

NetDragon Websoft Inc.

(incorporated in the Cayman Islands with limited liability)

Stock Code : 777



Third Quarterly Report 2008

FINANCIAL HIGHLIGHTS

- The unaudited consolidated revenue of the Group for the nine months ended 30 September 2008 amounted to approximately RMB459.5 million (nine months ended 30 September 2007: RMB453.3 million), maintaining at a steady level when compared with the same period last year. However, the unaudited consolidated revenue of the Group for the three months ended 30 September 2008 amounted to approximately RMB136.6 million (three months ended 30 September 2007; RMB191.6 million), representing a decrease of approximately 28.7% as compared with the same period last year.
- Profit attributable to equity holders of the Company for the nine months ended 30 September 2008 amounted to approximately RMB166.2 million (nine months ended 30 September 2007: RMB265.7 million), representing a decrease of approximately 37.5% as compared with the same period last year.
- For the nine months ended 30 September 2008, the earnings per share amounted to approximately RMB30.67 cents (nine months ended 30 September 2007: RMB63.93 cents).
- The Directors do not recommend the payment of an interim dividend for the three months ended 30 September 2008 (three months ended 30 September 2007: Nil).

RESULTS

The board (the “Board”) of directors (the “Directors”) of NetDragon Websoft Inc. (the “Company”) is pleased to announce the unaudited consolidated financial results of the Company and its subsidiaries (the “Group”) for the three months and nine months ended 30 September 2008 together with the unaudited comparative figures for the corresponding period in 2007 as follows:

UNAUDITED CONSOLIDATED INCOME STATEMENTS

| | Notes | Three months ended | | Nine months ended | |
|---------------------------------|-------|--|--------------------------------|--|--------------------------------|
| | | 30 September 2008 (Unaudited) RMB'000 | 2007 (Unaudited) RMB'000 | 30 September 2008 (Unaudited) RMB'000 | 2007 (Unaudited) RMB'000 |
| Revenue | 4 | 136,618 | 191,579 | 459,515 | 453,328 |
| Cost of revenue | | (17,341) | (10,096) | (49,742) | (24,761) |
| Gross profit | | 119,277 | 181,483 | 409,773 | 428,567 |
| Other revenue and gains | 4 | 34,328 | 1,935 | 50,109 | 3,265 |
| Selling and marketing expenses | | (26,446) | (25,635) | (70,686) | (55,980) |
| Administrative expenses | | (50,142) | (12,034) | (112,455) | (31,452) |
| Development costs | | (22,713) | (10,885) | (58,343) | (24,022) |
| Other operating expenses | | (3,870) | (11,082) | (23,165) | (24,330) |
| Profit before income tax | | 50,434 | 123,782 | 195,233 | 296,048 |
| Income tax expense | 5 | 450 | (11,745) | (29,156) | (29,924) |
| Profit for the period | | 50,884 | 112,037 | 166,077 | 266,124 |
| Attributable to | | | | | |
| - Equity holders of the Company | | 50,884 | 111,860 | 166,189 | 265,698 |
| - Minority interests | | — | 177 | (112) | 426 |
| | | 50,884 | 112,037 | 166,077 | 266,124 |
| Dividends | 6 | — | — | 47,496 | 79,069 |
| | | | | | <i>RMB cents</i> (Restated) |
| | | <i>RMB cents</i> | <i>RMB cents</i> | <i>RMB cents</i> | |
| Earnings per share | 7 | | | | |
| - Basic | | 9.45 | 25.17 | 30.67 | 63.93 |
| - Diluted | | N/A | N/A | N/A | N/A |

NOTES:

1. General information

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 Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY1-1111, 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 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.

3. Principal accounting policies

The unaudited consolidated quarterly results for the three months and nine months ended 30 September 2008 are prepared under the historical cost convention except for certain financial assets which are stated at fair value, and the accounting policies used in preparing the unaudited consolidated quarterly results are consistent with those followed in the Group's annual financial statement for the year ended 31 December 2007. The 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 user accounts directly. 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) 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.
- (iii) Bank interest income is recognised on a time-proportion basis using the effective interest method.
- (iv) Advertising income is recognised when the advertisements are published or broadcasted on our online game and film advertisement. The advertising income is net of any discounts, business tax and other related taxes and charges.

