



Xteam Software International Limited
衝浪平台軟件國際有限公司

(incorporated in the Cayman Islands with limited liability)

FIRST QUARTERLY RESULTS REPORT
FOR THE THREE MONTHS ENDED
30TH JUNE, 2002

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

SUMMARY

- The Group is one of the early movers in the development of the Chinese Linux operating system with kernel rewritten to specifically cater for Chinese users in the PRC and software based on the Linux operating platform for various hardware appliances. While its products support personal computer applications, the Group is also widely recognised for its efficient operating system that leads the server, Internet and Internet markets. The Group also provides technical support and after sales to its customers.
- Turnover for the quarter ended 30th June, 2002 amounted to approximately HK\$7.63 million (2001: HK\$8.85 million).
- As at 30th June, 2002, the Group has net current assets of approximately HK\$18 million (2001: net current liabilities of approximately HK\$274,000) and did not have any outstanding bank loans (2001: nil).

FIRST QUARTERLY RESULTS FOR THE THREE MONTHS ENDED 30TH JUNE, 2002

The board of Directors (the “Board”) of Xteam Software International Limited (the “Company”) announce the unaudited results of the Company and its subsidiaries (collectively, the “Group”) for the three months ended 30th June, 2002, together with the unaudited comparative figures for the corresponding period in 2001, as follows:

		Three months ended 30th June,	
		2002	2001
	<i>Note</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Turnover	2	7,634	8,849
Cost of sales		(831)	(540)
Gross profit		6,803	8,309
Other income		—	39
Operating expenses		(4,207)	(5,511)
Profit from operations		2,596	2,837
Finance (cost)/income, net		(30)	2
Profit before income tax		2,566	2,839
Income tax	3	—	—
Profit for the period		2,566	2,839
Earnings per share	4		
- Basic (in cents)		0.47	0.63
- Diluted (in cents)		0.41	N/A
Dividend per share		Nil	Nil

1. Basis of presentation

The Company was incorporated as an exempted company with limited liability in the Cayman Islands on 24th May, 2001 under the Companies Law (2001 Second Revision) of the Cayman Islands. Pursuant to a reorganization of the Group in November 2001 to rationalize the structure of the Group in preparation for the listing of the shares of the Company on GEM, the Company became the holding company of the subsidiaries now comprising the Group (the "Group Reorganization"). The Company was successfully listed on GEM on 11th December, 2001. Further details of the Group Reorganization are set out in the prospectus of the Company dated 30th November, 2001 (the "Prospectus").

The unaudited results of the Group are prepared in accordance with generally accepted accounting principles in Hong Kong.

The Group comprising the Company and its subsidiaries resulting from the Group Reorganization is regarded as a continuing entity for the financial periods presented (i.e. the merger basis of accounting has been adopted in presenting the results for the respective periods).

2. Turnover

Turnover represents the invoiced value of goods sold and services rendered, net of value added tax and business tax.

3. Taxation

- (i) No provision for taxation in the Cayman Islands, the British Virgin Islands and Hong Kong has been made as the Group had no income assessable to tax for the period in those jurisdictions.
- (ii) Under the Income Tax Law of the People's Republic of China (the "PRC"), pursuant to an approval document issued by the relevant PRC tax authorities, the Company's subsidiary in the PRC is subject to income tax at the rate of 15% as an advanced-technology enterprise. The subsidiary in the PRC is exempted from income tax for the first two profitable years of operations and thereafter is entitled to a 50% relief from income tax for the following three years subject to a minimum overall tax rate of 10%. The subsidiary in the PRC has submitted an application for the aforementioned preferential tax exemptions.
- (iii) No provision for deferred taxation has been made as the Group had overall deferred tax benefits which will be recognized when realization of such benefits is assured beyond reasonable doubt.

4 Earnings per share

The calculation of basic earnings per share for the three months ended 30th June, 2002 is based on the Group's unaudited profits after tax of approximately HK\$2,566,000 (2001: HK\$2,839,000), and the number of 550,253,233 shares (2001: 448,114,286 shares).

