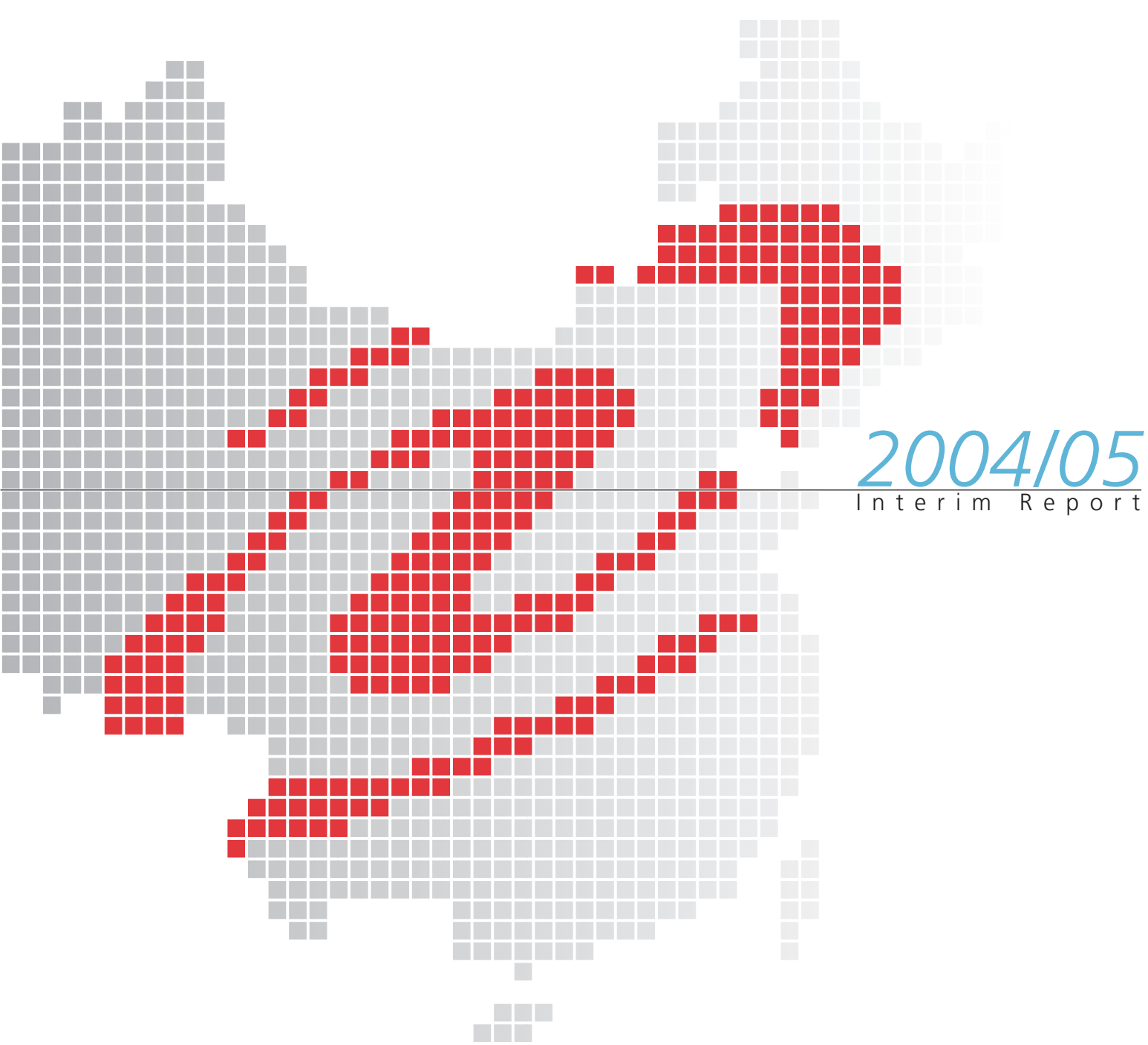




神州数码  
Digital China



2004/05  
Interim Report

**Digital China Holdings Limited**  
神州數碼控股有限公司  
(Incorporated in Bermuda with limited liability)

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The board of directors (the "Board") of Digital China Holdings Limited (the "Company") would like to announce the unaudited consolidated interim results of the Company and its subsidiaries (the "Group") for the six months ended 30 September 2004 together with the comparative figures for the corresponding period of the last financial year.

## CONDENSED CONSOLIDATED INCOME STATEMENT

	Notes	Three months ended 30 September 2004 (Unaudited) HK\$'000	Six months ended 30 September 2004 (Unaudited) HK\$'000	Three months ended 30 September 2003 (Unaudited) HK\$'000	Six months ended 30 September 2003 (Unaudited) HK\$'000
<b>Turnover</b>	2	<b>4,141,875</b>	<b>7,595,820</b>	3,719,574	7,020,122
Cost of inventories sold and services provided		<b>(3,830,840)</b>	<b>(7,010,085)</b>	(3,519,531)	(6,595,662)
Selling expenses		<b>(26,342)</b>	<b>(49,445)</b>	(23,510)	(42,048)
Promotion and advertising expenses		<b>(20,010)</b>	<b>(38,428)</b>	(23,125)	(42,646)
Staff costs		<b>(94,781)</b>	<b>(183,236)</b>	(90,113)	(171,022)
Other operating income/(expenses), net		<b>(81,062)</b>	<b>(172,997)</b>	16,174	(217,456)
<b>Earnings/(Loss) before interest, tax and depreciation</b>		<b>88,840</b>	<b>141,629</b>	79,469	(48,712)
Depreciation		<b>(13,945)</b>	<b>(28,132)</b>	(12,939)	(25,726)
Interest income	2	<b>676</b>	<b>1,645</b>	616	1,378
<b>Profit/(Loss) from operating activities</b>	3	<b>75,571</b>	<b>115,142</b>	67,146	(73,060)
Finance costs		<b>(13,270)</b>	<b>(23,896)</b>	(10,252)	(23,603)
Share of profits/(losses) of associates		<b>796</b>	<b>765</b>	(1,050)	(4,077)
<b>Profit/(Loss) before tax</b>		<b>63,097</b>	<b>92,011</b>	55,844	(100,740)
Tax	4	<b>722</b>	<b>607</b>	965	7,774
<b>Profit/(Loss) before minority interests</b>		<b>63,819</b>	<b>92,618</b>	56,809	(92,966)
Minority interests		<b>1,368</b>	<b>2,905</b>	864	2,004
<b>Net profit/(loss) from ordinary activities attributable to shareholders</b>		<b>65,187</b>	<b>95,523</b>	57,673	(90,962)
<b>Earnings/(Loss) per share</b>	5				
— Basic (HK cents)			<b>11.10</b>		(10.59)
— Diluted (HK cents)			<b>11.07</b>		N/A