Revenue and gains recognised are as follows:

| | Three months ended | | Nine months ended | |
|--|--------------------|----------------|-------------------|----------------|
| | 30 September | | 30 September | |
| | 2008 | 2007 | 2008 | 2007 |
| | <i>RMB'000</i> | <i>RMB'000</i> | <i>RMB'000</i> | <i>RMB'000</i> |
| Revenue | | | | |
| Online game revenue | 136,618 | 191,579 | 459,515 | 453,328 |
| Other revenue and gains | | | | |
| Grants from government | 3,676 | — | 4,872 | 220 |
| Fair value gain on financial assets at fair value through profit or loss | — | — | 609 | 104 |
| Fair value gain on derivative financial instruments | 20,355 | — | 20,793 | — |
| Bank interest income | 7,288 | 1,531 | 17,528 | 2,382 |
| Advertising income | 2,622 | — | 5,609 | — |
| Others | 387 | 404 | 698 | 559 |
| | <u>34,328</u> | <u>1,935</u> | <u>50,109</u> | <u>3,265</u> |
| | <u>170,946</u> | <u>193,514</u> | <u>509,624</u> | <u>456,593</u> |

5. Income tax expense

- (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 nine months ended 30 September 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 nine months ended 30 September 2007.

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 nine months ended 30 September 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 nine months ended 30 September 2008 (nine months ended 30 September 2007: 33%).

- (ii) The USA income tax rates applicable to the Group for the nine months ended 30 September 2008 are 34% (nine months ended 30 September 2007: 34%) for federal tax and 8.84% (nine months ended 30 September 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 nine months ended 30 September 2008 (nine months ended 30 September 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 nine months ended 30 September 2008 (nine months ended 30 September 2007: Nil).

6. Dividends

The interim dividend of HKD 0.1 per share amounting to approximately HKD47,496,000 for the six months ended 30 June 2008 had been approved by the Directors at the Board meeting and was subsequently paid on 16 September 2008.

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 nine months ended 30 September 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.

The Board does not recommend the payment of interim dividends for the three months ended 30 September 2008 (three months ended 30 September 2007: Nil).

7. Earnings per share

The calculation of basic earnings per share for each of the three months ended 30 September 2008 and nine months ended 30 September 2008 are based on the unaudited consolidated profit attributable to the equity holders of the Company of RMB50,884,000 and RMB166,189,000, respectively, (three months ended 30 September 2007 and nine months ended 30 September 2007: RMB111,860,000 and RMB265,698,000, respectively) and the weighted average number of 538,357,817 ordinary shares and 541,915,637 ordinary shares (three months ended 30 September 2007 and nine months ended 30 September 2007: 444,407,860 ordinary shares and 415,639,922 ordinary shares, respectively) in issue during the three months ended 30 September 2008 and nine months ended 30 September 2008, respectively.

Diluted earnings per share for the nine months ended 30 September 2008 and 2007 have not presented as there were no dilutive potential ordinary shares outstanding.

8. Reserves

For the nine months ended 30 September 2007 and 2008, the movements of reserve are as follows:

| | Share premium | Capital contribution | Capital redemption | | Statutory reserves | Translation reserve | Treasury shares | | Dividend reserve | Retained profits | Total |
|--|------------------|----------------------|--------------------|--------------|--------------------|---------------------|-----------------|-----------|------------------|------------------|------------------|
| | | | reserve | reserve | | | reserves | reserves | | | |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| For the nine months ended 30 September 2007 (unaudited) | | | | | | | | | | | |
| At 1 January 2007 | 16,267 | 21,755 | — | 11,596 | 6,768 | (10) | — | — | — | 46,749 | 103,125 |
| Exchange difference arising on translation of overseas operations/ Income recognised directly in equity | — | — | — | — | — | 393 | — | — | — | — | 393 |
| Profit for the period | — | — | — | — | — | — | — | — | — | 265,698 | 265,698 |
| Total recognised income and expense for the period | — | — | — | — | — | 393 | — | — | — | 265,698 | 266,091 |
| Issue of shares by a subsidiary | 69,984 | (21,755) | — | 170 | — | — | — | — | — | — | 48,399 |
| Issue of shares by the Company | — | — | — | (1,820) | — | 127 | — | — | — | — | (1,693) |
| Dividend declared | — | — | — | — | — | — | — | — | — | (79,069) | (79,069) |
| At 30 September 2007 | 86,251 | — | — | 9,946 | 6,768 | 510 | — | — | — | 233,378 | 336,853 |
| For the nine months ended 30 September 2008 (unaudited) | | | | | | | | | | | |
| At 1 January 2008 | 1,379,483 | — | 8 | 9,946 | 61,216 | (10,680) | — | 216,093 | — | 71,985 | 1,728,051 |
| Exchange difference arising on translation of overseas operations/ Expense recognised directly in equity | — | — | — | — | — | (47,428) | — | — | — | — | (47,428) |
| Profit for the period | — | — | — | — | — | — | — | — | — | 166,189 | 166,189 |
| Total recognised income and expense for the period | — | — | — | — | — | (47,428) | — | — | — | 166,189 | 118,761 |
| Repurchase and cancellation of shares | (217,197) | — | 1,794 | — | — | — | — | — | — | (1,794) | (217,197) |
| Purchase of treasury shares | — | — | — | — | — | — | (14,107) | — | — | — | (14,107) |
| Dividend paid | — | — | — | — | — | — | — | (216,093) | — | (47,496) | (263,589) |
| At 30 September 2008 | 1,162,286 | — | 1,802 | 9,946 | 61,216 | (58,108) | (14,107) | — | — | 188,884 | 1,351,919 |

MANAGEMENT DISCUSSION AND ANALYSIS

Financial Review

Revenue

For the nine months ended 30 September 2008, the Group recorded an unaudited consolidated revenue of approximately RMB459.5 million, maintaining at a steady level from approximately RMB453.3 million for the corresponding period in last year. However, the unaudited consolidated revenue of the Group for the three months ended 30 September 2008 amounted to approximately RMB136.6 million, representing a decrease of approximately 28.7% as compared with that of approximately RMB191.6 million for the same period in last year.

The following table sets out the breakdown of peak concurrent users ("PCU") and average concurrent users ("ACU") for our online games for periods indicated below (*note*):

| | 30 September 2008 | For the three months ended | | | |
|-----|----------------------|----------------------------|------------------|---------------------|----------------------|
| | | 30 June 2008 | 31 March 2008 | 31 December 2007 | 30 September 2007 |
| PCU | 544,000 | 697,000 | 669,000 | 787,000 | 707,000 |
| ACU | 311,000 | 355,000 | 313,000 | 407,000 | 404,000 |

Note: Online games include Conquer Online, Eudemons Online, Zero Online, Tou Ming Zhuang Online, Heroes of Might and Magic Online and other games.

The PCU for online games was approximately 544,000 for the three months ended 30 September 2008, representing a decrease of approximately 23.1% from the three months ended 30 September 2007 and a decrease of approximately 22.0% from the three months ended 30 June 2008.

We also recorded a ACU for online games of approximately 311,000 for the three months ended 30 September 2008, it also represented a decrease of approximately 23.0% from the three months ended 30 September 2007 and a decrease of approximately 12.4% from the three months ended 30 June 2008.

The revenue derived from Conquer Online for the nine months ended 30 September 2008 amounted to approximately RMB114.6 million, representing an increase of approximately 14.8% from approximately RMB99.8 million for the corresponding period in last year.

Eudemons Online was launched in late March 2006. Revenue derived from Eudemons Online for the nine months ended 30 September 2008 amounted to approximately RMB277.3 million, representing a decrease of approximately 11.5% from approximately RMB313.4 million for the corresponding period in last year. The revenue derived from Eudemons Online for the three months ended 30 September 2008 decreased by approximately 12.2%, when compared to the three months ended 30 June 2008.

Further, Eudemons Online also recorded a PCU and ACU of approximately 380,000 and 210,000, respectively for the three months ended 30 September 2008 whereas it recorded a PCU and ACU of approximately 527,000 and 294,000, respectively for the three months ended 30 September 2007, representing a decrease of approximately 27.9% and 28.6%, respectively. The decrease of revenue and concurrent users was mainly attributable to (i) decrease of players in Sichuan Province (“Sichuan”) of the PRC after the earthquake in May 2008; and (ii) the negative impact of commonly known industry problem, “private servers”.

