

# NetDragon Websoft Inc.

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

Stock Code : 8288



Third Quarterly Report 2007

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

## **SUMMARY**

- The Company's shares were listed on GEM of the Stock Exchange on 2 November 2007 with a total net proceeds of approximately HK\$1,378.9 million.
- The unaudited consolidated revenue of the Group for the three months and nine months ended 30 September 2007 amounted to RMB191.6 million (three months ended 30 September 2006: RMB30.6 million) and RMB453.3 million (nine months ended 30 September 2006: RMB56.7 million) respectively, representing an increase of approximately 526.4% and 699.6% respectively as compared with the same periods last year.
- Profit attributable to equity holders of the Company for the three months and nine months ended 30 September 2007 amounted to RMB111.9 million (three months ended 30 September 2006: RMB12.4 million) and RMB265.7 million (nine months ended 30 September 2006: RMB9.6 million), representing an increase of approximately 801.1% and 2,657.9% respectively as compared with last corresponding periods.
- For the three months and nine months ended 30 September 2007, the earnings per share amounted to RMB25.17 cents (three months ended 30 September 2006: RMB3.10 cents) and RMB59.98 cents (nine months ended 30 September 2006: RMB2.41 cents) respectively.
- The Directors do not recommend the payment of an interim dividend for the three months ended 30 September 2007 (three months ended 30 September 2006: Nil).

## UNAUDITED RESULTS

The board of Directors (the “Board”) of the Company is pleased to announce the following unaudited consolidated results of the Company and its subsidiaries (the “Group”) for the three months and nine months ended 30 September 2007 together with the comparative figures for the corresponding periods in the last financial year.

### CONSOLIDATED INCOME STATEMENTS (UNAUDITED)

	<i>Notes</i>	<b>Three months ended</b>		<b>Nine months ended</b>	
		<b>30 September</b>		<b>30 September</b>	
		<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
		<b><i>RMB'000</i></b>	<b><i>RMB'000</i></b>	<b><i>RMB'000</i></b>	<b><i>RMB'000</i></b>
<b>Revenue – turnover</b>	4	<b>191,579</b>	<b>30,582</b>	<b>453,328</b>	<b>56,693</b>
Cost of revenue		<b>(10,096)</b>	<b>(3,145)</b>	<b>(24,761)</b>	<b>(6,398)</b>
<b>Gross profit</b>		<b>181,483</b>	<b>27,437</b>	<b>428,567</b>	<b>50,295</b>
Other revenue and gains	4	<b>1,935</b>	<b>423</b>	<b>3,265</b>	<b>2,138</b>
Selling and marketing expenses		<b>(25,635)</b>	<b>(2,612)</b>	<b>(55,980)</b>	<b>(8,143)</b>
Administrative expenses		<b>(12,034)</b>	<b>(7,222)</b>	<b>(31,452)</b>	<b>(16,421)</b>
Development costs		<b>(10,885)</b>	<b>(1,709)</b>	<b>(24,022)</b>	<b>(7,172)</b>
Other operating expenses		<b>(11,082)</b>	<b>(1,531)</b>	<b>(24,330)</b>	<b>(7,191)</b>
<b>Profit before income tax</b>		<b>123,782</b>	<b>14,786</b>	<b>296,048</b>	<b>13,506</b>
Income tax expense	5	<b>(11,745)</b>	<b>(2,372)</b>	<b>(29,924)</b>	<b>(3,872)</b>
<b>Profit for the period</b>		<b>112,037</b>	<b>12,414</b>	<b>266,124</b>	<b>9,634</b>
Attributable to					
- Equity holders of the Company		<b>111,860</b>	<b>12,414</b>	<b>265,698</b>	<b>9,634</b>
- Minority interests		<b>177</b>	<b>—</b>	<b>426</b>	<b>—</b>
		<b>112,037</b>	<b>12,414</b>	<b>266,124</b>	<b>9,634</b>
<b>Dividends</b>	6	<b>—</b>	<b>—</b>	<b>79,069</b>	<b>—</b>
		<b><i>RMB cents</i></b>	<b><i>RMB cents</i></b>	<b><i>RMB cents</i></b>	<b><i>RMB cents</i></b>
<b>Earnings per share</b>	7				
- attributable to the equity holders of the Company		<b>25.17</b>	<b>3.10</b>	<b>59.98</b>	<b>2.41</b>

## **NOTES:**

### **1. Company information**

The Company was incorporated in the Cayman Islands as an exempted company with limited liability on 29 July 2004 and is an investment holding company. Its shares were listed on the GEM of the Stock Exchange on 2 November 2007.