## CONDENSED CONSOLIDATED BALANCE SHEET

	Notes	At 30 September 2004 (Unaudited) HK\$'000	At 31 March 2004 (Audited) HK\$'000
<b>Non-current assets</b>			
Fixed assets		455,552	393,726
Goodwill		13,563	14,393
Intangible assets		29,529	20,291
Deferred tax assets		21,124	16,774
Interests in associates		36,445	29,669
Long-term investments		28,757	—
		<b>584,970</b>	474,853
<b>Current assets</b>			
Inventories		1,236,306	1,101,402
Trade and bills receivables	6	2,059,834	1,613,821
Prepayments, deposits and other receivables		325,238	327,069
Cash and bank balances		377,902	521,071
		<b>3,999,280</b>	3,563,363
<b>Current liabilities</b>			
Trade and bills payables	7	1,533,472	1,199,830
Other payables and accruals		549,502	452,424
Tax payable		992	1,308
Interest-bearing bank borrowings, unsecured		620,446	463,014
		<b>2,704,412</b>	2,116,576
<b>Net current assets</b>		<b>1,294,868</b>	1,446,787
<b>Total assets less current liabilities</b>		<b>1,879,838</b>	1,921,640
<b>Non-current liabilities</b>			
Interest-bearing bank borrowings, unsecured		409,500	546,000
<b>Minority interests</b>		<b>7,827</b>	10,459
		<b>1,462,511</b>	1,365,181
<b>Capital and reserves</b>			
Issued capital		86,063	85,975
Reserves		1,376,448	1,279,206
		<b>1,462,511</b>	1,365,181

## CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	<b>Six months ended 30 September 2004 (Unaudited) HK\$'000</b>	Six months ended 30 September 2003 (Unaudited) HK\$'000
Net cash outflow from operating activities	<b>(11,416)</b>	(53,433)
Net cash outflow from investing activities	<b>(130,807)</b>	(158,177)
Net cash inflow/(outflow) from financing activities	<b>(946)</b>	64,597
Decrease in cash and cash equivalents	<b>(143,169)</b>	(147,013)
Cash and cash equivalents at the beginning of the period	<b>521,071</b>	667,097
Cash and cash equivalents at the end of the period	<b>377,902</b>	520,084

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Issued share capital (Unaudited) HK\$'000	Share premium account (Unaudited) HK\$'000	Capital reserve (Unaudited) HK\$'000	Reserve funds (Unaudited) HK\$'000	Exchange fluctuation reserve (Unaudited) HK\$'000	Retained profits (Unaudited) HK\$'000	Proposed final dividend (Unaudited) HK\$'000	Total (Unaudited) HK\$'000
At 1 April 2004	85,975	291,850	623,689	37,100	578	325,989	—	1,365,181
Exercise of share options	88	1,657	—	—	—	—	—	1,745
Net profit for the period	—	—	—	—	—	95,523	—	95,523
Exchange realignment	—	—	—	—	62	—	—	62
<b>At 30 September 2004</b>	<b>86,063</b>	<b>293,507</b>	<b>623,689</b>	<b>37,100</b>	<b>640</b>	<b>421,512</b>	<b>—</b>	<b>1,462,511</b>
At 1 April 2003	85,870	289,895	623,689	27,874	1,003	301,285	63,372	1,392,988
Exercise of share options	5	84	—	—	—	—	—	89
Net loss for the period	—	—	—	—	—	(90,962)	—	(90,962)
Payment of dividend	—	—	—	—	—	—	(63,372)	(63,372)
At 30 September 2003	85,875	289,979	623,689	27,874	1,003	210,323	—	1,238,743

## NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS

### 1. Basis of Presentation and Principal Accounting Policies

The unaudited condensed consolidated interim financial statements for the six months ended 30 September 2004 are prepared in accordance with Hong Kong Statement of Standard Accounting Practice No. 25 "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 Group's consolidated financial statements for the year ended 31 March 2004 had been consistently applied except for the following change in segment accounting policy:

#### Change in segment accounting policy

During the six months ended 30 September 2004, the Group has changed its identification of reportable business segments. The Group has reclassified its previous three business segments, namely, "Distribution of information technology ("IT") products", "Provision of systems integration services" and "Development and distribution of networking products" into three new business segments, namely, "Distribution", "Systems" and "Services". Further information of the three new business segments is detailed in note 2 below. In the opinion of the directors of the Company, the new basis of segmentation provides a more appropriate presentation of the segment information. Prior period segment information is restated for comparative purposes.

### 2. Turnover, Revenue and Segment Information

The Group is principally engaged in the distribution of general IT and systems products and the provision of IT services. 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.

From 1 April 2004, the Group has adopted a new segment reporting basis and reclassified its businesses into three new business segments. Summary details of the three new business segments are as follows:

- (a) the "Distribution" segment engages in the distribution of general 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..

**NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS** *(continued)*
**2. Turnover, Revenue and Segment Information** *(continued)*
**Primary reporting format — business segments**

	Three months ended 30 September 2004 (Unaudited) HK\$'000	Six months ended 30 September 2004 (Unaudited) HK\$'000	Three months ended 30 September 2003 (Unaudited) (Restated) HK\$'000	Six months ended 30 September 2003 (Unaudited) (Restated) HK\$'000
<b>Segment turnover</b>				
Distribution	2,308,835	4,268,260	2,170,673	4,012,249
Systems	1,156,050	2,268,628	1,132,000	2,063,644
Services	676,990	1,058,932	416,901	944,229
	<b>4,141,875</b>	<b>7,595,820</b>	3,719,574	7,020,122
Other revenue				
Interest income	676	1,645	616	1,378
	<b>4,142,551</b>	<b>7,597,465</b>	3,720,190	7,021,500
<b>Segment results</b>				
Distribution	118,858	240,070	31,608	100,591
Systems	116,514	225,863	108,874	200,660
Services	75,663	119,802	59,561	123,209
	<b>311,035</b>	<b>585,735</b>	200,043	424,460
Unallocated expenses	<b>(235,464)</b>	<b>(470,593)</b>	(132,897)	(497,520)
Profit/(Loss) from operating activities	75,571	115,142	67,146	(73,060)
Finance costs	<b>(13,270)</b>	<b>(23,896)</b>	(10,252)	(23,603)
Share of profits/(losses) of associates	796	765	(1,050)	(4,077)
Profit/(Loss) before tax	<b>63,097</b>	<b>92,011</b>	55,844	(100,740)
Tax	722	607	965	7,774
Profit/(Loss) before minority interests	<b>63,819</b>	<b>92,618</b>	56,809	(92,966)
Minority interests	1,368	2,905	864	2,004
Net profit/(loss) from ordinary activities attributable to shareholders	<b>65,187</b>	<b>95,523</b>	57,673	(90,962)

