



神州数码
Digital China

DIGITAL CHINA HOLDINGS LIMITED

(神州數碼控股有限公司*)

(Incorporated in Bermuda with limited liability)

(Stock Code: 0861)

**ANNOUNCEMENT OF INTERIM RESULTS
FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2006**

FINANCIAL HIGHLIGHTS

- Turnover for the six months ended 30 September 2006 increased by 34.78% over the same period of last financial year to reach approximately HK\$11,872 million.
- Profit attributable to equity holders of the parent for the six months ended 30 September 2006 was approximately HK\$92 million.

UNAUDITED CONSOLIDATED INTERIM RESULTS

The board of directors (the “**Board**”) of Digital China Holdings Limited (the “**Company**”) is pleased to announce the unaudited consolidated interim results of the Company and its subsidiaries (collectively the “**Group**”) for the six months ended 30 September 2006 together with comparative figures for the corresponding period of last financial year as follows:

CONDENSED CONSOLIDATED INCOME STATEMENT

		Three months ended 30 September 2006 (Unaudited) HK\$'000	Six months ended 30 September 2006 (Unaudited) HK\$'000	Three months ended 30 September 2005 (Unaudited) HK\$'000	Six months ended 30 September 2005 (Unaudited) HK\$'000
	<i>Notes</i>				
Revenue	3	6,259,735	11,871,649	4,879,803	8,808,131
Cost of sales		<u>(5,816,468)</u>	<u>(11,043,101)</u>	<u>(4,527,311)</u>	<u>(8,179,386)</u>
Gross profit		443,267	828,548	352,492	628,745
Other income and gains	3	36,538	84,858	70,001	83,576
Selling and distribution costs		(267,724)	(490,959)	(182,338)	(342,675)
Administrative expenses		(71,622)	(139,292)	(75,702)	(126,439)
Other operating expenses, net		<u>(56,886)</u>	<u>(113,607)</u>	<u>(47,114)</u>	<u>(87,183)</u>
Total operating expenses	4	<u>(396,232)</u>	<u>(743,858)</u>	<u>(305,154)</u>	<u>(556,297)</u>
Finance costs		(42,296)	(72,532)	(25,936)	(39,837)
Share of profits and losses of:					
Jointly-controlled entities		(2,153)	(3,334)	(628)	(628)
Associates		<u>(503)</u>	<u>(2,296)</u>	<u>(1,064)</u>	<u>(785)</u>
Profit before tax	5	38,621	91,386	89,711	114,774
Tax	6	<u>(4,436)</u>	<u>(5,856)</u>	<u>(1,109)</u>	<u>(373)</u>
Profit for the period		<u><u>34,185</u></u>	<u><u>85,530</u></u>	<u><u>88,602</u></u>	<u><u>114,401</u></u>
Attributable to:					
Equity holders of the parent		36,652	91,542	89,485	118,790
Minority interests		<u>(2,467)</u>	<u>(6,012)</u>	<u>(883)</u>	<u>(4,389)</u>
		<u><u>34,185</u></u>	<u><u>85,530</u></u>	<u><u>88,602</u></u>	<u><u>114,401</u></u>
Earnings per share attributable to ordinary equity holders of the parent	7				
Basic (HK cents)			<u><u>10.53</u></u>		<u><u>13.78</u></u>
Diluted (HK cents)			<u><u>10.48</u></u>		<u><u>13.71</u></u>

CONDENSED CONSOLIDATED BALANCE SHEET

		At 30 September 2006 (Unaudited) <i>HK\$'000</i>	At 31 March 2006 (Audited) <i>HK\$'000</i>
NON-CURRENT ASSETS			
Property, plant and equipment		343,786	420,168
Investment properties		186,263	184,293
Prepaid land premiums		13,454	13,485
Goodwill		–	28,265
Intangible assets		29,652	39,324
Interests in jointly-controlled entities		21,192	24,526
Interests in associates		38,860	36,453
Available-for-sale equity investments		31,612	32,944
Deferred tax assets		30,750	31,150
		695,569	810,608
TOTAL non-current assets			
		695,569	810,608
CURRENT ASSETS			
Inventories		1,223,489	1,567,027
Trade and bills receivables	8	2,896,475	2,584,673
Prepayments, deposits and other receivables		787,230	567,288
Cash and bank balances		342,679	297,768
		5,249,873	5,016,756
Non-current assets classified as held for sale	9	89,537	–
		5,339,410	5,016,756
TOTAL current assets			
		5,339,410	5,016,756
CURRENT LIABILITIES			
Trade and bills payables	10	2,484,133	2,055,757
Other payables and accruals		733,144	741,563
Tax payable		21,887	17,991
Interest-bearing bank and other borrowings		760,948	1,206,185
		4,000,112	4,021,496
TOTAL current liabilities			
		4,000,112	4,021,496
NET CURRENT ASSETS		1,339,298	995,260
TOTAL ASSETS LESS CURRENT LIABILITIES		2,034,867	1,805,868