Gross profit

For the nine months ended 30 September 2008, the unaudited gross profit reached approximately RMB409.8 million with a gross profit margin of approximately 89.2%, whereas the unaudited gross profit and gross profit margin were approximately RMB428.6 million and 94.5% respectively for the corresponding period in last year. The decrease in gross profit and the percentage of gross profit margin were mainly due to the decrease in the player usage as demonstrated by the decrease in revenue derived for the three months ended 30 September 2008 as compared with the same period in 2007 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 nine months ended 30 September 2008 increased by approximately 1,434.7% to approximately RMB50.1 million as compared with the corresponding period in 2007. The increase in other revenue and gains was mainly attributable to (i) the net increase in the fair value of the forward foreign currency contract of approximately RMB20.4 million was recognised; and (ii) the increase in the contribution of advertising income. The increase in fair value of the forward foreign currency contract for the nine months period and cumulated changes of RMB20.8 million was solely attributable to the changes in market conditions that give rise to market risk.

Operating costs and expenses

Selling and marketing expenses for the nine months ended 30 September 2008 increased by approximately 26.3% to approximately RMB70.7 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 provide marketing support for promoting the collaboration of Tou Ming Zhuang Online and Heroes of Might and Magic Online. Besides, the Group has started the marketing and promotional activities of its self-developed game, Way of the Five, before its expected 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 relating to the use of various defensive and counter-attack measures in an attempt to resolve and reduce the negative impact to our 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 increased by approximately 257.5% to approximately RMB112.5 million for the nine months ended 30 September 2008 as compared with the same period in 2007, as a result of the continuous expansions of our online game business. The increase of administrative expenses for the nine months ended 30 September 2008 was mainly attributable to (i) the significant increase of our business development needs including cooperation with different business partners such as China Film Group Corporation and Buena Vista Internet Group (“BVIG”); (ii) our overall expansion of the Group; (iii) the exchange loss resulted from the appreciation of RMB against USD and HKD for the nine months ended 30 September 2008; and (iv) the net decrease in the fair value of the 1-year USD denominated consecutive digital note (“USD Note”) and 1-year AUD denominated credit-linked note (“AUD Note”) of approximately RMB22.3 million. The decrease in the fair value of the USD Note and AUD Note for the nine months period and cumulated changes of RMB22.3 million was solely attributable to the changes in market conditions that give rise to market risk.

Development costs increased by approximately 142.9% to approximately RMB58.3 million for the nine months ended 30 September 2008 as compared with the same period in 2007. The increase in development costs was mainly due to expansion of our development team and the increase in compensation for our employees. The number of staff in our development team increased from 355 as at 30 September 2007 to 1,093 as at 30 September 2008. We also increased the compensation in order to provide a competitive and attractive increment in the basic salary. The increase in the amount of development costs was also caused by the increase in staff costs for addressing and resolving the issues of private servers as mentioned in the selling and marketing expenses.

Other operating expenses for the nine months ended 30 September 2008 decreased by approximately 4.8% to approximately RMB23.2 million as compared with the same period in 2007. The decrease in other operating expenses was primarily attributable to the decrease in professional fees related to the listing due to the successful listing of the Company on the GEM in last year and successfully transferred to Main Board in the middle of 2008.

The profit before tax for the nine months ended 30 September 2008 dropped by approximately 34.1% as compared with the corresponding period in 2007. We also recorded a decrease in the income tax expenses for the nine months ended 30 September 2008 of approximately 2.6% to approximately RMB29.2 million as compared with the corresponding period in 2007. The decrease in income tax expenses was mainly due to the tax refund of RMB9.8 million approved by the 福建省福州市經濟技術開發區地方稅務局 (“關發局地方稅務局”) in September 2008. The tax refund was related to the overpayment of income tax of NetDragon (Fujian) for the year ended 31 December 2007. The overpayment of income tax was related to an expense allowed by 開發區地方稅務局 for deduction recently.