**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 People's Republic of China ("PRC").

**NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS** *(continued)*
**3. Profit/(Loss) from Operating Activities**

The Group's profit/(loss) from operating activities is arrived at after (crediting)/charging:

	<b>Six months ended 30 September 2004 (Unaudited) HK\$'000</b>	Six months ended 30 September 2003 (Unaudited) HK\$'000
Exchange (gains)/losses, net	<b>(138)</b>	3
Operating lease rentals in respect of land and buildings	<b>22,774</b>	15,024
Loss on disposal of fixed assets	<b>906</b>	461
Amortisation of intangible assets	<b>1,962</b>	110
Amortisation of goodwill	<b>830</b>	1,104
Provisions and write-off of obsolete inventories	<b>22,221</b>	26,227
Provisions and write-off of doubtful trade receivables	<b>42,553</b>	83,499

**4. Tax**

	<b>Six months ended 30 September 2004 (Unaudited) HK\$'000</b>	Six months ended 30 September 2003 (Unaudited) HK\$'000
<b>Group</b>		
Current tax:		
PRC corporate income tax	<b>(3,743)</b>	(2,178)
Deferred tax	<b>4,350</b>	9,952
Total tax credit for the period	<b>607</b>	7,774

- (a) PRC corporate income tax represents tax charges on the estimated assessable profits of the PRC subsidiaries of the Group. In general, the PRC subsidiaries of the Group are subject to the PRC corporate income tax rate of 33% except for certain subsidiaries which are entitled to tax holidays and preferential tax rates.
- (b) No provision for Hong Kong profits tax had been made as the Group had no estimated assessable profits arising in Hong Kong nor had tax losses brought forward from prior years to set off assessable profits for the six months ended 30 September 2003 and 2004.

## NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS (continued)

### 4. Tax (continued)

- (c) For the six months ended 30 September 2004, no provision for Hong Kong profits tax had been made for the associates as the associates had no estimated assessable profits arising in Hong Kong and no provision for PRC corporate income tax had been made for the associates as the associates had tax losses brought forward from prior years to set off assessable profits. No provision for Hong Kong profits tax and PRC corporate income tax had been made for the associates as the associates had no estimated assessable profits for the six months ended 30 September 2003.

### 5. Earnings/(Loss) per Share

The calculation of basic earnings/(loss) per share was based on the net profit attributable to shareholders for the six months ended 30 September 2004 of approximately HK\$95,523,000 (For the six months ended 30 September 2003: net loss of approximately HK\$90,962,000), and the weighted average of 860,575,380 (For the six months ended 30 September 2003: 858,704,823) ordinary shares in issue during the six months ended 30 September 2004.

The calculation of diluted earnings per share was based on the net profit attributable to shareholders for the six months ended 30 September 2004 of approximately HK\$95,523,000 and 862,826,200 ordinary shares, which were the weighted average of 860,575,380 ordinary shares in issue during the six months ended 30 September 2004 and the weighted average of 2,250,820 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 2004.

Diluted loss per share for the six months ended 30 September 2003 had not been calculated as the impact of the outstanding share options was anti-dilutive.

### 6. Trade and Bills Receivables

An aged analysis of the trade and bills receivables at balance sheet dates, net of provisions, is as follows:

	At 30 September 2004 (Unaudited) HK\$'000	At 31 March 2004 (Audited) HK\$'000
Within 30 days	1,128,447	700,029
31 to 60 days	268,896	343,666
61 to 90 days	183,768	101,999
91 to 180 days	237,291	233,266
Over 180 days	241,432	234,861
	<b>2,059,834</b>	1,613,821

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 periods normally range from 30 days to 180 days.

**NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS** *(continued)*
**7. Trade and Bills Payables**

An aged analysis of the trade and bills payables at balance sheet dates is as follows:

	<b>At 30 September 2004 (Unaudited) HK\$'000</b>	At 31 March 2004 (Audited) HK\$'000
Within 30 days	<b>869,577</b>	576,741
31 to 60 days	<b>340,540</b>	491,577
61 to 90 days	<b>176,796</b>	35,847
Over 90 days	<b>146,559</b>	95,665
	<b>1,533,472</b>	1,199,830

**8. Contingent Liabilities**

At 30 September 2004, the Group had discounted bills with recourse to banks amounting to approximately HK\$396 million (31 March 2004: HK\$252 million).

**9. Commitments**
**(a) Capital commitments**

At 30 September 2004, the Group's capital commitments comprised:

	<b>At 30 September 2004 (Unaudited) HK\$'000</b>	At 31 March 2004 (Audited) HK\$'000
Contracted, but not provided for:		
Land use rights, leasehold land and buildings	<b>173,873</b>	216,447

**NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS** *(continued)*
**9. Commitments** *(continued)*

## (b) Commitments under operating leases

At 30 September 2004, the Group had total future minimum lease payments under non-cancellable operating leases falling due as follows:

	<b>At 30 September 2004 (Unaudited) HK\$'000</b>	At 31 March 2004 (Audited) HK\$'000
Within one year	<b>39,744</b>	23,743
In the second to fifth years, inclusive	<b>63,809</b>	31,588
After five years	<b>15,373</b>	14,138
	<b>118,926</b>	69,469

**INTERIM DIVIDEND**

The Board does not recommend the payment of an interim dividend for the six months ended 30 September 2004 (For the six months ended 30 September 2003: nil).

## MANAGEMENT DISCUSSION AND ANALYSIS

### 1. New Business Segments

The Group has adopted a new segment reporting basis for analysing its performance and results since 1 April 2004. In the past, the Group's businesses were classified into three business segments namely, "Distribution of IT products", "Provision of systems integration services" and "Development and distribution of networking products". The three new business segments now adopted are "Distribution" business, "Systems" business and "Services" business. The new Distribution business includes the distribution of general IT products, which consist of seven major product categories including notebook computers, desktop computers, PC servers, data projectors, peripherals, accessories and consumer IT products. The Systems business covers the distribution of systems products, including Unix servers, networking products, storage products and packaged software, as well as the provision of related value-added services. The Services business includes systems integration, applications software development, consultancy and training, etc..