NON-CURRENT LIABILITIES

Interest-bearing bank borrowings	<u>203,725</u>	<u>–</u>
Total non-current liabilities	<u>203,725</u>	<u>–</u>

NET ASSETS

<u>1,831,142</u>	<u>1,805,868</u>
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EQUITY**Equity attributable to equity holders of the parent**

Issued capital	87,145	86,693
Reserves	1,731,000	1,613,473
Proposed final dividend	–	86,693
	<u>1,818,145</u>	<u>1,786,859</u>
Minority interests	<u>12,997</u>	<u>19,009</u>
TOTAL EQUITY	<u>1,831,142</u>	<u>1,805,868</u>

CONDENSED CONSOLIDATED CASH FLOW STATEMENT**Six months ended 30 September**

	2006	2005
	(Unaudited)	(Unaudited)
	<i>HK\$'000</i>	<i>HK\$'000</i>
Net cash inflow/(outflow) from operating activities	482,329	(66,763)
Net cash outflow from investing activities	(48,279)	(19,150)
Net cash outflow from financing activities	<u>(391,819)</u>	<u>(154,351)</u>
Net increase/(decrease) in cash and cash equivalents	42,231	(240,264)
Cash and cash equivalents at the beginning of the period	297,768	453,286
Effects of foreign exchange rate changes, net	<u>2,680</u>	<u>7,718</u>
Cash and cash equivalents at the end of the period	<u>342,679</u>	<u>220,740</u>

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity holders of the parent										
	Issued share capital (Unaudited) <i>HK\$'000</i>	Share premium account (Unaudited) <i>HK\$'000</i>	Capital reserve (Unaudited) <i>HK\$'000</i>	Employee share-based compensation reserve (Unaudited) <i>HK\$'000</i>	Reserve funds (Unaudited) <i>HK\$'000</i>	Exchange fluctuation reserve (Unaudited) <i>HK\$'000</i>	Retained profits (Unaudited) <i>HK\$'000</i>	Proposed final dividend (Unaudited) <i>HK\$'000</i>	Total (Unaudited) <i>HK\$'000</i>	Minority interests (Unaudited) <i>HK\$'000</i>	Total equity (Unaudited) <i>HK\$'000</i>
At 1 April 2006	86,693	305,334	625,334	50,458	53,762	6,434	572,151	86,693	1,786,859	19,009	1,805,868
Exchange realignment and net gain recognised directly in equity for the period	-	-	-	-	-	13,450	-	-	13,450	-	13,450
Profit for the period	-	-	-	-	-	-	91,542	-	91,542	(6,012)	85,530
Total income and expense for the period	-	-	-	-	-	13,450	91,542	-	104,992	(6,012)	98,980
Exercise of share options	452	8,466	-	-	-	-	-	-	8,918	-	8,918
Equity-settled share option arrangements	-	-	-	4,069	-	-	-	-	4,069	-	4,069
Final 2006 dividend	-	-	-	-	-	-	(86,693)	(86,693)	-	-	(86,693)
At 30 September 2006	<u>87,145</u>	<u>313,800</u>	<u>625,334</u>	<u>54,527</u>	<u>53,762</u>	<u>19,884</u>	<u>663,693</u>	<u>-</u>	<u>1,818,145</u>	<u>12,997</u>	<u>1,831,142</u>
At 1 April 2005	86,126	294,683	623,689	37,595	45,668	640	416,666	73,465	1,578,532	9,972	1,588,504
Exchange realignment and net gain recognised directly in equity for the period	-	-	-	-	-	5,885	-	-	5,885	-	5,885
Profit for the period	-	-	-	-	-	-	118,790	-	118,790	(4,389)	114,401
Total income and expense for the period	-	-	-	-	-	5,885	118,790	-	124,675	(4,389)	120,286
Exercise of share options	183	3,430	-	-	-	-	-	-	3,613	-	3,613
Equity-settled share option arrangements	-	-	-	7,783	-	-	-	-	7,783	-	7,783
Capital injection from minority shareholders of a subsidiary	-	-	-	-	-	-	-	-	-	19	19
Final 2005 dividend	-	-	-	-	-	-	-	(73,465)	(73,465)	-	(73,465)
At 30 September 2005	<u>86,309</u>	<u>298,113</u>	<u>623,689</u>	<u>45,378</u>	<u>45,668</u>	<u>6,525</u>	<u>535,456</u>	<u>-</u>	<u>1,641,138</u>	<u>5,602</u>	<u>1,646,740</u>

NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS

1. Basis of presentation

These unaudited condensed consolidated interim financial statements for the six months ended 30 September 2006 have been prepared in accordance with Hong Kong Accounting Standard (“HKAS”) 34 “Interim Financial Reporting” issued by the Hong Kong Institute of Certified Public Accountants. In preparing the unaudited condensed consolidated interim financial statements, the same basis of presentation, accounting policies and methods of computation as set out in the annual financial statements for the year ended 31 March 2006 had been consistently applied except in relation to the following new and revised Hong Kong Financial Reporting Standards (“HKFRSs”) (which also include HKASs and Interpretations) that affect the Group and has adopted the first time for the current period’s condensed consolidated interim financial statements:

HKAS 21 Amendment	Net Investment in a Foreign Operation
HKAS 39 Amendment	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 Amendment	The Fair Value Option
HKAS 39 & HKFRS 4 Amendments	Financial Guarantee Contracts
HK(IFRIC)-Int 4	Determining whether an Arrangement contains a Lease

The adoption of the above new and revised HKFRSs has no material impact on the Group's condensed consolidated interim financial statements.