The Company's registered office is located at Scotia Centre, 4th Floor, P.O. Box 2804, George Town, Grand Cayman, Cayman Islands.

The Group is principally engaged in online game development, including game design, programming and graphics, and online game operation.

### **2. Basis of preparation**

The Group's unaudited consolidated quarterly results have been prepared in accordance with accounting principles generally accepted in Hong Kong and comply with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements set out in Chapter 18 of the GEM Listing Rules.

### **3. Principal accounting policies**

The unaudited consolidated quarterly results for the three months and nine months ended 30 September 2007 are prepared under the historical cost convention and the accounting policies used in the preparation of the unaudited consolidated results are consistent with those used in the prospectus of the Company dated 23 October 2007 in connection with the initial listing of the shares of the Company (the "Listing") on the Stock Exchange. The condensed consolidated quarterly results have not been audited by the Company's auditors, but have been reviewed by the Company's audit committee.

The unaudited consolidated quarterly results are presented in Renminbi ("RMB"), which is also the functional currency of the Group.

#### 4. Revenue

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

- (i) The Group sells pre-paid game cards to distributors and online game players. With the pre-paid game cards, online game players can credit their online game accounts with game points which can be used for the consumption of certain online games of the Group or for purchasing virtual products or premium features for the consumption of other online games of the Group which are free-to-play. The game players can also credit their online game accounts by direct payment. Such income received is deferred and recorded as deferred income under current liabilities and would be recognised as revenue (i.e. online game revenue) upon the actual usage of the game points. Revenue recognised in respect of operating the online games is net of any discounts, business tax and other related taxes and charges.
- (ii) Game development fee which arises from developing online games for customers is recognised as revenue by reference to the stage of completion of developing the respective online game. As game development fee is non-recurring revenue and developing online games for outsider is not a principal activity of the Group, such fee income is recognised as other revenue.
- (iii) Grants from government are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. When the grant relates to an expense item, it is recognised as other revenue and presented as such over the periods necessary to match the grant on a systematic basis to the costs that it is intended to compensate.
- (iv) Bank interest income is recognised on a time-proportion basis using the effective interest method.

Revenue and gains recognised are as follows:

	Three months ended 30 September		Nine months ended 30 September	
	2007 <i>RMB'000</i>	2006 <i>RMB'000</i>	2007 <i>RMB'000</i>	2006 <i>RMB'000</i>
Revenue				
Online game revenue	191,579	30,582	453,328	56,693
Other revenue and gains				
Game development fee	—	—	—	270
Grants from government	—	224	220	584
Bank interest income	1,531	113	2,382	251
Others	404	86	663	1,033
	<u>1,935</u>	<u>423</u>	<u>3,265</u>	<u>2,138</u>
	<u>193,514</u>	<u>31,005</u>	<u>456,593</u>	<u>58,831</u>

## 5. Income tax expense

- (i) The Group is not subject to any taxation under the jurisdiction of the Cayman Islands and Bermuda Virgins Islands (“BVI”) for the periods ended 30 September 2006 and 2007. Provision for Hong Kong profits tax is not made as the Group does not derive any assessable profits in Hong Kong for the periods ended 30 September 2006 and 2007.
- (ii) 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 periods ended 30 September 2006 and 2007 were 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 the period ended 30 September 2006. Pursuant to a notice issued by a government authority (福建省科學技術廳) on 16 August 2007, NetDragon (Fujian) continued to be recognised as a hi-tech enterprise and is thereby subject to EIT tax rate of 15% for the period ended 30 September 2007.

Shanghai Tiankun Digital Technology Ltd. (“NetDragon (Shanghai)”), one of the subsidiaries of the Company, is subject to EIT tax rate of 33%.

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

## 6. Dividends

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

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

The Directors do not recommend the payment of an interim dividend for the three months ended 30 September 2007 (three months ended 30 September 2006: Nil).

## 7. Earnings per share

The earnings per share for the three months ended 30 September 2007 is calculated based on the unaudited consolidated profit attributable to equity holders of the Company for the period of RMB111,860,000 (three months ended 30 September 2006: RMB12,414,000) and the weighted average number of 444,407,860 (three months ended 30 September 2006: 400,407,860) ordinary shares in issue during the period.