The reason for making the above business realignments was mainly due to the obvious distinctions in business models arising between the general IT products distribution and the systems products distribution. Such divergence includes customer groups, product life cycles, gross profit margins and technical support requirements, etc.. Therefore, different management strategies and yardsticks are required. The new segmentation will provide a better perception of the characteristics, market size, profitability of each business segment, as well as the current performance and development trends of the Group's businesses.

### 2. Business Performance

The Group recorded a solid profit growth in the first half of the financial year as compared with the same period of the last financial year. Turnover amounted to HK\$7,596 million, an 8.20% increase as compared with HK\$7,020 million for the same period of the last financial year. Gross profit margin improved to 7.71%, higher than the 6.05% for the same period of the last financial year. Earnings before interest, tax and depreciation (EBITD) amounted to HK\$142 million, compared to loss before interest, tax and depreciation of HK\$49 million for the same period of the last financial year. Net profit attributable to shareholders amounted to HK\$96 million, compared to net loss attributable to shareholders of HK\$91 million for the same period of the last financial year, which was affected by the outbreak of the severe acute respiratory syndrome (SARS). In the first half of the financial year, net profit attributable to shareholders as a percentage of turnover was 1.26%, compared to net loss attributable to shareholders as a percentage of turnover of 1.30% in the same period of the last financial year. This reflected that the Group's profitability has resumed remarkably. Earnings per share for the six months ended 30 September 2004 amounted to 11.10 HK cents, compared to loss per share of 10.59 HK cents for the same period of the last financial year.

#### 2.1 Turnover and Gross Profit

The Distribution, Systems and Services businesses accounted for HK\$4,268 million, HK\$2,269 million and HK\$1,059 million, respectively, of the Group's turnover.

## MANAGEMENT DISCUSSION AND ANALYSIS (continued)

### 2. Business Performance (continued)

#### 2.1 Turnover and Gross Profit (continued)

Turnover of the Distribution business gained a 6.38% increase as compared with HK\$4,012 million recorded in the same period of the last financial year. Turnover of the same period last year included HK\$230 million contributed by the mobile phone business. Such business was terminated in the third quarter of the last financial year. Therefore, should the turnover contribution of the mobile phone business in the first half of the last financial year be excluded, turnover of the Distribution business for the first half of this financial year would have recorded an increase of 12.85%. Gross profit margin of the Distribution business was also restored to a higher level at 5.62%, compared to 2.51% in the same period of the last financial year.

Turnover generated from the Systems business increased 9.93% as compared with HK\$2,064 million for the same period of the last financial year. Gross profit margin improved to 9.96%, higher than the 9.72% recorded in the same period of the last financial year.

Turnover generated from the Services business increased 12.15% as compared with HK\$944 million for the same period of the last financial year. Gross profit margin was lower at 11.31%, compared to 13.05% recorded in the same period of the last financial year.

#### 2.2 Operating Expenses

Operating expenses for the first half of the financial year decreased 6.14% from the same period of the last financial year to HK\$444 million. Operating expenses as a percentage of turnover (expenses ratio) was 5.85%, which was substantially lower than the expenses ratio of 6.74% recorded in the same period last year. The management is actively pursuing more effective strategies and measures on cost controls, as it endeavours to establish a low-cost operation model with dual emphasis on cost savings and securing new sources of revenue that would contribute to enhancing cost effectiveness and profitability. Priorities set by the Group for the financial year, including process management which focuses on risk controls and implementation of a staff motivation regime linked to business performance targets, should help to enhance cost effectiveness.

#### 2.3 Financial Management

At 30 September 2004, the Group's total trade receivable amounted to HK\$2,060 million, an increase of HK\$208 million as compared with HK\$1,852 million recorded at 30 June 2004. The increase was mainly attributable to the new businesses under the Distribution segment. The Group geared up its efforts in risk management during the first half of the financial year and successfully improved the ages of its trade receivable, of which the proportion of aged trade receivable for 181 days or above decreased from 16.17% of the total at the end of the first quarter of the financial year to 11.72% at the end of the second financial quarter. In the first half of the financial year, trade receivable turnover day was 43.53 days, being 1.62 days less as compared with 45.15 days in the first financial quarter, which was mainly attributable to shortened trade receivable turnover day for the Services business in the second financial quarter as compared to the first financial quarter.

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### 2. Business Performance *(continued)*

#### 2.3 Financial Management *(continued)*

At 30 September 2004, the Group's total inventory amounted to HK\$1,236 million, which was slightly less than HK\$1,253 million at 30 June 2004, reflecting mainly the effective inventory controls over the Systems business and the Services business. Inventory turnover day for the first half of the financial year fell to 30.01 days from 33.32 days for the first financial quarter.

At 30 September 2004, the Group's total trade payable increased HK\$356 million to HK\$1,533 million from HK\$1,177 million at 30 June 2004. The increase was primarily attributable to increases in trade payable of HK\$209 million and HK\$105 million in the Distribution business and the Services business, respectively. Trade payable turnover day for the first half of the financial year increased 2.31 days to 34.43 days from 32.12 days for the first financial quarter.

Net cash outflow from operating activities in the first half of the financial year amounted to HK\$11 million, comprising net cash outflow from operating activities in the first financial quarter of HK\$287 million and net cash inflow from operating activities in the second financial quarter of HK\$276 million. Cash inflow in the second financial quarter was mainly attributable to an increase of trade payable, which partially set off net cash outflow from operating activities in the first half of the financial year. Net cash outflow from investing activities in the first half of the financial year was HK\$131 million, which was used mainly for the purchase of fixed assets.

### 3. Business Review

According to International Data Corporation (IDC), China remains as one of the fast-growing IT markets in the world in 2004, posting a double-digit growth over 2003. The Group's turnover for the first half of the financial year grew approximately 12% (such growth rate was calculated on the basis of the total turnover excluding the turnover of the mobile phone business for the same period of the last financial year) which was in tandem with the market growth. Meanwhile, progress was seen in the Group's profitability, customer servicing capabilities, product development and management capabilities, all of which not only contributed to the results for the current period but also laid the solid foundations for the Group's future development.

#### 3.1 Distribution Business

For the six months ended 30 September 2004, turnover of general IT distribution business recorded a 12.85% growth (such growth rate was calculated on the basis of the total turnover excluding the turnover of the mobile phone business for the same period of the last financial year) and gross profit margin was restored to a higher level. The achievement of these results was attributable to comprehensive operating strategies set by the Group at the beginning of the financial year on the expansion of product categories, the development of distribution channels and the refinement of operations.