2. Segment information

Summary details of the business segments are as follows:

- (a) the "Distribution" segment engages in the distribution of general information technology ("IT") products which consist of notebook computers, desktop computers, PC servers, data projectors, peripherals, accessories and consumer IT products;
- (b) the "Systems" segment engages in the distribution of systems products which consist of Unix servers, networking products, storage products and packaged software, as well as the provision of related value-added services; and
- (c) the "Services" segment engages in the provision of systems integration, applications software development, consultancy and training, etc..

Primary reporting format – business segments

The following table presents revenue and results for the Group's business segments for the six months ended 30 September 2006 and 2005:

	Distribution		Systems		Services		Consolidated	
	Six months ended 30 September							
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Segment revenue:								
Sales to external customers	<u>7,048,662</u>	<u>5,290,624</u>	<u>3,470,471</u>	<u>2,528,276</u>	<u>1,352,516</u>	<u>989,231</u>	<u>11,871,649</u>	<u>8,808,131</u>
Segment gross profit	<u>350,894</u>	<u>261,967</u>	<u>321,554</u>	<u>239,288</u>	<u>156,100</u>	<u>127,490</u>	<u>828,548</u>	<u>628,745</u>
Segment results	153,817	123,852	104,923	75,669	(63,954)	(37,097)	194,786	162,424
Interest income, unallocated revenue and gains							73,068	69,901
Unallocated expenses							(98,306)	(76,301)
Finance costs							(72,532)	(39,837)
Share of profits and losses of:								
Jointly-controlled entities	-	-	-	-	(3,334)	(628)	(3,334)	(628)
Associates	-	-	-	-	(2,296)	(785)	(2,296)	(785)
Profit before tax							91,386	114,774
Tax							(5,856)	(373)
Profit for the period							<u>85,530</u>	<u>114,401</u>

Secondary reporting format – geographical segments

No geographical segment information is presented as over 90% of the Group's customers and operations are located in the Mainland of the People's Republic of China ("Mainland China").

3. Revenue, other income and gains

Revenue, which is also the Group's turnover, represents invoiced value of goods sold and services rendered to customers, net of business tax, value-added tax and government surcharges, and after allowances for goods returned and trade discounts.

An analysis of the Group's revenue, other income and gains is as follows:

	Six months ended 30 September	
	2006	2005
	(Unaudited)	(Unaudited)
	HK\$'000	HK\$'000
Revenue	<u>11,871,649</u>	<u>8,808,131</u>
<u>Other income</u>		
Government grants	16,867	14,271
Bank interest income	2,362	1,712
Gross rental income	14,518	–
Others	<u>3,325</u>	<u>2,892</u>
	<u>37,072</u>	<u>18,875</u>
<u>Gains</u>		
Gain on disposal of non-current assets classified as held for sale	–	3,196
Gain on disposal of intangible assets	–	3,487
Foreign exchange differences, net	<u>47,786</u>	<u>58,018</u>
	<u>47,786</u>	<u>64,701</u>
	<u>84,858</u>	<u>83,576</u>

4. Total operating expenses

An analysis of the Group's total operating expenses by nature is as follows:

	Six months ended 30 September	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Selling expenses	62,656	49,294
Promotion and advertising expenses	87,749	49,003
Staff costs included in operating expenses (including directors' remuneration)	290,729	227,094
Other expenses	302,724	230,906
	<u>743,858</u>	<u>556,297</u>

5. Profit before tax

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

	Six months ended 30 September	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Cost of inventories sold	10,866,427	8,040,625
Depreciation	33,017	27,458
Amortisation of prepaid land premium	176	104
Impairment of goodwill	28,566	12,894
Amortisation of intangible assets	2,101	2,373
Impairment of intangible assets	8,045	5,885
Provisions and write-off of obsolete inventories	5,660	11,527
Impairment and write-off of doubtful trade receivables	33,918	45,916
Impairment of available-for-sale equity investments	2,425	–
Loss on disposal of items of property, plant and equipment	896	826
	<u>10,981,665</u>	<u>8,197,538</u>

6. Tax

	Six months ended 30 September	
	2006 (Unaudited) HK\$'000	2005 (Unaudited) HK\$'000
Group:		
Current – The People's Republic of China corporate income tax ("CIT")	5,124	2,723
Deferred	732	(2,350)
	<u>5,856</u>	<u>373</u>
Total tax charge for the period	<u>5,856</u>	<u>373</u>