The earnings per share for the nine months ended 30 September 2007 is calculated based on the unaudited consolidated profit attributable to equity holders of the Company for the period of RMB265,698,000 (nine months ended 30 September 2006: RMB9,634,000) and the weighted average number of 442,957,310 (nine months ended 30 September 2006: 400,407,860) ordinary shares in issue during the period.

Diluted earning per share has not been presented as there were no dilutive potential ordinary shares outstanding during the nine months ended 30 September 2007.

## 8. Reserves

For the nine-month period ended 30 September 2006 and 2007, the movements of reserve are as follows:

	Share premium RMB'000	Capital contribution RMB'000	Capital reserve RMB'000	Statutory reserves RMB'000	Translation reserve RMB'000	Retained profits RMB'000	Total RMB'000
<b>For the nine months ended</b>							
<b>30 September 2006</b>							
<b>(unaudited)</b>							
At 1 January 2006	16,267	—	11,399	2,676	(8)	7,985	38,319
Exchange difference arising on translation of overseas operations/ Expense recognised directly in equity	—	—	—	—	(324)	—	(324)
Profit for the period	—	—	—	—	—	9,634	9,634
Total recognised income and expense for the period	—	—	—	—	(324)	9,634	9,310
At 30 September 2006	<u>16,267</u>	<u>—</u>	<u>11,399</u>	<u>2,676</u>	<u>(332)</u>	<u>17,619</u>	<u>47,629</u>
<b>For the nine months ended</b>							
<b>30 September 2007</b>							
<b>(unaudited)</b>							
At 1 January 2007	16,267	21,755	11,399	6,768	(10)	46,749	102,928
Exchange difference arising on translation of overseas operations/ Expense recognised directly in equity	—	—	—	—	376	—	376
Profit for the period	—	—	—	—	—	265,698	265,698
Total recognised income and expense for the period	—	—	—	—	376	265,698	266,074
Issues of shares by the Company	—	—	360	—	—	—	360
Issues of shares by a subsidiary	69,984	(21,755)	—	—	—	—	48,229
Dividend declared (Note 6)	—	—	—	—	—	(79,069)	(79,069)
Arising from shares swap	—	—	(1,813)	—	144	—	(1,669)
At 30 September 2007	<u>86,251</u>	<u>—</u>	<u>9,946</u>	<u>6,768</u>	<u>510</u>	<u>233,378</u>	<u>336,853</u>

## MANAGEMENT DISCUSSION AND ANALYSIS

### Financial Review

#### Revenue

For the three months and nine months ended 30 September 2007, the Group recorded an unaudited revenue of approximately RMB191.6 million and RMB453.3 million respectively, representing an increase of about 526.4% and 699.6% from the unaudited revenue of approximately RMB30.6 million and RMB56.7 million respectively for the corresponding periods in last year. The increase of total revenue was mainly due to the continuing popularity of Conquer Online, Eudemons Online and Zero Online.

The following table sets out the breakdown of our revenue by game for the three months ended 30 September 2006 and 2007:

	<b>Three months ended 30 September</b>			
	<b>2007</b>		<b>2006</b>	
	<b><i>RMB'000</i></b>	<b><i>% of total revenue</i></b>	<b><i>RMB'000</i></b>	<b><i>% of total revenue</i></b>
<b>Online games</b>				
Conquer Online	<b>37,878</b>	<b>19.8</b>	11,430	37.4
Eudemons Online	<b>128,349</b>	<b>67.0</b>	18,796	61.5
Zero Online	<b>24,533</b>	<b>12.8</b>	—	—
Others	<b>819</b>	<b>0.4</b>	356	1.1
Total revenue	<b><u>191,579</u></b>	<b><u>100.0</u></b>	<b><u>30,582</u></b>	<b><u>100.0</u></b>

The following table sets out the breakdown of our revenue by game for the nine months ended 30 September 2006 and 2007:

	<b>Nine months ended 30 September</b>			
	<b>2007</b>		<b>2006</b>	
	<b><i>RMB'000</i></b>	<b><i>% of total revenue</i></b>	<b><i>RMB'000</i></b>	<b><i>% of total revenue</i></b>
<b>Online games</b>				
Conquer Online	<b>99,751</b>	<b>22.0</b>	35,557	62.7
Eudemons Online	<b>313,389</b>	<b>69.1</b>	19,999	35.3
Zero Online	<b>38,950</b>	<b>8.6</b>	—	—
Others	<b>1,238</b>	<b>0.3</b>	1,137	2.0
Total revenue	<b><u>453,328</u></b>	<b><u>100.0</u></b>	<b><u>56,693</u></b>	<b><u>100.0</u></b>