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### 3. Business Review *(continued)*

#### 3.1 Distribution Business *(continued)*

##### 3.1.1 *Positive results in product expansion with significant growth in market share for various products as compared to the same period of the last financial year*

The Group's growth strategy is achieved through rapid expansion of product range and enlargement of market share for various products. Thirteen new distributorships to the Distribution business were added during the first half of the financial year, such as NEC notebook computers, NEC servers, Langchao (浪潮) servers and digital products of Samsung, Konica and Casio, etc., which enriched the product line for each product category. New products added during the past twelve months generated turnover of HK\$246 million for the Group in the first half of the financial year. Riding on the market trend, data projectors, consumer IT products and accessories achieved growth of 58%, 138% and 80% respectively as compared with the same period of the last financial year.

##### 3.1.2 *Optimising existing distribution channels to strengthen risk controls and gearing up network expansion to reinforce competitive edge*

Through analysis and reassessment of several thousands of distributors in the industry based on stringent criteria in respect of regional coverage, ability to carry multiple product lines and different brands, order volume, financial strength and creditability, certain existing distributors were screened out while new distributors were solicited. A sound, nationwide network of distribution channels was established comprising 900 core distributors and over 5,700 primary distributors. The Group's competitive edge in distribution network was further reinforced with the new nationwide network showing marked improvement in the Group's ability to resist risk. The doubtful and bad debt provisions for the Distribution business were decreased by approximately HK\$5 million in the first half of the financial year as compared with the same period of the last financial year.

##### 3.1.3 *Enhancement of corporate value through refined operations and cost controls*

In order to increase the cost effectiveness, the Group has sub-divided its auditing units, based originally on business units, into about 40 product-based auditing units, to largely refine the management of its operations. This initiative not only resulted in strengthened ability to maintain a low-cost operation but also drove higher the gross profit margin of the Distribution business in the first half of the financial year. On another front, the Group has implemented a new regime of staff remuneration at the beginning of the financial year, whereby remuneration of the sales team is linked to turnover and gross profit. As a result, both per capita turnover and per capita gross profit in the first half of the financial year recorded growth as compared with that in the same period of the last financial year.

## MANAGEMENT DISCUSSION AND ANALYSIS (continued)

### 3. Business Review (continued)

#### 3.2 Systems Business

The Systems business recorded an increase in turnover of 9.93% in the first half of the financial year as compared with the same period of the last financial year. According to the survey conducted by Computer Business Information Research (CBI Research), the size of the Group's Systems business more than doubled that of the second ranking competitor in the same business. Gross profit margin improved slightly as compared with that in the same period of the last financial year despite intensified competition, on the back of strategies in product development and regional development as well as the fostering of servicing capabilities.

##### 3.2.1 A fully-fledged line-up in systems products following efforts in product development

After three and a half years of hard work, the Systems business has put in place a full range of products. As indicated in the following table, the Group is now offering a full range of systems products ranging from Unix servers, networking products to storage products and packaged software, effectively supporting any integrated and complex solution requirements of customers. Turnover of the networking products marked an increase of 17% for the first half of the financial year, while turnover of the network security products grew by 30%. New distributorships obtained in the first half of the financial year, including LINKSYS networking products, Hitachi Data Systems (HDS) storage products and Trendmicro network security products, are also expected to drive turnover growth in the second half of the financial year.

Business structure	Already in the product portfolio before 2002/03	New products added in 2002/03	New products added in 2003/04	New products added in the first half of 2004/05
Unix servers	SUN, IBM, HP	—	—	—
Networking products	CISCO	PROXIM, NETSCOUT, POLYCOM, NOKIA, F5, NETSCREEN, CHECKPOINT	RADWARE, PACKETEER	TRENDMICRO, LINKSYS
Storage products	IBM, SUN, HP, EMC	BROCADE	VERITAS, NETAPP	HDS, STK
Packaged software	ORACLE, BEA, MICROSOFT, SYMANTEC	AUTODESK, IBM, SYBASE	RSA, BO, BORLAND, HP Openview	Sichuan Huiyuan (四川彙源), GE

##### 3.2.2 Adjusting regional imbalances by pursuing rapid growth in Shandong and Hubei

The regional focus of the Systems business was traditionally placed on Beijing, East China and South China regions. Striving to achieve a more rapid growth, the Group identified the expansion of regional markets as an important growth niche. As a result, turnover of the Systems business in Hubei and Shandong for the first half of the financial year achieved growth of 75% and 309%, respectively, over the same period of the last financial year.

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### 3. Business Review *(continued)*

#### 3.2 Systems Business *(continued)*

##### 3.2.3 *Enhancing the servicing capabilities and profitability of the Systems business*

Enhancement of servicing capabilities is taken by the Group as an important strategy to increase the gross profit level of and realise added value for the Systems business. For the first half of the financial year, the Systems business recorded a turnover of HK\$74 million from the services provided, representing a 61% increase over the same period of the last financial year. There were more than 120 qualified engineers, while the number of attained service qualifications increased to nine (as shown in the following table). Meanwhile, this business also recorded growth in the gross profit margin. The management believes that the positive impact from the enhanced servicing capabilities will become more evident in the coming years.

Service qualifications attained by the Group:

- SUN LSP (Jade Grade)
- EMC-authorized PS&CS supplier
- Brocade-authorized Sole QSP Service Partner for China
- BEA-authorized Training Centre
- NETSCREEN Training Centre
- NETSCREEN Service Centre
- HP Openview Authorised Technology Centre
- IBM Partner World for Software, PWSW
- NETAPP Authorised Service Centre

##### 3.2.4 *Attempts at channel combination in the Systems business to unleash new growth potentials*

Currently there are approximately 2,500 channels, about 70% of which are systems integrators and independent software developers. With increased combination of channels, the Group can leverage fully on the competitive advantages of its product lines and technical servicing capabilities and also increase the sales volume of each individual channel, while lowering the promotion costs of new products. This approach will be an important growth strategy of the Group in future.

#### 3.3 Services Business

The Services business involves mainly hardware integration and development of software application. Major clients are from the telecommunications, banking, government and taxation sectors. Turnover for the first half of the financial year showed an increase of 12.15% as compared with the same period of the last financial year, which was attributable mainly to remarkably increases in turnover from the telecommunications and government sectors thanks to improved capabilities in customer management, project management and technology management.