- (a) CIT represents tax charged on the estimated assessable profits of the People's Republic of China ("PRC") subsidiaries of the Group. In general, the PRC subsidiaries of the Group are subject to the CIT rate of 33% except for certain subsidiaries which are entitled to tax holiday and preferential tax rates.
- (b) No provision for Hong Kong profits tax has been made as the Group had no estimated assessable profits arising in Hong Kong or had tax losses brought forward from prior years to set off assessable profits for the six months ended 30 September 2005 and 2006.
- (c) No provision for Hong Kong profits tax has been made for the jointly-controlled entities and associates as the jointly-controlled entities and associates had no estimated assessable profits arising for the six months ended 30 September 2005 and 2006. CIT has been provided at the rate of 33% on the estimated assessable profits of the PRC jointly-controlled entities and associates for the six months ended 30 September 2006. The share of tax charge attributable to the jointly-controlled entities of approximately HK\$15,000 (six months ended 30 September 2005: Nil) and the share of tax credit attributable to the associates of approximately HK\$187,000 (six months ended 30 September 2005: Nil) for the six months ended 30 September 2006 are included in "Share of profits and losses of jointly-controlled entities" and "Share of profits and losses of associates" respectively on the face of the condensed consolidated income statement.

7. Earnings per share attributable to ordinary equity holders of the parent

The calculation of basic earnings per share is based on the profit attributable to ordinary equity holders of the parent for the six months ended 30 September 2006 of approximately HK\$91,542,000 (six months ended 30 September 2005: approximately HK\$118,790,000), and the weighted average of 869,606,731 (six months ended 30 September 2005: 862,150,126) ordinary shares in issue during the six months ended 30 September 2006.

The calculation of diluted earnings per share is based on the profit attributable to ordinary equity holders of the parent for the six months ended 30 September 2006 of approximately HK\$91,542,000 (six months ended 30 September 2005: approximately HK\$118,790,000) and 873,236,826 (six months ended 30 September 2005: 866,203,426) ordinary shares, which was the weighted average of 869,606,731 (six months ended 30 September 2005: 862,150,126) ordinary shares in issue during the six months ended 30 September 2006, and the weighted average of 3,630,095 (six months ended 30 September 2005: 4,053,300) ordinary shares deemed to have been issued at no consideration on the deemed exercise of all the outstanding share options during the six months ended 30 September 2006.

8. Trade and bills receivables

The Group's trading terms with its customers are mainly on credit, except for new customers, where payment in advance is normally required. The credit period is generally for a period of 30 days to 180 days. An aged analysis of the Group's trade and bills receivables as at the balance sheet date and net of impairment is as follows:

	At 30 September 2006 (Unaudited) <i>HK\$'000</i>	At 31 March 2006 (Audited) <i>HK\$'000</i>
Within 30 days	1,649,127	1,444,990
31 to 60 days	347,572	339,584
61 to 90 days	245,036	250,167
91 to 180 days	300,495	324,812
Over 180 days	354,245	225,120
	<u>2,896,475</u>	<u>2,584,673</u>

9. Non-current assets classified as held for sale

The balance represented the Group's land and buildings at Court No. 5, Shangdidong Road, Haidian District, Beijing City, the PRC. The non-current assets classified as held for sale are measured at the lower of its carrying amount and fair value less costs to sell.

10. Trade and bills payables

An aged analysis of the Group's trade and bills payables as at the balance sheet date is as follows:

	At 30 September 2006 (Unaudited) <i>HK\$'000</i>	At 31 March 2006 (Audited) <i>HK\$'000</i>
Within 30 days	1,063,137	778,527
31 to 60 days	646,927	765,235
61 to 90 days	581,689	267,857
Over 90 days	192,380	244,138
	<u>2,484,133</u>	<u>2,055,757</u>

INTERIM DIVIDENDS

The Board does not recommend the payment of an interim dividend for the six months ended 30 September 2006 (for the six months ended 30 September 2005: Nil).

MANAGEMENT DISCUSSION AND ANALYSIS

1. Overall Business Performance

For the six months ended 30 September 2006, the Group sustained a rapid growth in its business, achieved significant increase in profit (before special items) for the current period and reinforced its market position. Moreover, the Group's operating cash flow and cash cycle also achieved outstanding performance.

During the second quarter of the financial year, the overall turnover of the Group continued its robust growth of 28.28% comparing to the corresponding period of last financial year, which sustained its leading market position and competitive edges. According to a report provided by IDC in November 2005, the PRC IT market is expected to have a stable growth in 2006 with an estimated growth rate of 14.4%. The Group recorded a turnover of HK\$11,872 million for the six months ended 30 September 2006, representing an increase of 34.78% comparing to HK\$8,808 million of the corresponding period of last financial year, with a growth rate far exceeding the estimated growth rate of the PRC IT market. The remarkable performance was mainly attributable to the better implementation of the Group's different business growth strategies set for its three business segments. The Group's gross profit margin for the six months ended 30 September 2006 was 6.98% and remained stable as comparing to the corresponding period of last financial year.