The revenue derived from Conquer Online for the three months and nine months ended 30 September 2007 amounted to approximately RMB37.9 million and RMB99.8 million, respectively representing an increase of about 231.4% and 180.5% from RMB11.4 million and RMB35.6 million respectively for the corresponding periods in last year. Eudemons Online was launched in late March 2006. Revenue derived from Eudemons Online for the three months ended 30 September 2007 amounted to approximately RMB128.3 million, representing an increment of about 582.9% from RMB18.8 million for the corresponding period in last year. Zero Online was launched in late April 2007.

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

	<b>For the three months ended</b>	
	<b>30 September 2007</b>	<b>30 June 2007</b>
<b>PCU</b>		
Conquer Online	<b>92,000</b>	89,000
Eudemons Online	<b>527,000</b>	496,000
Zero Online	<b>88,000</b>	53,000
<b>ACU</b>		
Conquer Online	<b>64,000</b>	64,000
Eudemons Online	<b>294,000</b>	274,000
Zero Online	<b>46,000</b>	21,000
	<b>Nine months ended</b>	
	<b>30 September 2007</b>	<b>2006</b>
<b>PCU</b>		
Conquer Online	<b>92,000</b>	74,000
Eudemons Online	<b>527,000</b>	128,000
Zero Online	<b>88,000</b>	—
<b>ACU</b>		
Conquer Online	<b>63,000</b>	49,000
Eudemons Online	<b>260,000</b>	39,000
Zero Online	<b>33,000</b>	—

Conquer Online was launched in September 2003. The PCU and ACU for Conquer Online was approximately 92,000 and 64,000, respectively for the three months ended 30 September 2007 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 3.4% on PCU. It also recorded a growth on PCU and ACU of approximately 24.3% and 28.6% when compare to the corresponding period in last year.

Eudemons Online was launched in late March 2006 and achieved a PCU and ACU of approximately 527,000 and 294,000, respectively for the three months ended 30 September 2007 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 6.3% and 7.3% respectively.

Zero Online was launched in late April 2007 and achieved a PCU and ACU of approximately 88,000 and 46,000, respectively for the three months ended 30 September 2007 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.

### **Gross profit**

For the nine months ended 30 September 2007, the unaudited gross profit reached approximately RMB428.6 million with a gross profit margin of about 94.5%, where the unaudited gross profit and gross profit margin were approximately RMB50.3 million and 88.7% respectively for the corresponding period in last year. The gross profit margin was increased by approximately 5.8%, which was mainly due to the increased player usage.

### **Operating costs and expenses**

Selling and marketing expenses for the nine months ended 30 September 2007 increased by approximately 587.5% to approximately RMB56.0 million as compared with the same period in 2006. The increase in the amount of selling and marketing expenses was mainly attributable to our increased advertising and promotion expenses for Eudemons Online and Zero Online, and the increased staff costs as we raised employee compensations.

Administrative expenses increased by approximately 91.5% to approximately RMB31.5 million for the nine months ended 30 September 2007 as a result of the continuous expansions of our online game business. The increase in the amount of administrative expenses was mainly attributable to our increased staff costs which was due to the expansion of our administrative team in line with the expansion of development team and the increase of compensation of employees. The numbers of staff in our administrative team were 68 and 167 for each of the nine months ended 30 September 2006 and 2007, respectively.

The increase in development costs was mainly due to the expansion of our development team and the increase of compensation for our employees. The numbers of staff in our development team were 245 and 355 for each of the nine months ended 30 September 2006 and 2007, respectively. We also increased the compensation in order to provide a competitive and attractive increment in the basic salary and distribution of discretionary bonus due to the success of Eudemons Online and to further motivate employees.

Other operating expenses for nine months ended 30 September 2007 increased by approximately 238.3% to approximately RMB24.3 million as compared with the same period in 2006. The increase in other operating expenses was mainly attributable to the increase in business tax for intercompany transactions as a result of our revenue increase, and the increase in our professional fees relating to the listing of the Company's shares on GEM of the Stock Exchange.

Income tax expenses for the nine months ended 30 September 2007 increased by approximately 672.8% to approximately RMB29.9 million as compared with the corresponding period in 2006. The increase was primarily due to the fact that we had profit before tax of RMB296.0 million for the nine months ended 30 September 2007 as compared with a profit before tax of RMB13.5 million for the same period in 2006.