## MANAGEMENT DISCUSSION AND ANALYSIS *(continued)*

### 3. Business Review *(continued)*

#### 3.3 Services Business *(continued)*

##### 3.3.1 *Account manager system showed effect with improved rates of mission fulfillment and project completion for core customers*

The Group started to develop a customer-oriented marketing regime in the first half of the financial year. To begin with, targetted customers were identified and the Group's targetted contract volume was ascertained in accordance with the IT requirements of each customer. IT requirements of all customers were consolidated and input into the integrated pipeline system for pre-sale tracking and management. A total of 135 core customers was identified at the beginning of the financial year and 110 account managers were assigned to serve these customers. In the first half of the financial year, core customers accounted for 66% of the turnover generated from the Services business, providing strong support to the growth of the Services business. At 30 September 2004, the success rate of securing contracts for specific projects with the core customers in the pipeline system reached 55%, compared to 45% at 31 March 2004.

##### 3.3.2 *Project management and project-oriented auditing regime*

After a contract is secured, the effectiveness of project management will have a direct impact on the quality of work delivered and budget control. Starting from this financial year, the Group has implemented a project management and auditing regime. On top of controls over the process, the regime also includes risk assessment and risk control parameters set in respect of the technical requirements and the project budget. In the first half of the financial year, the budget variance for projects worth over HK\$2 million was 3.32%, reflecting effective cost control of the software development projects.

##### 3.3.3 *Cooperation in technological development to facilitate a breakthrough in developing solutions for various sectors*

The Group received relatively strong support from the government as it collaborated closely with various government authorities, such as the Ministry of Science and Technology and the Ministry of Information Industry, on a number of projects. Meanwhile, the Group also cooperated closely with 18 renowned international companies for technological development as well as forming partnerships with small and medium enterprises to develop solutions.

The management is aware that despite a growth in the turnover of the Services business was recorded in the first half of the financial year, its gross profit margin dropped 1.74% to 11.31% compared to the same period of the last financial year. This was mainly attributable to relatively low gross profit margins of several hardware integration projects. However, payment terms of these projects were better and amounts due had largely been received after delivery of work.

## MANAGEMENT DISCUSSION AND ANALYSIS (continued)

### 4. Internal Management

The management realises that reinforcement of internal management would be one of the fundamental means to safeguard healthy, long-term growth after the Group suffered the loss in the first quarter of the last financial year. Three specific areas for management are identified for this financial year as a result with a view to balancing business growth and risk controls. These three areas are the establishment of a customer-oriented marketing and management regime, a process management system focused on risk controls, and a staff motivation regime linked to business performance targets.

During the first half of the financial year, sound results were achieved in each of these three areas. Following the adoption of the customer-oriented business strategy, the Group was able to reinforce its competitive strengths in the market by improved capabilities in managing customer relationships and sales process. In terms of risk controls, doubtful and bad debt provisions as a percentage of turnover of the Group in the relevant period was significantly lower at 0.19% for the first half of the financial year, compared with 0.23% for the same period of the last financial year. In respect of staff motivation, the Group has instituted a substantial change to the motivation regime for the sales team, whereby the annual remuneration of sales staff under the new regime is linked to business performance targets. The new regime not only represents a significant change in the Group's traditional concept of staff motivation method, but also plays a proactive role in the achievement of the Group's business performance targets.

### 5. Outlook

The management projects an approximate 8% growth of the IT market in the second half of the financial year, as IT spending will continue to be subject to the macro-economic control measures exercised by the PRC government. The Group expects to achieve turnover growth in tandem with the market and record solid profit growth.

In the second half of the financial year, the management will continue with the operating strategies implemented at the beginning of the financial year.

In the Distribution business, the Group will continue to enhance its strengths in low-cost competition while increased efforts will be devoted to the expansion of channels, including ongoing attempts to tap opportunities in retail channels.

In the Systems business, the management is of the opinion that the core capabilities of this business are shifting from being product-oriented to service-oriented. Therefore, the Group will continue to put emphasis on its customer servicing capabilities while focus is placed on the expansion of channels and product development. The Group will seek to develop integrated technical servicing capabilities for the Systems business through the enrichment of its technical resources, the enhancement of the service process and the provision of diversified services, so that its competitive strengths will continuously be enhanced by value-added services.

In the Services business, the Group will continue to implement the account manager system, enhance the capabilities in project management and provision of solutions, driving to realising the full value of the service business ultimately.

## MANAGEMENT DISCUSSION AND ANALYSIS (continued)

### 5. Outlook (continued)

The Group will continue to uphold the principle of prudent development and strengthen risk controls from macro to micro levels with an aim to enhance the overall value of the Group by continuously improving its ability to deploy its assets profitably.

### 6. 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\$4,584 million at 30 September 2004 which were financed by total liabilities of HK\$3,114 million, minority interests of HK\$8 million and shareholders' funds of HK\$1,462 million. The Group's current ratio at 30 September 2004 was 1.48 as compared with 1.62 at 30 June 2004 and 1.68 at 31 March 2004.

During the six months ended 30 September 2004, capital expenditure of HK\$91 million were incurred for the acquisition of fixed assets.

The aggregate interest-bearing debts as a ratio of shareholders' funds was 0.70 at 30 September 2004 as compared to 0.84 at 30 June 2004 and 0.74 at 31 March 2004. The computation of the said ratio was based on the total interest-bearing borrowings of HK\$1,030 million (30 June 2004 and 31 March 2004: HK\$1,171 million and HK\$1,009 million respectively) and shareholders' funds of HK\$1,462 million (30 June 2004 and 31 March 2004: HK\$1,397 million and HK\$1,365 million respectively).

At 30 September 2004, all the interest-bearing borrowings of the Group were denominated in United States dollar.

Part of the United States dollar borrowings amounting to approximately HK\$484 million were short-term bank borrowings repayable within one year and guaranteed by the Company. The rest of the United States dollar borrowings amounting to approximately HK\$546 million represented the syndicated loan (the "Syndicated Loan") repayable within four years counting from the date of the first drawdown and guaranteed by Digital China Limited, a wholly owned subsidiary of the Company. Part of the Syndicated Loan amounting to approximately HK\$136 million was repayable within one year and, therefore, was classified as current liabilities.

The Group's total available credit facilities at 30 September 2004 amounted to HK\$4,687 million, of which HK\$2,887 million were in trade lines, HK\$1,254 million were in short-term and revolving money market facilities and HK\$546 million were in transferable loan facility. At 30 September 2004, the facility drawn down was HK\$1,504 million in trade lines, HK\$332 million in short-term and revolving money market facilities and HK\$546 million in transferable loan facility.

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 were 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.