During the financial year, the Group focused on enhancing the investment returns for its business, and achieved a satisfactory growth on current period profit (before special items). The Group's profit (before special items) for the second quarter of the financial year was approximately HK\$60 million, an increase of 56.21% comparing to the corresponding period of last financial year. Profit (before special items) for the six months ended 30 September 2006 was approximately HK\$87 million, representing an increase of 26.28% from the corresponding period of last financial year.

In respect of special items, apart from the exchange gains, while the Group obtained satisfactory operating results, the Group adopted, following prudence principle, financial treatments on certain special items arose in previous financial years with contingency risks. As a result of the direct impacts of these special items, profit attributable to equity holders of the parent (profit attributable to equity holders) for the second quarter and the first six months of the financial year decreased as compared with the corresponding period of last financial year. Relevant special items are illustrated as follows:

- (1) The Group recorded an exchange gain of approximately HK\$15 million in the second quarter of the financial year, representing a decrease of HK\$42 million from approximately HK\$57 million of the corresponding period of last financial year;

- (2) After the completion of merger of Beijing Si-Tech Information Technology Co., Ltd. (“STQ”), the new company has fully deployed initiatives to promote systems integration services as well as application development services to all telecom customers in China. In order to reflect the future profit and loss of this new company in a clearer manner, based on prudence principle, the Group charged in full the goodwill arising from the acquisition of STQ of approximately HK\$29 million as impairment in the financial year;
- (3) In respect of a systems business customer with trade receivable balance of approximately HK\$12 million, the Group, based on prudence principle, made a provision for bad debts of approximately HK\$5 million for such trade receivable in the second quarter of the financial year in light of the progress of the legal proceedings. Despite the provision, the Group has adopted active measures to recover the outstanding amount so as to reach an appropriate settlement for the case as earliest as possible; and
- (4) During the second quarter of the financial year, the Group amortised and impaired an aggregate amount of approximately HK\$5 million in respect of intangible assets (development costs capitalised) capitalised in previous financial years. No additional development costs were capitalised for the current financial year (additional development costs capitalised in the corresponding period of last financial year was approximately HK\$2 million higher than the amount amortised and impaired).

After taking into account the above special items, the profit attributable to equity holders of the parent for the second quarter of the financial year amounted to approximately HK\$37 million, while the profit attributable to equity holders of the parent for the six months ended 30 September 2006 was approximately HK\$92 million, representing a decrease of 22.94% from the corresponding period of last financial year. Basic earnings per share and diluted earnings per share amounted to 10.53 HK cents and 10.48 HK cents respectively.

The Group continued to put emphasis on healthy growth during the second quarter of the financial year, with cash cycle recording satisfactory performance and operating cash flow achieving significant improvement. Net cash inflow from operating activities of the Group for the second quarter of the financial year amounted to approximately HK\$900 million, representing a significant increase from approximately HK\$230 million of the corresponding period of last financial year. For the six months ended 30 September 2006, accumulated net cash inflow from operating activities increased by HK\$549 million from the corresponding period of last financial year. The increase was mainly attributable to the decrease in inventory and the increase in trade payables. The Group’s cash cycle for the second quarter of the financial year also recorded satisfactory performance with overall cash cycle reducing 5.76 days comparing to the corresponding period of last financial year. The turnover days of trade receivables and inventory reduced by 2.16 days and 5.77 days respectively. The Group’s cash cycle for the first six months of the financial year reduced 6.60 days comparing to the corresponding period of last financial year, whereas the turnover days of trade receivables and inventory reduced by 4.16 days and 4.99 days respectively.

2. Business Strategy Review

2.1 The Distribution business

Backed by the stable gross profit margin brought about by the Group's growth strategies for its overall business, the turnover from its Distribution business again experienced robust growth in the financial year. Turnover from the Group's Distribution business for the second quarter of the financial year was HK\$3,717 million, representing an increase of 28.87% from the corresponding period of last financial year, while that for the six months ended 30 September 2006 amounted to HK\$7,049 million, representing an increase of 33.23% from the corresponding period of last financial year, both of which were far exceeding the estimated growth rate of the PRC IT market. The outstanding performance was attributable to the Group's continuous efforts in business expansion for its Distribution business and strengthening of its internal management.

2.1.1 Expansion-driven Growth

After the development for almost a year, the new products introduced by the Group's Distribution business in last financial year began to grow rapidly during the financial year, where the ACER business division had already recorded a turnover of HK\$949 million in the first six months of the financial year, accounting for 13.46% of the turnover from the Distribution business. The continuous exploration of new products enabled the major business segments of the Group to experience robust growth in turnover for the six months ended 30 September 2006. Desktop computers, Consumer IT products and notebook computers achieved a growth of 77.28%, 55.06% and 45.87% respectively comparing to the corresponding period of last financial year.