The unaudited profit attributable to equity holders of the Company increased by approximately RMB256.1 million or about 26.6 times from approximately RMB9.6 million for the corresponding period in 2006 to approximately RMB265.7 million for the nine months ended 30 September 2007.

### **Business review and prospects**

The Group is continuously recruiting additional experienced game developers to cope with our game development and enhance the internal training programs by inviting professionals to organise trainings and seminars. As at the date of this report, the Company employed a total of approximately 600 staff, of which 360 staff are in the development team. The management will continue its efforts to further strengthen our core game development capabilities by recruiting experienced game developers and enhancing our game development software in order to equip our team with advanced technologies.

The Company is currently developing three 2.5D MMORPGs, namely Happiness Q, Piao Miao Online and Heroes of Might and Magic Online. We have commenced the closed beta testing of Happiness Q and it will be launched by the end of 2007. The Company expects to have a revenue contribution from Happiness Q beginning from the first quarter of 2008 onwards. Piao Miao Online and Heroes of Might and Magic Online have also commenced the closed beta testing and the Company expects to launch it in the first half year of 2008.

During the review period, the Company had launched the Portuguese version of Eudemons Online. The English version of Zero Online had also commenced the closed beta testing and it is expected to be launched in the fourth quarter of 2007.

The Company rolls out free weekly upgrade patches on Conquer Online, Eudemons Online and Zero Online for players to download. Besides that, we have also rolled out several major upgrades for both Eudemons Online and Zero Online during the review period. Eudemons Online was upgraded in October 2007 by introducing castle building element to the game whereas Zero Online was also upgraded by introducing large-scale galaxy wars and new commanders to the game. As at the date of this report, the Company had recorded a PCU of approximately 570,000 and 88,000 for Eudemons Online and Zero Online respectively.

The Company had established an exclusive cooperation relationship with a renowned film making company in developing a new online game namely Tou Ming Zhuang Online. Tou Ming Zhuang Online is being developed based on the theme, contents and story of the movie “Tou Ming Zhuang (投名狀)”. The game is scheduled to be launched, the same time of the scheduled launch of the movie. The Company will continue to seek cooperation with international corporations in game development and operation. To license popular contents and develop them into online games is becoming an increasingly important means of expanding our game portfolio.

In addition, we had also established two cooperation partnerships with well-known Internet portals, namely Beijing Sina Information Technology Co., Ltd. and Shenzhen Tencent Computer Systems Company Limited, for expanding our business channels. As at the date of this report, we have also added an additional online payment service provider to which allow players to credit their game accounts by debiting their bank accounts, credit cards or debit cards online. The Company will also continue to expand various distribution channels and established cooperation partnerships with well-known Internet portals to expand the popularity of our game portfolio to the players.

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

As at 30 September 2007, no interests or short positions of any Directors or chief executive of the Company in any 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 (Chapter 571 Laws of Hong Kong) (“SFO”)) were required to be recorded in the register maintained by the Company under section 352 of the SFO; or notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO as the shares of the Company were not listed on the Stock Exchange on such date.

The shares of the Company were listed on GEM of the Stock Exchange on 2 November 2007. 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 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 recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO or which were required, pursuant to Rules 5.46 to 5.67 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange as at the date of this report, are 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)	50.15%
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)	50.15%
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)	50.15%
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)	2.34%

**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 32.97% 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 4.74% 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 32.97% and 6.38%, 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 6.06% 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 50.15% 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 2.34% of the issued share capital of the Company. Chen Hongzhan is deemed to be interested in 2.34% 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 the date of this report, 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 recorded in the register required to be kept by the Company pursuant to Section 352 of the SFO or which were required, pursuant to Rules 5.46 to 5.67 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange.

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

As at 30 September 2007, the Directors were not aware of any disclosure of interests or short positions of the persons, other than the Directors and chief executive of the Company, in the shares and underlying shares of the Company, as notified to the Company pursuant to the provisions of Divisions 2 and 3 of Part XV 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 the shares of the Company were not listed on the Stock Exchange on such date.