## MANAGEMENT DISCUSSION AND ANALYSIS (continued)

### 7. Human Resources

At 30 September 2004, the Group had approximately 4,300 (30 September 2003: approximately 4,100) full-time employees. Most of these employees were employed in the PRC. The Group offers remuneration packages in line with industry practice. Employees' remuneration includes basic salaries and bonuses. As a result of increased manpower to cope with the Group's continuous business growth and developments, the total staff costs incurred by the Group for the six months ended 30 September 2004 increased 7.1% to approximately HK\$183 million as compared with an approximate sum of HK\$171 million for the same period of the last financial year. In order to attract and retain high calibre, capable and motivated staff, the Company offers share options to staff based on the individual performance and the achievement of Company's targets. The Group is committed to providing its staff with various in-house and external training and development programs.

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

At 30 September 2004, the interests and short positions of the directors of the Company and their associates in the shares and underlying shares of the Company which were required to be notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to Divisions 7 and 8 of Part XV of the Securities and Futures Ordinance (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 recorded in the register kept by the Company pursuant to Section 352 of the SFO, or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") contained in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"), were as follows:

#### Shares of HK\$0.10 each of the Company

Name of director	Capacity	Interests in shares (Note 1)	Interests in underlying shares (Note 1)	Percentage of aggregate holding (%) (Note 2)
LI Qin	Beneficial owner	1,016,000	2,500,000	0.41
GUO Wei	Beneficial owner	904,000	10,600,000	1.34
ZENG Maochao	Beneficial owner	808,000	—	0.09
	Interest of spouse	60,000	—	0.01
LIN Yang	Beneficial owner	220,000	5,500,000	0.66
HUA Zhinian	Beneficial owner	80,000	4,200,000	0.50

Notes:

- All the above interests in the shares and underlying shares of the Company were long positions. None of the directors of the Company or their associates held any short positions in the shares or underlying shares of the Company at 30 September 2004. Interests in underlying shares of the Company represented share options granted to such directors, further details of which are set out in the section headed "Share Options" below.

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

(continued)

2. The percentages of aggregate holding were calculated on the basis of 860,629,331 shares of the Company in issue at 30 September 2004.

Save as disclosed above, at 30 September 2004, none of the directors and chief executives of the Company or their associates had any interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of the SFO) which were required to be recorded in the register kept by the Company pursuant to Section 352 of the SFO or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code.

### SHARE OPTIONS

The Company has two share option schemes. The old share option scheme of the Company was adopted on 14 May 2001 (the "2001 Share Option Scheme") and terminated on 18 July 2002. Despite termination and no further options can be granted under the 2001 Share Option Scheme, the provisions of the 2001 Share Option Scheme remain in full force and effect in all other respects to govern all outstanding options granted prior to the termination of the said scheme. The new share option scheme of the Company was adopted on 18 July 2002 (the "2002 Share Option Scheme").

#### (i) 2001 Share Option Scheme

The following table shows the movements in the share options under the 2001 Share Option Scheme during the six months ended 30 September 2004 and the options outstanding at the beginning and end of the period:

Grantee	Number of share options				Outstanding at 30/09/2004	Subscription price per share HK\$ (Note 2)	Date of grant	Exercisable period (Note 1)
	Outstanding at 01/04/2004	Granted during the period (Note 3)	Exercised during the period	Lapsed during the period				
<b>Directors</b>								
GUO Wei	2,800,000	—	—	—	2,800,000	3.180	12/07/2001	12/07/2002–11/07/2009
	2,800,000	—	—	—	2,800,000	1.976	31/08/2001	31/08/2002–30/08/2009
LIN Yang	1,500,000	—	—	—	1,500,000	3.180	12/07/2001	12/07/2002–11/07/2009
	1,500,000	—	—	—	1,500,000	1.976	31/08/2001	31/08/2002–30/08/2009
HUA Zhinian	1,100,000	—	—	—	1,100,000	3.180	12/07/2001	12/07/2002–11/07/2009
	1,100,000	—	—	—	1,100,000	1.976	31/08/2001	31/08/2002–30/08/2009
<b>Other employees</b>	32,582,000	—	—	4,161,000	28,421,000	3.604	08/06/2001	08/06/2002–19/06/2009
	1,100,000	—	—	—	1,100,000	3.180	12/07/2001	12/07/2002–11/07/2009
	19,736,000	—	883,000	1,166,000	17,687,000	1.976	31/08/2001	31/08/2002–30/08/2009

Notes:

- All options granted are subject to a vesting period of 4 years with 25% becoming exercisable on the first anniversary, 25% on the second anniversary, 25% on the third anniversary and 25% on the fourth anniversary of the respective date of grant.
- The subscription price of the options is subject to adjustment in the case of rights or bonus issues, or other similar changes in the Company's share capital.

**SHARE OPTIONS** (continued)**(i) 2001 Share Option Scheme** (continued)

- The weighted average of the closing prices of the Company's shares immediately preceding the dates on which the options were exercised was HK\$2.671.
- No options were cancelled under the 2001 Share Option Scheme during the period.

**(ii) 2002 Share Option Scheme**

The following table shows the movements in the share options under the 2002 Share Option Scheme during the six months ended 30 September 2004 and the options outstanding at the beginning and end of the period:

Grantee	Number of share options				Outstanding at 30/09/2004	Subscription price per share HK\$ (Note 2)	Date of grant	Exercisable period (Note 1)
	Outstanding at 01/04/2004	Granted during the period	Exercised during the period	Lapsed during the period				
<b>Directors</b>								
LI Qin	—	2,500,000 (Note 3)	—	—	2,500,000	2.068	24/06/2004	24/06/2005–23/06/2012
GUO Wei	5,000,000	—	—	—	5,000,000	2.750	13/10/2003	13/10/2004–12/10/2011
LIN Yang	2,500,000	—	—	—	2,500,000	2.750	13/10/2003	13/10/2004–12/10/2011
HUA Zhinian	2,000,000	—	—	—	2,000,000	2.750	13/10/2003	13/10/2004–12/10/2011
<b>Other employees</b>	50,310,000	—	—	1,110,000	49,200,000	2.750	13/10/2003	13/10/2004–12/10/2011

Notes:

- All options granted are subject to a vesting period of 4 years with 25% becoming exercisable on the first anniversary, 25% on the second anniversary, 25% on the third anniversary and 25% on the fourth anniversary of the respective date of grant.
- The subscription price of the options is subject to adjustment in the case of rights or bonus issues, or other similar changes in the Company's share capital.
- The closing price of the Company's shares on the Stock Exchange on the business day immediately preceding 24 June 2004, the date of grant of option to Mr. LI Qin, was HK\$1.990 per share.
- No options were cancelled under the 2002 Share Option Scheme during the period.