2.1.2 Expanded Business Channels to Support Business Growth

The Group is committed to expanding the coverage of its business channels. As at 30 September 2006, the number of effective channels for its Distribution business increased to 6,218 companies, representing an increase of 50.12% from the corresponding period ended 30 September 2005. Such expansion in channel coverage has become a solid foundation for the current and future growth of the Group's Distribution business.

2.1.3 Continued Enhancement of Internal Management to Maintain the Leading Position in the Market

On the internal management front, the Group continued to enhance its internal procedures, risk management and business operations. Such enhancement of internal management enabled the Group to manage the operating risks exposed to its Distribution business effectively, which resulted in an improved turnover days in terms of trade receivables and inventory comparing to the corresponding period of last financial year and stable provision for bad debts.

2.2 The Systems business

The Group's Systems business for the first six months of the financial year maintained a rapid growth. During the second quarter of the financial year, turnover from the Group's Systems business reached HK\$1,810 million, representing an increase of 36.47% comparing to the corresponding period of last financial year. Turnover for the six months ended 30 September 2006 amounted to HK\$3,470 million, representing a rise of 37.27% comparing to the corresponding period of last financial year. Along with the rapid growth in business scale, the profitability of the business remained stable. Gross profit margin of the Group's Systems business for the first six months of the financial year was 9.27%, basically maintaining the same level of the corresponding period of last financial year of 9.46%.

2.2.1 Cordial Relationship with Suppliers and Business Channels Boosted the Sustained Growth in Turnover for all Major Business Segments of the Group's Systems Business

For the first six months ended 30 September 2006, turnover from the Group's packaged software, storage products and UNIX servers increased by 36.94%, 34.56% and 37.80% respectively comparing to the corresponding period of last financial year.

2.2.2 The Group's Key Development Strategy for the Financial Year Focused on Close Alliance with Regional Core Channels and Expanded Coverage in Small to Middle-tier Cities

By undertaking a series of marketing initiatives for its Systems business during the financial year, including "2006 Conference of Channels in Tier 2 and 3 Cities" (2006夥伴關愛之旅), Core Channels Authorizing Conference (核心渠道峰會以及授牌) and "Core Channels Award Program" (成長聯盟採購積分計劃), the Group further increased the number of core channels, expanded the scope for business cooperation and enhanced cordial cooperation with respective channels. At the same time, the sales volume in small to middle-tier cities in the PRC was also expanded through the strengthening of regional penetration and coverage.

2.2.3 The Group Continued to Enhance its Technology Services and Management of its Servicing Staff and its Capabilities in the Financial Year

The number of technical staff increased from 178 persons as at 31 March 2006 to 201 persons as at 30 September 2006. The turnover of Services business from the Group's Systems business sustained its robust growth momentum in the second quarter of the financial year. Services turnover for the second quarter ended 30 September 2006 increased by 315% comparing to the corresponding period of last financial year, while that of the first six months of the financial year increased by 241% comparing to the corresponding period of last financial year.

2.3 *The Services business*

Turnover from the Group's Services business for the second quarter of the financial year amounted to HK\$732 million, representing an increase of 9.47% from the corresponding period of last financial year. During the six months ended 30 September 2006, the Group's Services business recorded a turnover of HK\$1,353 million, representing a surge of 36.72% from the corresponding period of last financial year. Gross profit margin of the Services business for the second quarter of the financial year slightly fell to 12.75% from 12.87% of the corresponding period of last financial year. It was partly due to the lower gross profit margin of sizeable telecommunication projects under the hardware system integration business of the Group's Services business. In addition, the Group's Services business was undergoing transformation and additional efforts were placed in the development of software localisation, and development of service, products and solution in the first six months of the financial year. Therefore, the overall gross profit of the Services business was affected, resulting in a declined gross profit of the Group's Services business for the first six months of the financial year of 11.54% from 12.89% of the corresponding period of last financial year.

2.3.1 *Fruitful Results Attained by Clientele Expansion with Enhanced Market Position*

During the six months ended 30 September 2006, the Group's Services business achieved a breakthrough on the clientele expansion, which further enhanced its market influence towards various industries such as finance, telecommunications and the government (including taxation), and continued to increase its market share.

According to a report provided by IDC in October 2006, the finance software and services under the Group's Services business increased by 0.2 percentage point in its market share in the PRC during the first six months of the financial year comparing to that of 2005, continuing to maintain its second largest position in the PRC market. The e-government services under the Group's Services business increased by 0.2 percentage point in its market share in the PRC for the first six months of the financial year from that of 2005, continuing to enjoy its dominant position in the PRC market. The telecommunications software services under the Group's Services business increased by 2.6 percentage points in its market share in the PRC for the first six months of the financial year from that of 2005, becoming one of the top four providers of the PRC market.

During the first six months of the financial year, the Group's Services business maintained its collaborative relationship with its existing core customers in the finance sector, such as China Construction Bank, and achieved another breakthrough in securing new customers such as policy banks and small to medium sized banks. In respect of its governmental sector, the Group successfully secured new core customers in various aspects such as local tax

bureau, electricity and power. In the telecommunications sector, the Group continued its collaboration with telecommunication operators such as China Mobile, China Telecom, China Network Communications and China Unicom, and concluded a number of hundred-million-worth major contracts.