The shares of the Company were listed on GEM of the Stock Exchange on 2 November 2007. So far as is known to the Directors, as at the date of this report, 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 recorded in the register required to be 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 are as follows:

Name	Name of Group member	Capacity and nature of interests	Number of ordinary shares held or registered amount of contributed capital (Note 1)	Approximate percentage of shareholding
DJM Holding Ltd.	The Company	Beneficial owner	183,402,600(L)	32.97%
Fitter Property Inc.	The Company	Beneficial owner	35,498,720(L)	6.38%
Eagle World International Inc. (Note 2)	The Company	Beneficial owner	33,712,920(L)	6.06%
Flowson Company Limited (Note 2)	The Company	Through a controlled corporation	33,712,920(L)	6.06%
IDG Group (Note 3)	The Company	Beneficial owner and through controlled corporations	78,333,320(L)	14.08%
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 6.06% of the issued share capital of the Company through its shareholding in Eagle World International Inc.

3. The IDG Group is comprised of five limited partnerships, namely IDG Technology Venture Investments, L.P., IDG-Accel China Growth Fund L.P., IDG Technology Venture Investments, III L.P., IDG-Accel China Growth Fund-A L.P. and IDG-Accel China Investors L.P., being interested in approximately 9.59%, 2.12%, 1.74%, 0.43% and 0.2%, respectively, in the Company who are deemed to be acting in concert to acquire interests in the Company, and their respective controlling entities. The controlling structure of each of the above partnerships are as follows:
- a) IDG Technology Venture Investments, L.P. is controlled by its sole general partner, IDG Technology Venture Investments, LLC, which in turn is controlled by its managing members, Zhou Quan and Patrick J. McGovern.
  - b) IDG Technology Venture Investments III, L.P. is controlled by its sole general partner, IDG Technology Venture Investments III, LLC, which in turn is controlled by its managing members, Zhou Quan and Patrick J. McGovern.
  - c) IDG-Accel China Growth Fund L.P. and IDG-Accel China Growth Fund-A L.P. are controlled by their sole general partner, IDG-Accel China Growth Fund Associates L.P., which in turn is controlled by its sole general partner, IDG-Accel China Growth Fund GP Associates Ltd. IDG-Accel China Growth Fund GP Associates Ltd. is held as to 35% by each of Zhou Quan and Patrick J. McGovern.
  - d) IDG-Accel China Investors is controlled by its sole general partner, IDG-Accel China Investor Associates Ltd., which in turn is held as to 100% by James W. Breyer.

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 recorded in the register required to be 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 the date of this report.

#### **SHARE OPTION SCHEME**

Pursuant to the resolution of all the shareholders of the Company dated 15 October 2007, the Company adopted a share option scheme the “Share Option Scheme”). As at the date of this report, no options had been granted under the Share Option Scheme.

#### **COMPETITION AND CONFLICT OF INTEREST**

None of the Director or the management shareholders of the Company or any of their respective associates, as defined in the GEM 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.

## **AUDIT COMMITTEE**

In compliance with Rules 5.28 and 5.29 of the GEM Listing Rules, the Company established an audit committee with written terms of reference on 15 October 2007. 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 three months and nine months ended 30 September 2007 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.

## **COMPLIANCE ADVISER'S INTEREST**

Pursuant to the compliance adviser agreement dated 29 October 2007 entered between the Company and First Shanghai Capital Limited ("First Shanghai"), First Shanghai has been appointed as the compliance adviser of the Company for the period commencing from 2 November 2007 and ending on the date on which the Company complies with Rules 18.03 of the GEM Listing Rules in respect of the Company's financial results for the second full financial year commencing after the date of Listing.

As notified by First Shanghai, none of First Shanghai, its directors, employees or associates had any interest in the securities of the Company or any member of the Group (including options or rights to subscribe for such securities) as at 30 September 2007 and as at the date of this report.

## **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 15 of the GEM Listing Rules since the commencement of trading of its shares on GEM on 2 November 2007.

## **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 Rules 5.48 to 5.67 of the GEM 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 GEM on 2 November 2007.

## **PURCHASE, SALE OR REDEMPTION OF SECURITIES**

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of its listed securities since its commencement of trading on GEM on 2 November 2007.

As of the date of this report, the Directors are as follows:

### **Executive Directors:**

Mr. Liu Dejian

Mr. Liu Luyuan

Mr. Zheng Hui

Mr. Chen Hongzhan

### **Non-executive Directors:**

Mr. Lin Dongliang

Mr. Zhu Xinkun

### **Independent non-executive Directors:**

Mr. Chao Guowei, Charles

Mr. Lee Kwan Hung

Mr. Liu Sai Keung, Thomas

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

Fujian, the PRC, 14 November 2007