The unaudited profit for the nine months ended 30 September 2008 of the Group decreased by approximately 37.6% to approximately RMB166.1 million as compared with the corresponding period in 2007.

Business review and prospects

Business Review

As a leading innovator in the rapidly evolving interactive media industry, 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 the PRC 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; (iii) supplement our existing pipeline of games with additional projects for future growth potential; and (iv) strengthen marketing activities and distribution channels in the PRC and overseas.

In order to expand and diversify our game offerings, extend the reach of our portfolio in existing and new markets, and further leverage the inherent advantages of vertical integration as a developer and operator of online games, the Group has increased its overall staff count to a total of 1,969, of which 1,093 are members of the development team, as at 30 September 2008. This compares with a total of 1,482 staff as at 30 June 2008, of which 781 were in the development team.

During the period under review, based upon our strengthening core competencies and increased internal resources, several notable developments are as follows:

- We officially launched the traditional Chinese version of the flagship online games of our Group, Eudemons Online and Zero Online, in Hong Kong, Macau Special Administrative Region (“Macau”) and Taiwan markets (in association with our business partners in the respective markets).
- We licensed Zero Online for commercial operations in the Thailand market (in association with our business partner in Thailand).
- We officially launched Heroes of Might and Magic Online in the PRC.
- We provided upgrades of Conquer Online, Eudemons Online, Zero Online and Tou Ming Zhuang Online to players weekly for free downloads in the PRC.
- We continued to meet internal milestones for games in our pipeline.
- We have signed a new cooperation contract with Electronic Arts Inc. (“EA”) to use EA’s property to design and develop a MMORPG and the right to distribute throughout the PRC, Hong Kong, Macau and Republic of China (Taiwan).

As one of the leading online game developers and operators in the PRC, and as a solid corporate citizen, the Group has continued to receive awards from public and private entities in the PRC, including:

- “Economic Contribution Award” from the Organising Committee of the 6th China International Digital Content Expo organised by the Ministry of Culture. The award is a reflection of NetDragon’s outstanding performance in research and development as well as its global marketing efforts which received widespread recognition from the online gaming industry and the Chinese Government.
- “Top 10 Favourite Online Games” and “Top 10 Most Anticipated Online Games” for Eudemons Online and Way of the Five, respectively, at the 2008 Golden Plume Awards. The received awards from the China Digital Entertainment Expo and Conference (“ChinaJoy”), which were based upon a public poll utilizing a sample size in excess of 2.7 million respondents.
- “China Internet Contribution Award for Self-Discipline” by the Internet Society of China. With an aim of promoting a healthy, well-organized, harmonious and sustainable development of the Internet industry in the PRC, the awards paid tribute to the efforts and contributions made by web-based companies and individuals over the last year (from 1 July of last year to 30 June of this year).

Notably, 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 of late May 2008.

Finally, private servers had impacted our Eudemons Online franchise during the period under review. We continued to employ defensive and counter-attack measures to mitigate the impact to the Eudemons Online franchise and the Group’s financial performance.

Prospects

In the PRC, the Group plans to further enhance its core game development capabilities, streamline its integrated mode of operation, strengthen marketing efforts and channel management, 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. As regards our core game development capabilities, we expect to (i) recruit experienced game developers to join our game development team; (ii) engineer game development automation software to replace certain manual and repetitive tasks, which should lead to improved efficiency in our game development process; and (iii) purchase 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.

Overseas, the Group has been servicing an international online gaming customer base since 2004. With an eye on growing our international customer base, we expect to continue to establish and develop overseas distribution channels - either directly or in association with agents and licensees. We also expect to entertain the possibilities of forming strategic relationships in certain overseas markets.

Regarding our game pipeline:

- We are continuing development of two 2.5D MMORPGs, Way of the Five and Tian Yuan. We expect the official launch of Way of the Five in late 2008 and Tian Yuan in the first half of 2009. The Company expects to have satisfactory revenue contribution from these games in the future.
- We have 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. We expect this game to be officially launched in 2009. The Company expects to have satisfactory revenue contribution from this game in the future.
- We expect to continue to pursue myriad 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, we will continue to strengthen security and defensive measures to prevent the emergence of private servers and reduce any potential negative impact.