The calculation of diluted earnings per share for the three months ended 30th June, 2002 is based on the Group's unaudited profit after tax of approximately HK\$2,566,000, and the weighted average number of 622,282,149 shares, taking into account the options granted to certain Executive Directors of the Company and employees of the Group to subscribe for a total of 106,000,000 shares of the Company under the Pre-IPO Share Option Scheme. Diluted earnings per share figures for the comparative periods are not shown as no dilutive events took place in that period.

5 Movements in reserves

	Share premium account <i>HK\$'000</i>	Accumulated losses <i>HK\$'000</i>	Total <i>HK\$'000</i>
At 1st April, 2001	10,867	(9,672)	1,195
Profit for the period	—	2,839	2,839
	<hr/>	<hr/>	<hr/>
At 30th June, 2001	10,867	(6,833)	4,034
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
At 1st April, 2002	36,248	(6,191)	30,057
Profit for the period	—	2,566	2,566
	<hr/>	<hr/>	<hr/>
At 30th June, 2002	36,248	(3,625)	32,623
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

6 Subsequent Events

Subsequent to the balance sheet date, on 26th July, 2002, the share capital and share premium account of the Company were increased by HK\$324,087 and HK\$21,713,832, respectively by the issue of additional 32,408,705 shares (the "Additional Shares") of HK\$0.01 each at a premium of HK\$0.67 per share ranking pari passu with the existing shares of the Company. The Company has obtained approval from the GEM Listing Committee for the listing of, and permission to deal in, the Additional Shares on 30th July, 2002.

INTERIM DIVIDEND

The Board does not recommend the payment of an interim dividend for the period (2001: Nil).

BUSINESS REVIEW AND PROSPECTS

General

The Group is one of the early movers in the development of the Chinese Linux operating system with kernel rewritten to specifically cater for Chinese users in the PRC and software based on the Linux operating platform for various hardware appliances. While its products support personal computer applications, the Group is also widely recognized for its efficient operating system that leads the server, Internet and Intranet markets. The Group also provides technical support and after-sales services to its customers.

On 26th July, 2002, the Company increased its share capital and share premium by issue of additional 32,408,705 new shares at HK\$0.68 per share. HK\$6 million of the proceeds received from the issue of additional shares to be used as part of the considerations for the purchase of a 60% equity interest in a company and the remaining balance, after deducting the placing expenses, to be used for possible future acquisitions and as additional working capital for the Company.

Financial

The Group reported unaudited turnover of approximately HK\$7.63 million for the quarter ended 30th June, 2002 (2001: HK\$8.85 million). The Group also reported unaudited gross profit of approximately HK\$6.80 million for the quarter ended 30th June, 2002 (2001: HK\$8.31 million).

Profit attributable to shareholders for the quarter ended 30th June, 2002 was approximately HK\$2.57 million (2001: HK\$2.84 million).

As at 30th June, 2002, the Group has net current assets of approximately HK\$18 million (2001: net current liabilities of approximately HK\$274,000) and there were no outstanding bank loans (2001: nil).

The Group continues to lead the Linux server market

In June 2002, the Group received "The Best Linux Product Award" from CCID under the Ministry of Information Industry in recognition of its efforts in providing professional products and services to its customers.

To maintain our competitive edge, we will continue to invest in developing new features. We will also enhance our server application software, even though it already enjoys wide market recognition among Internet service providers, Internet data centres and e-commerce companies.

The server market's corporate clientele minimizes the problem of intellectual property right infringement that continuously troubles the personal computer market. At the same time, corporate clients provide a stable customer base with strong spending power. In the booming PRC economy, growing Internet access and the rapid development of e-commerce is certain to fuel the demand for quality server products. As a recognized leader in the PRC server market, it is our ongoing business strategy to continue to excel in this segment.

Our commitment to service

We strongly believe that the concept of a modern product includes not only superior quality, which satisfies all the demands of our customers, it also includes value-added, after-sales services. To stay ahead of the competition, we pride ourselves in offering customers a broad range of professional services related to the development and use of open-source products, including technical support, maintenance and consulting.

