—	1,813
Proceeds from shares issued by a subsidiary	—	48,399
<b>Net cash used in financing activities</b>	<b>(393,818)</b>	(28,857)
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>(1,073,586)</b>	141,228
<b>Cash and cash equivalents at beginning of the period</b>	<b>1,651,380</b>	66,322
Effect of foreign exchange rate changes	(83,557)	(1,144)
<b>Cash and cash equivalents at end of the period</b>	<b>494,237</b>	206,406



# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

*For the six months ended 30 June 2008*

## 1. GENERAL INFORMATION

NetDragon Websoft Inc. (the “Company”) was incorporated in the Cayman Islands on 29 July 2004 as an exempted company with limited liability. The registered office of the Company is situated at Scotia Centre, 4th Floor, P.O. Box 2804, George Town, Grand Cayman, Cayman Islands and its principal place of business is situated at 58 Hot Spring Branch Road, Fuzhou, Fujian, the People’s Republic of China, except Hong Kong (the “PRC”).

The Company’s shares were listed on the Growth Enterprise Market (“GEM”) of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) on 2 November 2007. On 12 June 2008, an extraordinary general meeting (“EGM”) were held to approve, among others, the Company’s voluntary withdrawal of listing on GEM and proposed listing on the Main Board of the Stock Exchange by way of introduction. The proposed withdrawal was passed by the shareholders at the EGM. Further details are set out in the announcement of the Company dated 12 June 2008.

The shares of the Company have been listed on the Main Board of the Stock Exchange since 24 June 2008.

The Company is an investment holding company. The Company and its subsidiaries (collectively, the “Group”) are principally engaged in online game development, including game design, programming and graphics, and online game operation.

The unaudited condensed consolidated financial statements for the six months ended 30 June 2008 (the “Interim Financial Statements”) have been prepared in accordance with Hong Kong Accounting Standard 34 “Interim Financial Reporting” issued by the Hong Kong Institute of Certified Public Accountants and the applicable disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on the Stock Exchange. The Interim Financial Statements do not include all the information required in annual financial statements and thereby they should be read in conjunction with the Group’s annual financial statements for the year ended 31 December 2007 and the Company’s listing document dated 27 May 2008.

The 2008 interim results of the Group are unaudited and have been reviewed by the Company’s audit committee.

# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008



## 2. PRINCIPAL ACCOUNTING POLICIES

The Interim Financial Statements have been prepared under the historical cost convention except for certain financial assets which are stated at fair value.

The accounting policies used in preparing the Interim Financial Statements are consistent with those followed in the Group's annual financial statements for the year ended 31 December 2007.

### (a) Impact of new and revised HKFRSs which are effective in the current interim period

All the new and revised standards and interpretations of Hong Kong Financial Reporting Standards ("HKFRSs") which are effective during the six months ended 30 June 2008 are not relevant to the Group. They did not result in significant changes in the Group's accounting policies and had no significant impact on the current or the prior accounting periods.

### (b) Impact of new and revised HKFRSs which are issued but not yet effective

The Group has not early adopted the following new and revised HKFRSs that have been issued but are not yet effective in the current interim period:

HKAS 1 (Revised)	Presentation of Financial Statements <sup>1</sup>
HKAS 23 (Revised)	Borrowing Costs <sup>1</sup>
HKAS 27 (Revised)	Consolidated and Separate Financial Statements <sup>3</sup>
HKFRS 2 (Amendment)	Vesting Conditions and Cancellations <sup>1</sup>
HKFRS 3 (Revised)	Business Combination <sup>3</sup>
HKFRS 8	Operating Segments <sup>1</sup>
Amendments to HKAS 1 (Revised)	Presentation of Financial Statements – Puttable financial instruments and obligations arising on liquidation <sup>1</sup>
Amendments to HKAS 32	Financial Instruments: Presentation – Puttable financial instruments and obligations arising on liquidation <sup>1</sup>
Amendments to HKAS 39	Financial Instruments: Recognition and Measurement – Puttable financial instruments and obligations arising on liquidation <sup>1</sup>
Amendments to HKFRS 7	Financial Instruments: Disclosures – Puttable financial instruments and obligations arising on liquidation <sup>1</sup>
HK(IFRIC)-Int 13	Customer Loyalty Programmes <sup>2</sup>
Amendments to (HKIFRIC)-Int 2	Members' Shares in Co-operative Entities and Similar Instruments <sup>1</sup>