2.3.2 Significant Increase of Products Support and IT Outsourcing and Maintenance Services and Efficiency in System Structure

For the six months ended 30 September 2006, the products support and IT outsourcing and maintenance services of the Group's Services business concluded contracts valued over HK\$150 million, representing an increase of 60% from the corresponding period of last financial year. The Group's Services business collaborated with various customers such as China Mobile and China Railcom, and signed various million-worth major contracts in respect of product support and IT outsourcing and maintenance services. The Group also successfully passed the international certification of IT service management (ITIL/ITSM) system ISO 20000 on 19 October 2006, and became the first enterprise obtaining such certification in the PRC after such international standard was upgraded to ISO20000:2005. This manifests the management system and management capabilities of the Group's Services business attained advanced international standards, and attached significance towards the overall development of the transformation strategy of the Group's IT services.

2.3.3 Enhancement in the Development of Core Capabilities of Services and the Investment in Infrastructure for the Implementation of Services Business Strategies

For the six months ended 30 September 2006, in view of providing better services to customers in the industry and enhance the profitability of its software and services business, the Group's Services business devoted additional efforts on transformation by establishing and promoting three core capabilities, which will also be the ongoing commitment of the Group's Services business in a long run.

- (1) Transforming from customer on-site development to localised development. In the first six months of the financial year, the Group's Services business significantly enhanced the infrastructure capabilities of its Xi'an software development base, including expansion of workforce and investment in infrastructure. Such moves aimed at changing the traditional service model and improving the delivery capabilities for its customers, so as to achieve unification and standardisation for its Services business;

- (2) Transforming from applied software development business to IT operation outsourcing business. The Group expanded its Services business and established outsourcing data centres and service control centres in the financial year, building up the capability of providing comprehensive operation outsourcing services of labour, equipments and facilities; and
- (3) Transforming from customised software development to software product development. In the first six months of the financial year, the Group's Services business increased its contribution in software product development for its major sectors such as finance, telecommunications and government. The gradual enhancement of its software product capabilities will improve the efficiency by way of module replication, thereby reducing the delivery costs for software projects and improving delivery efficiencies.

3. Outlook

The management of the Group are very satisfied with the better implementation of its operation and management strategies in the first half of the financial year and the achievements of its outstanding operating results. Looking forward, the management will strike to ensure the achievement of the annual performance target by adhering to the existing operation and management strategies, while at the same time continue to apply its prudent financial principle, in order to lay a solid foundation for the realisation of the Group's target in its IT services transformation.

Capital Expenditure, Liquidity and Financial Resources

The Group mainly finances its operations with internally generated cash flows, bank loans and banking facilities.

The Group had total assets of HK\$6,035 million at 30 September 2006 which were financed by total liabilities of HK\$4,204 million, minority interests of HK\$13 million and equity attributable to equity holders of the parent of HK\$1,818 million. The Group's current ratio at 30 September 2006 was 1.33 as compared to 1.24 at 30 June 2006 and 1.25 at 31 March 2006.

During the six months ended 30 September 2006, capital expenditure of HK\$43 million were mainly incurred for the acquisition of office equipment and leasehold improvements of buildings in Beijing.

The aggregate interest-bearing borrowings as a ratio of equity attributable to equity holders of the parent was 0.53 at 30 September 2006 as compared to 0.89 at 30 June 2006 and 0.68 at 31 March 2006. The computation of the said ratio was based on the total interest-bearing borrowings of HK\$965 million (30 June 2006 and 31 March 2006: HK\$1,661 million and HK\$1,206 million respectively) and equity attributable to equity holders of the parent of HK\$1,818 million (30 June 2006 and 31 March 2006: HK\$1,862 million and HK\$1,787 million respectively).

At 30 September 2006, the denomination of the interest-bearing borrowings of the Group was shown as follows:

	Denominated in United States dollar HK\$'000	Denominated in Renminbi HK\$'000	Total HK\$'000
Current			
Interest-bearing bank borrowings, unsecured	727,964	8,731	736,695
Interest-bearing bank borrowing, secured	–	4,851	4,851
Interest-bearing other loan, secured	–	19,402	19,402
	<u>727,964</u>	<u>32,984</u>	<u>760,948</u>
Non-current			
Interest-bearing bank borrowings, unsecured	–	203,725	203,725
	<u>–</u>	<u>203,725</u>	<u>203,725</u>
Total	<u><u>727,964</u></u>	<u><u>236,709</u></u>	<u><u>964,673</u></u>

The Group's current borrowings of approximately HK\$24 million extended by financial institutions to a subsidiary of the Group, STQ, were secured by a property situated in the Mainland China with a net carrying amount of approximately HK\$17 million at 30 September 2006 and 14,061,976 issued shares of STQ in favour of Beijing Zhongguancun Sci-Tech Guaranty Co. Ltd. (the "Pledgee"), an independent third party, for securing a guarantee issued by such Pledgee on behalf of STQ. The Group's non-current bank borrowings of approximately HK\$204 million represented the term loans which are repayable in July 2008.