For the server market, providing quality after-sales services is crucial in creating loyal, long-term, corporate customers.

Through telephone hotlines, e-mail inquiry, online and on-site services, our technical support service team and service consultants continue to offer customers a wide range of quality services that include system installation, system upgrades, display equipment, network facilities, system services, system status analysis, system error analysis and system error correction.

We are committed to upholding our status as one of the major software vendors in the PRC that is capable of providing customers with total solutions from open-source operating systems, to user-specific applications, to comprehensive services.

Strategic expansion

Because of the PRC market's rapid Internet and e-business development, we see exciting growth opportunities and intend to fully realize business potential through strategic expansion. One way is through mergers and acquisitions. We will seek vertical growth opportunities in diverse business segments, with particular focus on education, government, security, banking and insurance.

During the quarter under review, we signed a letter of intent to take up a 60% equity interest in Snow Fair Co., Ltd. ("Snow Fair"). Snow Fair is the holding company of Shanghai Pantosoft Co., Ltd., a leading software vendor in the Shanghai education software market, which has an existing clientele of about 100 education institutions, representing the largest market share of approximately 30%. The Snow Fair acquisition presents a starting point for our penetration into the education market. The opportunities are immense. The potential to digitalize the more than 700,000 schools in the region has so far not been fully realized. Children are our future. Accustomed to Linux at an early age, they will become long-term, loyal customers and are crucial to the popularization of Linux in the PRC. The success of Snow Fair in Shanghai is sure to become the template used for the digitalization of education throughout the PRC. Our acquisition of Snow Fair will allow us to become the prime mover in this field.

We can leverage our close connections in the education sector to tap business opportunities in the government sector.

On the geographical level, we have successfully expanded our foothold from Beijing, where we already enjoy an established presence, into Shanghai as planned. The acquisition of Snow Fair is a major step in the cost-effective expansion of our business to Eastern China. This will provide us with a springboard to expand our business to other key cities - Guangzhou and Shenzhen - that are among our long-term strategic targets.

To expand horizontally, we will explore business opportunities with Internet data centres, Internet service providers and e-commerce companies. While we will continue to pursue business opportunities through our core competence in the development and creation of new product features, we will also explore further collaboration with strategic partners.

One of the major reasons for our leadership position in the Linux open-source market is our creativity in developing new products and enhancing existing products. We also apply this creativity and agility to the formation of strategic partnerships.

An excellent example is the Group's strategic partnership with China Netcom Corporation Ltd. ("China Netcom"). China Netcom is one of the largest Internet data centres in the PRC, possessing a large and prestigious client base of several thousand, large, state-owned and private enterprises in the country. We have formed a partnership under which China Netcom will utilize our value-added services in the provision of broadband services to its Internet customers. We will in return enjoy continuously increasing revenue, calculated on a commission basis, depending on the total number of China Netcom's Internet customers.

To continue to strengthen our leadership status in the PRC Linux market, it is crucial for us to expand our market share relentlessly. To strengthen our sales, we will also continue collaborating with hardware and software vendors and distributors, bundling our products with their products, so as to increase our product penetration. At the same time, we will broaden market segments, extend our service capabilities and create strategic alliances.

Prospects

The software market in China grew 34% from 2000 to 2001 to reach US\$1.6 billion. According to the International Data Corporation forecast, it is expected that the PRC software market will continue to grow at a high annual compound growth rate of 36.9%, reaching US\$7.8 billion by 2006.

Recent figures released by the China Internet Network Information Centre recorded that the number of Internet users in the PRC spending more than one hour on the web per week has exceeded 450 million. This ranks China third in the world after the United States and Japan. The number of websites also reached a new high. There are a total of 300,000 websites in the country with 16,113 new websites established in the first half of 2002.