<sup>1</sup> Effective for annual periods beginning on or after 1 January 2009

<sup>2</sup> Effective for annual periods beginning on or after 1 July 2008

<sup>3</sup> Effective for annual periods beginning on or after 1 July 2009



## NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008

### 2. PRINCIPAL ACCOUNTING POLICIES (Cont'd)

The Group is in the process of assessing the impact of these new or revised HKFRSs upon initial application. The Group anticipates that these new and revised HKFRSs are unlikely to have any material impact on the Group's financial statements except for HKAS 1 (Revised) which would affect the presentation of financial statements as disclosed in the Group's annual financial statements for the year ended 31 December 2007.

### 3. SEGMENT INFORMATION

Based on risks and returns, the directors of the Company consider that the primary reporting format of the Group is by business segment. The directors consider that there is only one business segment, being online game development, including game design, programming and graphics, and online game operation. The disclosures for the primary segment have already been given in these financial statements and therefore no further information about business segment is presented.

Geographical segment is the secondary reporting format of the Group. In determining the Group's geographical segments, revenue is attributed to the segments based on the location where services are provided.

The Group's online game revenue analysed by geographical markets during the six months ended 30 June 2008 is presented below:

	Six months ended 30 June	
	2008 (Unaudited) RMB'000	2007 (Audited) RMB'000
PRC	251,719	208,747
USA	68,668	52,582
Others	2,510	420
	<u>322,897</u>	<u>261,749</u>

# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008



## 4. REVENUE AND GAINS

	Six months ended 30 June	
	2008 (Unaudited) RMB'000	2007 (Audited) RMB'000
Revenue – turnover		
Online game revenue	322,897	261,749
Other revenue and gains		
Advertising income	2,987	—
Bank interest income	10,240	851
Dividend income from available-for-sale financial asset	176	—
Fair value gain on financial assets at fair value through profit or loss	609	104
Fair value gain on derivative financial instruments	438	—
Government grants	1,196	220
Others	135	155
	<hr/>	<hr/>
	15,781	1,330
	<hr/>	<hr/>
	338,678	263,079
	<hr/> <hr/>	<hr/> <hr/>

# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008

## 5. PROFIT BEFORE INCOME TAX

The Group's profit before income tax is arrived at after charging:

	<b>Six months ended 30 June</b>	
	<b>2008</b>	2007
	<b>(Unaudited)</b>	(Audited)
	<b>RMB'000</b>	RMB'000
Amortisation of land use rights	40	—
Amortisation of intangible asset	733	—
Depreciation of property, plant and equipment	15,363	3,569
Operating lease charged on:		
– land and buildings	1,227	1,206
– computer equipment	17,396	5,264
Development costs ( <i>note</i> )	35,630	13,137
Staff costs	59,256	25,430
Net foreign exchange losses	20,330	353
Loss on disposal of property, plant and equipment	—	20
Impairment on receivables	210	247
Write off of property, plant and equipment	11	—
	<b>—</b>	<b>—</b>

*Note:*

Development costs mainly comprise depreciation of property, plant and equipment of RMB711,000 (six months ended 30 June 2007: RMB47,000), and staff costs of RMB33,344,000 (six months ended 30 June 2007: RMB12,943,000), which are also included in the total amounts disclosed separately above for each of these types of expenses.

The Group did not capitalise any development costs for the six months ended 30 June 2008 (six months ended 30 June 2007: Nil).

# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008



## 6. INCOME TAX EXPENSE

The major components of income tax expense for the period are as follows:

	<b>Six months ended 30 June</b>	
	<b>2008</b>	2007
	<b>(Unaudited)</b>	(Audited)
	<b>RMB'000</b>	RMB'000
Current tax		
– PRC (note (i))	<b>29,386</b>	17,875
– USA (note (ii))	<b>220</b>	157
	<b>29,606</b>	18,032
Deferred income tax	—	147
Income tax expense	<b>29,606</b>	18,179

Notes:

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

Fujian TQ Digital Inc. (“TQ Digital”), a subsidiary of the Company, is a foreign-invested enterprise and was approved to be a hi-tech enterprise located in high technology development zone on 29 July 2005. Pursuant to the Circular on Some Preferential Policies for the Enterprise Income Tax (關於企業所得稅若干優惠政策的通知) issued by the Ministry of Finance (財政部) and the State Administration of Taxation (國家稅務總局) on 29 March 1994, TQ Digital is entitled to a preferential income tax rate of 15%. The qualification of hi-tech enterprise is subject to review once every two years and TQ Digital continued to be recognised as a hi-tech enterprise on 16 August 2007. On 25 December 2003, TQ Digital was approved to be a software enterprise. Pursuant to the Circular on the Tax Policies for Encouraging the Development of Software and Integrated Circuit Industries (關於鼓勵軟件產業和集成電路產業發展有關稅收政策問題的通知) issued by the Ministry of Finance (財政部), the State Administration of Taxation (國家稅務總局) and the General Administration of Customs (海關總署) on 22 September 2000, TQ Digital is entitled to tax benefits of tax exemption for two years starting from the first year of profitable operations after offsetting prior year tax losses, followed by 50% tax reduction for three years. 2003 was the first profitable year for TQ Digital. Accordingly, the EIT tax rate applicable to TQ Digital for the six months ended 30 June 2007 was 7.5%.

Fujian NetDragon Websoft Co. Ltd. (“NetDragon (Fujian)”), another subsidiary of the Company, continued to be recognised as a hi-tech enterprise located in high technology industrial development zone on 9 November 2004. Pursuant to the Circular on Some Preferential Policies for the Enterprise Income Tax (關於企業所得稅若干優惠政策的通知) as mentioned in the previous paragraph, NetDragon (Fujian) was entitled to paying EIT at the reduced tax rate of 15% for 2005 and 2006. Pursuant to a notice issued by a government authority (福建省科學技術廳) on 16 August 2007, NetDragon (Fujian) continued to be recognised as a hi-tech enterprise and is thereby subject to EIT tax rate of 15% during the six months ended 30 June 2007.





## NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008

### 6. INCOME TAX EXPENSE (Cont'd)

On 16 March 2007, the PRC promulgated the Law of the PRC on Enterprise Income Tax (the “New Tax Law”) by order No. 63 of the president of the PRC, which became effective on 1 January 2008. According to the New Tax Law, the income tax rate applicable to the Group’s PRC subsidiaries is unified at 25%. According to the Circular of State Administration of Taxation Concerning Pre-Payment Issues Relevant to Enterprise Income Tax (國家稅務總局關於企業所得稅預繳問題通知) issued by the State Administration of Taxation on 31 January 2008, NetDragon (Fujian) which was recognised as hi-tech enterprise prior to 1 January 2008 shall provisionally subject to the EIT tax prepayment rate of 25%, pending further recognition in accordance with the New Tax Law.

Pursuant to the Circular Concerning Transitional Preferential Tax Policies in view of the implementation of the PRC Enterprise Income Tax Law (關於實施企業所得稅過渡優惠政策的通知) issued by the State Council (國務院) on 26 December 2007, as TQ Digital is a foreign-invested enterprise and enjoying preferential income tax rate of 15% in 2007, the new tax rate is increasing from 15% over 5 years to 25% as transitional provision. Accordingly, the EIT tax rate applicable to TQ Digital during the six months ended 30 June 2008 was 18%.

Shanghai Tiankun Digital Technology Ltd. (“NetDragon (Shanghai)”), one of the subsidiaries of the Company is subject to EIT tax rate of 25% for the six months ended 30 June 2008 (six months ended 30 June 2007: 33%).

- (ii) The USA income tax rates applicable to the Group for the six months ended 30 June 2008 are 34% (six months ended 30 June 2007: 34%) for federal tax and 8.84% (six months ended 30 June 2007: 8.84%) for state income tax.
- (iii) The Group is not subject to any taxation under the jurisdiction of the Cayman Islands and British Virgin Islands (“BVI”) during the six months ended 30 June 2008 (six months ended 30 June 2007: Nil). Provision for Hong Kong profits tax is not made as the Group has not derived any assessable profits in Hong Kong during the six months ended 30 June 2008 (six months ended 30 June 2007: Nil).

# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008



## 7. DIVIDENDS

	Six months ended 30 June	
	2008 (Unaudited) RMB'000	2007 (Audited) RMB'000
Proposed interim dividend of HKD 0.1 per share (six months ended 30 June 2007: Nil)	47,496	—
Special dividends paid during the period	—	79,069
	<u>47,496</u>	<u>79,069</u>

The proposed interim dividend was determined based on the number of shares as at the date of these financial statements. The proposed interim dividend for the six months ended 30 June 2008 has not been recognised as a liability at the balance sheet date.