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

As at 30 September 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 | 279,634,540 (L) | 52.68% |
| 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 | 279,634,540 (L) | 52.68% |
| 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 | 279,634,540 (L) | 52.68% |
| 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) | 2.45% |

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 34.68% 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 4.96% 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 34.68% and 6.69%, 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 6.35% 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 52.68% 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 2.45% of the issued share capital of the Company. Chen Hongzhan is deemed to be interested in 2.45% 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 September 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.

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 September 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 Holdings Ltd. | The Company | Beneficial owner | 184,078,100 (L) | 34.68% |
| Fitter Property Inc. | The Company | Beneficial owner | 35,498,720 (L) | 6.69% |
| Eagle World International Inc. (Note 2) | The Company | Beneficial owner | 33,712,920 (L) | 6.35% |
| Flowson Company Limited (Note 2) | The Company | Through a controlled corporation | 33,712,920 (L) | 6.35% |
| IDG Group | The Company | Beneficial owner | 78,333,320 (L) | 14.76% |
| 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 6.35% 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 September 2008.

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 option has been granted under the Main Board Share Option Scheme.

SHARE AWARD SCHEME

On 2 September 2008 (the “Adoption Date”), the Board approved and adopted the share award scheme (the “Share Award Scheme”) in which selected employees of the Group are entitled to participate. Unless early terminated by the Board, the Share Award Scheme shall be valid and effective for a term of ten years commencing on the Adoption Date. The Board shall not grant any award of shares which would result in the total number of shares which are the subject of awards granted by the Board under the Share Award Scheme (but not counting any which have lapsed or have been forfeited) representing in aggregate over 10% of the issued capital of the Company as at the date of such grant.

Pursuant to the rules of the Share Award Scheme, the Group has signed an agreement with Bank of Communications Trustee Limited (the “Trustee”), for the purpose of administering the Share Award Scheme and holding the awarded shares before they are vested.

As at 25 September 2008, total awarded amount (the “Awarded Amount”) of HKD16,094,000 was awarded to a number of selected employees. The awarded shares (the “Awarded Shares”), which purchased with the Awarded Amount and allocated by the Trustee from the total number of Shares purchased by the Trustee on the market out of cash paid by the Company, will be transferred to the selected employees at nil consideration upon vesting between 6 November 2008 and 6 November 2012, subject to receipt by the Trustee of (a) transfer documents prescribed by the Trustee and duly signed by the selected employee within the period stipulated in the vesting notice issued by the Trustee to the selected employee and (b) a confirmation from the Company that all vesting conditions having been fulfilled. The Trustee acquired 3,023,000 shares of the Company at a total cost (including related transaction costs) of approximately HKD15.4 million in September 2008 and 151,000 shares at a total cost (including related transaction costs) of approximately HKD0.7 million in October 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.

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 three months ended and nine months ended 30 September 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.

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 of the Listing Rules since the commencement of trading of its shares on the Main Board on 24 June 2008.

PURCHASE, SALE OR REDEMPTION OF SECURITIES

During the review period, the Company repurchased a total of 25,229,000 shares on the Stock Exchange at an aggregate consideration of HKD240,292,436.66 before expenses.

Details of the share repurchase are as follows:

| Month of purchase | Number of ordinary shares repurchased | Price per share | | Aggregate Consideration paid HK\$ |
|-------------------|---|-----------------|----------------|--|
| | | Highest HK\$ | Lowest HK\$ | |
| 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 |
| September 2008 | 9,370,500 | 5.42 | 3.97 | 46,907,500.00 |
| | <u>25,229,000</u> | | | <u>240,292,436.66</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, 2 September 2008 and 17 September 2008, 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.

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

Hong Kong, 17 November 2008

As at the date of this report, the Board comprises four executive directors, namely Mr. Liu Dejian, Mr. Liu Luyuan, Mr. Zheng Hui and Mr. Chen Hongzhan; one non-executive director, namely Mr. Lin Dongliang and three independent non-executive directors, namely Mr. Chao Guo Wei, Charles, Mr. Lee Kwan Hung and Mr. Liu Sai Keung, Thomas.