It is our intention to continue to strengthen our foothold in the Linux-based server market, especially market segments related to the Internet. The PRC Internet market boom will accelerate the demand for server products and services. As an early developer of Chinese Linux-based software in the PRC, we have engineered what we believe to be the most technically advanced open-source operating system, and the highest levels of customer service. We are well placed to capture the tremendous business opportunities of the PRC Internet and e-commerce market.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN SECURITIES

As at 30th June, 2002, the interests of the Directors and chief executives of the Company in the share capital of the Company and its associated corporations (within the meaning of the Securities (Disclosure of Interests) Ordinance ("SDI Ordinance") as recorded in the register maintained under Section 29 of the SDI Ordinance or as notified to the Company and the Stock Exchange were as follows:

Name of directors	Number of shares of the Company			
	Personal interests	Family interests	Corporate interests	Other interests
Mr. Ma Gary Ming Fai	81,481,507 (note 3)	—	116,371,349 (note 1)	—
	—	—	51,860,472 (note 2)	—
Mr. Ren Yi	—	—	81,481,507 (note 3)	—
Mr. Wu Meng Jie	6,219,962	—	—	—

Notes:

- 1 The 116,371,349 shares are held by Upwise Investments Ltd., a company incorporated in the British Virgin Islands ("BVI"), the issued capital of which is beneficially owned by Mr. Ma Gary Ming Fai.
- 2 The 51,860,472 shares are held by Princeton Venture Partners Limited, a company incorporated in the BVI, the issued capital of which is indirectly beneficially owned by Mr. Ma Gary Ming Fai and Omnitech Group Limited (formerly known as O2New Technology Limited), a company incorporated in Bermuda and whose shares are listed on the Main Board of the Stock Exchange, equally.
- 3 The 81,481,507 shares are held by One Focus Group Limited, a company incorporated in the BVI, the issued capital of which is beneficially owned by Mr. Ren Yi. However, pursuant to a loan agreement between Mr. Ma Gary Ming Fai and Mr. Ren Yi dated 20th May, 2001, the shares of One Focus Group Limited owned by Mr. Ren Yi have been deposited in the hands of Mr. Ma Gary Ming Fai and pledged to him such shares as collateral security for granting a loan to Mr. Ren Yi. Therefore, the interests of Mr. Ma Gary Ming Fai and Mr. Ren Yi of the 81,481,507 shares have been duplicated.

Save as disclosed herein, as at 30th June, 2002, none of the Directors or chief executives of the Company had any interests in the share capital of the Company or its associated corporations as recorded in the register maintained under Section 29 of the SDI Ordinance or as notified to the Company and the Stock Exchange.

DIRECTORS' AND CHIEF EXECUTIVES' RIGHTS TO ACQUIRE SHARES OR DEBT SECURITIES

Save as disclosed herein, and other than in connection with the Reorganization prior to the listing of the Company's shares on GEM, as at the date hereof, neither the Company nor any of its subsidiaries was a party to any arrangements to enable the Directors and/or the chief executives of the Company to acquire benefits by means of the acquisition of shares in, or debt securities, including debentures, of the Company or any other body corporate, and none of the Directors, chief executives or their respective spouses or children under the age of 18 had any right to subscribe for the securities of the Company, or had exercised any such right.

SUBSTANTIAL SHAREHOLDERS

As at 30th June, 2002, the register of substantial shareholders maintained under Section 16 (1) of the SDI Ordinance showed that the following persons (other than a Director or chief executive of the Company) were interested in 10 per cent or more of the issued share capital of the Company:

Name	Number of shares	Percentage of issued share capital
Upwise Investments Ltd.	116,371,349 (<i>note 1</i>)	21.15%
One Focus Group Limited	81,481,507 (<i>note 2</i>)	14.81%

Notes:

1. The entire issued share capital of Upwise Investments Ltd. is beneficially owned by Mr. Ma Gary Ming Fai, the Chairman of the Company.
2. One Focus Group Limited is a company incorporated in the BVI with limited liability and is wholly and beneficially owned by Mr. Ren Yi, an executive Director of the Company. Pursuant to a loan agreement between Mr. Ma Gary Ming Fai and Mr. Ren Yi dated 20th May, 2001, the shares of One Focus Group Limited owned by Mr. Ren Yi have been deposited in the hands of Mr. Ma Gary Ming Fai and pledged to him such shares as collateral security for granting the loan to Mr. Ren Yi.