The Group's total available credit facilities at 30 September 2006 amounted to HK\$6,862 million, of which HK\$980 million were in term loan facilities, HK\$4,242 million were in trade lines and HK\$1,640 million were in short-term and revolving money market facilities. At 30 September 2006, the facility drawn down was HK\$204 million in term loan facilities, HK\$2,441 million in trade lines and HK\$421 million in short-term and revolving money market facilities.

Under the normal course of business, the Group has issued performance bonds to some customers for potential claims of non-performance in order to satisfy the specific requirements of these customers. As no material claims had been made by the customers under such performance bonds in the past, the management considers that the possibility of realisation of any actual material liabilities arising from such performance bonds is remote.

Human Resources

At 30 September 2006, the Group had approximately 6,700 (30 September 2005: approximately 4,800) full-time employees. The majority of these employees work in the PRC. The Group offers remuneration packages in line with industry practice. Employees' remuneration includes basic salaries and bonuses. With the increase in the total number of staff to cope with its business requirements, the Group has recorded a 31.47% increase in staff costs to approximately HK\$350 million for the six months ended 30 September 2006 as compared with

an approximate sum of approximately HK\$266 million for the same period of last financial year. In order to attract and retain a high caliber of capable and motivated workforce, the Company offers share options to staff based on the individual performance and the achievements of the Company's targets. The Group is committed to providing its staff with various in-house and external training and development programs.

AUDIT COMMITTEE

The audit committee has reviewed with the management of the Company the accounting principles and practices adopted by the Group and discussed auditing, internal control and financial reporting matters including the review of the unaudited condensed consolidated interim financial statements of the Group for the six months ended 30 September 2006.

CORPORATE GOVERNANCE

Subsequent to the publication of the Corporate Governance Report in the 2005/06 annual report, a special resolution was passed at the annual general meeting of the Company held on 23 August 2006 to amend the Company's Bye-Laws to the effect that: (i) any Director or Directors or Chairman of the meeting who, individually or collectively, hold proxies in respect of shares representing 5% or more of the total voting rights at a general meeting may demand a poll; and (ii) the Company in general meeting will have the power by ordinary resolution, instead of special resolution, to remove a Director before the expiration of his period of office.

Furthermore, a remuneration committee was established on 31 August 2006 with specific written terms of reference. The committee was made up of three members, namely Mr. ZENG Maochao (*Chairman*), Mr. WONG Man Chung, Francis and Mr. KWAN Ming Heung, Peter, the majority of whom are independent non-executive directors.

None of the directors of the Company is aware of any information that would reasonably indicate that the Company is not, or was not during the six months ended 30 September 2006, in compliance with the Code on Corporate Governance Practices (the "**Code**") as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, except for the following deviations:

Code Provision A.4.1

This Code Provision stipulates that non-executive directors should be appointed for a specific term, subject to re-election.

All Directors of the Company (including executive and non-executive Directors) were not appointed for any specific term. However, all Directors (save for Chairman or Managing Director) are subject to retirement by rotation at each annual general meeting in accordance with the Company's Bye-Laws and shall be eligible for re-election. The Board of Directors shall ensure all Directors (including the Chairman and Managing Director) shall be subject to retirement by rotation at least once every three years so as to accomplish the same purpose as a specific term of appointment.

Code Provision A.4.2

The second part of this Code Provision stipulates that every director, including those appointed for a specific term, should be subject to retirement by rotation at least once every three years.

Under the Company's Bye-Laws, at each annual general meeting one-third of the Directors for the time being or, if their number is not three or a multiple of three, the number nearest to one-third shall retire from office provided that notwithstanding anything herein, the Chairman of the Board and the Managing Director shall not, whilst holding such office, be subject to retirement by rotation or be taken into account in determining the number of Directors to retire in each year. In view of good corporate governance practices, the Chairman of the Company voluntarily retires from his office once every three years notwithstanding that he is not required to do so by the Bye-Laws.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

During the six months ended 30 September 2006, neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's listed securities.

On behalf of the Board

LI Qin
Chairman

Hong Kong, 28 November 2006

As at the date of this announcement, the Board comprises ten directors namely:

Executive Directors: Mr. LI Qin (*Chairman*), Mr. GUO Wei (*Vice Chairman, President and Chief Executive Officer*), Mr. ZENG Maochao, Mr. LIN Yang and Mr. HUA Zhinian.

Non-executive Director: Mr. William O. GRABE.

Independent Non-executive Directors: Mr. HU Zhao Guang, Professor WU Jinglian, Mr. WONG Man Chung, Francis and Mr. KWAN Ming Heung, Peter.

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(* For identification purpose only)

Please also refer to the published version of this announcement in South China Morning Post.