## SUBSTANTIAL SHAREHOLDERS' INTERESTS

At 30 September 2004, the following persons, not being a director or chief executive of the Company, had the following interests and short positions in the shares and underlying shares of the Company as recorded in the register required to be kept by the Company under Section 336 of the SFO:

Name	Notes	Capacity	Long	Short	Percentages of aggregate holding of long/short positions in shares (%) (Note 6)
			position held in shares	position held in shares	
Legend Holdings Limited	1, 2	Beneficial owner/ Interest of a controlled corporation	283,201,872/ 140,232,042	8,568,800	49.20/0.996
Employees' Shareholding Society of Legend Holdings Limited	1, 3	Interest of controlled corporations	423,433,914	8,568,800	49.20/0.996
General Atlantic Partners (Bermuda), L.P.	4	Beneficial owner/ Interests of persons acting in concert	92,037,409/ 19,736,591	—	12.99/—
GAP Coinvestment Partners II, L.P.	4	Beneficial owner/ Interests of persons acting in concert	12,748,289/ 99,025,711	—	12.99/—
GapStar, LLC	4	Beneficial owner/ Interests of persons acting in concert	6,988,302/ 104,785,698	—	12.99/—
GAP (Bermuda) Limited	4	Interest of a controlled corporation/ Interests of persons acting in concert	92,037,409/ 19,736,591	—	12.99/—
General Atlantic Partners, LLC	4	Interest of a controlled corporation/ Interests of persons acting in concert	6,988,302/ 104,785,698	—	12.99/—
J.P. Morgan Chase & Co.	5	Beneficial owner/ Investment manager/ Approved lending agent	600/ 75,572,200/ 53,906,700	—	15.04/—

Notes:

- The English names "Legend Holdings Limited" and "Employees' Shareholding Society of Legend Holdings Limited" are direct transliterations of their Chinese registered names "聯想控股有限公司" and "聯想控股有限公司職工持股會" respectively.
- 140,232,042 shares were held by Right Lane Limited, a wholly owned subsidiary and a controlled corporation of Legend Holdings Limited, and therefore Legend Holdings Limited was deemed to be interested in such shares by virtue of the SFO.

### **SUBSTANTIAL SHAREHOLDERS' INTERESTS** *(continued)*

3. Employees' Shareholding Society of Legend Holdings Limited was the controlling shareholder of Legend Holdings Limited and was therefore deemed to be interested in the 423,433,914 shares in which Legend Holdings Limited was interested.
4. GAP (Bermuda) Limited is the general partner of General Atlantic Partners (Bermuda), L.P., and General Atlantic Partners, LLC ("GAP LLC") is the sole member of GapStar, LLC. The individuals who are the managing members of GAP LLC are also the executive officers and directors of GAP (Bermuda) Limited. In addition, the general partners of GAP Coinvestment Partners II, L.P. are also the managing members of GAP LLC.
5. J.P. Morgan Chase & Co. was deemed to be interested in an aggregate of 129,479,500 shares by virtue of the SFO. Those interests comprised direct interests in 73,401,200 shares and 2,171,000 shares held by JF Asset Management Limited and JF International Management Inc. respectively, both of which were subsidiaries and controlled corporations of J.P. Morgan Fleming Asset Management (Asia) Inc. which itself was a subsidiary and a controlled corporation of J.P. Morgan Fleming Asset Management Holdings Inc.. J.P. Morgan Fleming Asset Management Holdings Inc. was then a subsidiary and a controlled corporation of J.P. Morgan Chase & Co.. Also, direct interest in 600 shares was held by J.P. Morgan Whitefriars Inc., which was a subsidiary controlled in turn by J.P. Morgan Overseas Capital Corporation, J.P. Morgan International Finance Limited, J.P. Morgan International Inc. and JPMorgan Chase Bank, all of which were subsidiaries and controlled corporations of J.P. Morgan Chase & Co.. In addition, JPMorgan Chase Bank had a direct interest in 53,906,700 shares of the Company.
6. The percentages of aggregate holding of long/short positions in shares were calculated on the basis of 860,629,331 shares of the Company in issue at 30 September 2004.

Save as disclosed above, at 30 September 2004, no other interests or short positions in the shares or underlying shares of the Company were recorded in the register required to be kept under Section 336 of the SFO.

### **COMPLIANCE WITH THE CONTINUING DISCLOSURE REQUIREMENTS UNDER CHAPTER 13 OF THE LISTING RULES**

In compliance with the continuing disclosure requirements under Rule 13.21 of Chapter 13 of the Listing Rules, the Board reports below details of a facility agreement which includes a condition relating to the specific performance of the controlling shareholder of the Company.

On 24 March 2003, the Company entered into a facility agreement (the "2003 Facility Agreement") with a syndicate of banks (the "Banks") for a 4-year transferable loan facility of up to US\$70 million. The said loan facility has been used by the Company to repay in full the outstanding amounts under a previous facility agreement entered into by the Company on 25 March 2002 and thereafter, finance its general working capital.

The 2003 Facility Agreement includes a condition to the effect that Legend Holdings Limited, the controlling shareholder of the Company, is to beneficially hold not less than 40% of the issued share capital of the Company throughout the term of the 2003 Facility Agreement. A breach of such condition, if not remedied within 30 days after the agent of the Banks has given written notice to the Company, shall constitute an event of default under the 2003 Facility Agreement and, upon such occurrence, all amounts outstanding under the 2003 Facility Agreement shall immediately become due and payable.

The loan facility under the 2003 Facility Agreement had been fully drawn and all remained outstanding at 30 September 2004.

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

During the six months ended 30 September 2004, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

## **AUDIT COMMITTEE**

The Company has an audit committee which now comprises members of the three independent non-executive directors of the Company, namely, Mr. LEUNG Pak To, Francis (chairman of the audit committee), Professor WU Jinglian and Mr. HU Zhao Guang. The audit committee is responsible for reviewing with the management the accounting principles and practices adopted by the Group and discussing auditing, internal control and financial reporting matters, including the review of the unaudited condensed consolidated interim financial statements for the six months ended 30 September 2004 of the Group.

## **CODE OF BEST PRACTICE**

So far as the directors of the Company are aware, the Company has complied with the Code of Best Practice as set out in Appendix 14 of the Listing Rules throughout the six months ended 30 September 2004, except that the non-executive director and independent non-executive directors of the Company are not appointed for a specific term but are subject to retirement by rotation and re-election at annual general meetings of the Company in accordance with the Company's Bye-Laws.

## **MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS OF THE COMPANY**

The Company has adopted a code of conduct regarding securities transactions by directors of the Company on terms no less exacting than the required standard set out in the Model Code contained in the Listing Rules.

On behalf of the Board

**LI Qin**

*Chairman*

Hong Kong, 23 November 2004