OUTSTANDING SHARE OPTIONS

(a) Pre-IPO Share Option Scheme

As at 30th June, 2002, options to subscribe for an aggregate of 106,000,000 shares had been granted under the pre-IPO share option scheme (“Pre-IPO Share Option Scheme”) adopted by the Company on 30th May, 2001 to the following persons:

Name of grantee	Date granted	Exercise period	No. of shares eligible for subscription under the share option	Exercise price
<i>Directors</i>				
Mr. Ma Gary Ming Fai	14th November, 2001	11th June, 2002 to 13th November, 2011	50,000,000	HK\$0.266
Mr. Mak To Wai	14th November, 2001	11th June, 2002 to 13th November, 2011	30,000,000	HK\$0.266
<i>Employees</i>				
Mr. Sham Heung Sang	14th November, 2001	11th June, 2002 to 13th November, 2011	15,000,000	HK\$0.266
Mr. Szeto Wai Yau	14th November, 2001	11th June, 2002 to 13th November, 2011	11,000,000	HK\$0.266

Details of the Pre-IPO Share Option Scheme have been disclosed in the Prospectus.

None of the options granted under the Pre-IPO Share Option Scheme have been exercised, cancelled or lapsed during the period from the date of grant of such options to the date hereof.

(b) Share Option Scheme

On 21st November, 2001, the shareholders of the Company adopted a share option scheme (“Share Option Scheme”), the principal terms of which were set out on pages 199 to 208 of the Prospectus. Under the terms of the Share Option Scheme, the Board may, at their discretion, invite any full-time employees of the Group, including any executive and non-executive directors, and any advisers, consultants of or to any member of the Group to take up options to subscribe for shares in the Company.

As at 30th June, 2002, no options have been granted under the Share Option Scheme.

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

During the three months ended 30th June, 2002, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

COMPETING INTERESTS

During the period under review, none of the Directors or the management shareholders (as defined in the GEM Listing Rules) of the Company had any interest in a business that competed or might compete with the business of the Group.

INTERESTS OF SPONSOR

First Shanghai Securities Limited ("FSSL") entered into a sponsor agreement ("Sponsor Agreement") on 30th November 2001 with the Company whereby, for a fee, FSSL would act as the Company's continuing sponsor for the purpose of Chapter 6 of the GEM Listing Rules for the period from 11th December, 2001 to 31st March, 2004.

In early 2002, FSSL has undergone a business rationalization with a view to having a better demarcation of various business units, including the segregation of corporate finance and securities trading business originally operated by it. As part of the rationalization, the corporate finance business and relevant staff of FSSL had been transferred to another fellow subsidiary, First Shanghai Capital Limited ("FSCL"), with effect from 16th January, 2002.

On 16th January, 2002, the Company agreed to novate with FSCL the rights and obligations under the Sponsor Agreement. As a result, FSCL will act as the continuing sponsor of the Company until 31st March, 2004.

None of FSCL, its directors, employees or associates had any interests in the securities of the Company or any member of the Group, or any right to subscribe for or to nominate persons to subscribe for the securities of the Company or any member of the Group as at 30th June, 2002.

AUDIT COMMITTEE

As required by Rule 5.23 of the GEM Listing Rules, the Company has established an audit committee on 21st November, 2001 with written terms of reference which deal clearly with its authority and duties. The audit committee's principal duties are the review and supervision of the Company's financial reporting process and internal control systems. The audit committee comprises two independent non-executive Directors, namely Mr. Cheng Shu Wing and Mr. Wang Shi Yu. The Group's unaudited results have been reviewed by the two independent non-executive Directors, the Qualified Accountant, and the auditors of the Company.

By order of the Board
Xteam Software International Limited
Mak To Wai
Director

Hong Kong, 9th August, 2002