Special dividends were declared and paid by the Company and NetDragon Websoft Inc., one of the Company's subsidiaries and incorporated in the BVI ("NetDragon (BVI)") prior to the reorganisation of the Group for the six months ended 30 June 2007:

- (a) On 3 February 2007, NetDragon (BVI) declared a special dividend of RMB44,839,000 to its then equity holders.
- (b) On 20 June 2007, NetDragon (BVI) declared a special dividend of RMB34,230,000 to the Company. On the same date, the Company declared the same amount of dividend to its equity holders who are effectively the then equity holders of NetDragon (BVI).

The dividend rates and the number of shares ranking for special dividends are not presented as such information is considered not meaningful for the purpose of this report.



## NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008

### 8. EARNINGS PER SHARE

The calculation of earnings per share attributable to the equity holders of the Company is calculated based on the profit attributable to the equity holders of the Company of RMB115,305,000 (six months ended 30 June 2007: RMB153,839,000) and on the weighted average number of 543,714,096 shares (six months ended 30 June 2007: 401,017,544 shares) in issue during the period, as adjusted to reflect the shares issued for capitalisation on 15 October 2007 in connection with the listing of the Company's shares on GEM of the Stock Exchange.

Diluted earnings per share for the six months ended 30 June 2008 and 2007 have not presented as there were no dilutive potential shares.

### 9. PROPERTY, PLANT AND EQUIPMENT

During the six months ended 30 June 2008,

- (a) the Group incurred capital expenditure of approximately RMB5,191,000 (six months ended 30 June 2007: Nil) in buildings, approximately RMB3,249,000 (six months ended 30 June 2007: RMB318,000) in leasehold improvements, approximately RMB29,904,000 (six months ended 30 June 2007: RMB13,013,000) in computer and office equipments and approximately RMB1,361,000 (six months ended 30 June 2007: RMB1,872,000) in motor vehicles.
- (b) the Group wrote off/disposed of certain items of property, plant and equipment with carrying value amounting to RMB11,000 (six months ended 30 June 2007: RMB30,000) and recognised a loss of RMB11,000 (six months ended 30 June 2007: Loss of RMB20,000) in the condensed consolidated income statement of the current interim period.

### 10. TRADE AND OTHER RECEIVABLES

	<b>30 June 2008 (Unaudited) RMB'000</b>	31 December 2007 (Audited) RMB'000
Trade receivables ( <i>note (i)</i> )	<b>20,477</b>	26,940
Other receivables	<b>9,467</b>	6,140
Deposits and prepayments	<b>52,413</b>	34,215
	<hr/> <b>82,357</b> <hr/>	<hr/> <hr/> <b>67,295</b> <hr/>

# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008



## 10. TRADE AND OTHER RECEIVABLES (Cont'd)

Notes:

- (i) The ageing analysis of trade receivables at the balance sheet date, based on the invoice date, is as follows:

	<b>30 June 2008 (Unaudited) RMB'000</b>	31 December 2007 (Audited) RMB'000
Outstanding balances with ages:		
– 30 days or below	<b>17,185</b>	22,881
– 31 – 60 days*	<b>3,073</b>	1,983
– 61 – 90 days*	<b>217</b>	1,876
– 91 – 180 days*	<b>2</b>	—
– Over 365 days*	<b>—</b>	200
	<b>20,477</b>	26,940

\* past due but not impaired

Trade receivables that are not yet past due relate to a wide range of corporation partners, sales distributors and distribution partners for whom there was no recent history of default. Trade receivables that were past due but not impaired related to a number of independent corporation partners, sales distributors and distribution partners that have a good track record with the Group. Based on the past experience, management believes that no impairment allowance is necessary in respect of these balances as there has not been a significant change in credit quality and the balances are still considered fully recoverable. The Group does not hold any collateral over the balances.

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

- (ii) Trade and other receivables are interest free and unsecured. Other receivables are not past due or impaired as at period/year end date. The directors consider that the carrying amounts of trade and other receivables approximate their fair values because of their short maturities.

# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008

## 11. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS

	<b>30 June 2008 (Unaudited) RMB'000</b>	31 December 2007 (Audited) RMB'000
Debt instruments – unlisted	<b>341,409</b>	—

During the period, the Group invested in two debt instruments, USD30,000,000 (equivalents to RMB205,773,000) in 1-year USD denominated consecutive digital note (“USD Note”) and AUD21,000,000 (equivalents to RMB135,044,000) in 1-year AUD denominated credit-linked note (“AUD Note”). The principal of the USD Note is 100% recoverable at maturity. The return of the USD Note is calculated based on the exchange rates of USD against RMB on monthly observation dates as specified in the term sheet of the USD Note, and is receivable at maturity date. The principal of the AUD Note is 100% recoverable at maturity, with the redemption and extension clauses as specified in the term sheet of the AUD Note. The return of the AUD Note is 8.3% per annum, and is receivable at maturity date or redemption date or extension date, as appropriate. The USD Note and the AUD Note have been designated as financial assets at fair value through profit or loss by the management in their initial recognition.

As at 30 June 2008, the carrying amount of USD Note amounted to USD30,000,000 (equivalents to RMB205,773,000) which is approximate to its fair value. The fair value of the USD Note has been determined by Asset Appraisal Limited, a firm of professional valuers using market approach (such as forward rates from reputable financial institution) and interpolation techniques on the forward rates of RMB against USD as at 30 June 2008. The valuation has been performed with the following assumptions: i) all the monthly returns were estimated using the forward rate as at 30 June 2008; and ii) the Group held the USD Note to maturity.

As at 30 June 2008, the carrying amount of the AUD Note of AUD21,092,000 (equivalents to RMB135,636,000) which was determined by reference to the valuation conducted by a third party financial institution.

The debt instruments are not designated as hedging instruments.

During the period, the net increase in the fair value of the AUD Note of approximately RMB609,000 (equivalents to AUD92,000) was recognised and recorded in “Other revenue and gains” in the condensed consolidated income statement. The increase in fair value for the period and cumulated changes of RMB609,000 was solely attributable to the changes in market conditions that give rise to market risk.

# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008



## 12. DERIVATIVE FINANCIAL INSTRUMENTS

	<b>30 June</b> <b>2008</b> <b>(Unaudited)</b> <b>RMB'000</b>	31 December 2007 (Audited) RMB'000
Forward foreign currency contract – unlisted	<b>425</b>	—

During the period, the Group entered into a 1-year forward foreign currency contract in respect of USD against AUD. Under the contract, the Group is required to buy USD in the amount equivalents to AUD21,000,000 at the exchange rate of maturity date.

During the period, the net increase in the fair value of the forward foreign currency contract of approximately RMB438,000 was recognised and recorded in “Other revenue and gains” in the condensed consolidated income statement. The increase in fair value for the period and cumulated changes of RMB438,000 was solely attributable to the changes in market conditions that give rise to market risk.

The forward foreign currency contract is not designated as hedging instrument and its fair value is determined by reference to the valuation conducted by a third party financial institution.

## 13. CASH AND CASH EQUIVALENTS

As at 30 June 2008, cash and cash equivalents of the Group denominated in RMB amounted to RMB333,659,000 (At 31 December 2007: RMB286,403,000). The conversion of RMB into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC government.

# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008

## 14. TRADE AND OTHER PAYABLES

	<b>30 June 2008 (Unaudited) RMB'000</b>	31 December 2007 (Audited) RMB'000
Trade payables ( <i>note</i> )	712	500
Accrued staff costs	4,313	5,789
Value added tax payables and other tax payables	5,294	5,333
Other payables and accrued charges	16,643	15,288
Deferred income	16,423	18,352
	<u>43,385</u>	<u>45,262</u>

*Note:*

The ageing analysis of trade payables is as follows:

	<b>30 June 2008 (Unaudited) RMB'000</b>	31 December 2007 (Audited) RMB'000
Outstanding balances with ages:		
– Within 90 days	692	500
– 181 – 365 days	20	—
	<u>712</u>	<u>500</u>



# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008



## 15. SHARE CAPITAL

	Number of common shares of USDO.01 each	Number of preferred shares of USDO.01 each	Total number of shares of USDO.01 each	Nominal value	
				USD	RMB'000
<b>Authorised:</b>					
At 1 January 2007	50,000,000	3,000,000	53,000,000	530,000	4,388
Increase/(Decrease) in authorised share capital	950,000,000	(3,000,000)	947,000,000	9,470,000	71,383
At 31 December 2007 and at 1 January 2008 and at 30 June 2008	<u>1,000,000,000</u>	<u>—</u>	<u>1,000,000,000</u>	<u>10,000,000</u>	<u>75,771</u>
<b>Issued:</b>					
At 1 January 2007	14,878,937	2,666,666	17,545,603	175,456	1,453
Issue of new shares on 26 March 2007	4,674,790	—	4,674,790	46,748	360
Issue of new shares on shares swap	19,553,727	2,666,666	22,220,393	222,204	1,693
Conversion of preferred shares to common shares	5,333,332	(5,333,332)	—	—	—
Issue of new shares by capitalisation issues	399,967,074	—	399,967,074	3,999,671	29,481
Issue of new shares by way of international placing	95,600,000	—	95,600,000	956,000	7,046
Issue of new shares by exercise of over-allotment options	16,200,000	—	16,200,000	162,000	1,194
Repurchase and cancellation of shares	(116,500)	—	(116,500)	(1,165)	(8)
At 31 December 2007 and at 1 January 2008	<u>556,091,360</u>	<u>—</u>	<u>556,091,360</u>	<u>5,560,914</u>	<u>41,219</u>
Repurchase and cancellation of shares ( <i>note</i> )	(15,858,500)	—	(15,858,500)	(158,585)	(1,137)
At 30 June 2008	<u>540,232,860</u>	<u>—</u>	<u>540,232,860</u>	<u>5,402,329</u>	<u>40,082</u>

*Note:*

The Company repurchased 15,858,500 of its own shares through purchase on the Stock Exchange during the six months ended 30 June 2008. The shares have been cancelled upon recognised. The total amount to acquire the shares was approximately HKD194 million (equivalents to RMB178 million) which have been deducted from the shareholders' equity.



## NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008

### 16. SHARE OPTION SCHEME

On 12 June 2008, in order to comply with the Main Board Listing Rules regarding share option scheme of a company, a new share option scheme (the “New Scheme”) was adopted by the Company to replace GEM share option scheme.

The Company operates the New Scheme for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group’s operations. Eligible participants of the New Scheme include executive directors, non-executive directors, employees, shareholders, suppliers, customers, consultants, advisers, other service providers, and joint venture partners, business or strategic alliance partners. The New Scheme became effective on 12 June 2008 and, unless otherwise cancelled or amended will remain in force for 10 years from that date.

Further details of the Company’s New Scheme are disclosed in the Company’s listing document dated 27 May 2008.

No share options have been granted since the adoption of the New Scheme and the Company had no share options outstanding at the balance sheet date.

### 17. RELATED PARTY TRANSACTIONS

Except as disclosed elsewhere in the Interim Financial Statements, the Group has the following transactions with the following related parties during the period:

	Six months ended 30 June	
	2008 (Unaudited) RMB’000	2007 (Audited) RMB’000
Rentals paid to:		
– 福建楊振華 851 生物工程技術研究開發有限公司	135	135
– Beso Biological Research Inc.	—	124
After-sales service fee paid to 福州天亮網絡技術有限公司	773	1,926
Technical service fee paid to 福州天亮網絡技術有限公司	773	511
	<u>1,681</u>	<u>2,596</u>

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

# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 30 June 2008



## 18. CAPITAL COMMITMENT

At the balance sheet date, the Group had the following capital commitment:

	<b>30 June 2008 (Unaudited) RMB'000</b>	31 December 2007 (Audited) RMB'000
Contracted, but not provided for:		
– acquisition of property, plant and equipment	<b>101</b>	2,547

## 19. OPERATING LEASE COMMITMENTS

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

	<b>30 June 2008 (Unaudited) RMB'000</b>	31 December 2007 (Audited) RMB'000
<u>Land and buildings</u>		
Within one year	<b>2,270</b>	1,448
In the second to fifth years	<b>3,887</b>	2,526
	<b>6,157</b>	3,974
<u>Computer equipment</u>		
Within one year	<b>1,997</b>	1,304
<u>Total</u>		
Within one year	<b>4,267</b>	2,752
In the second to fifth years	<b>3,887</b>	2,526
	<b>8,154</b>	5,278

## 20. CONTINGENT LIABILITIES

The Group did not have significant contingent liabilities as at 30 June 2008 (At 31 December 2007: Nil).