

Xteam Software International Limited
衝浪平台軟件國際有限公司
(Incorporated in the Cayman Islands with limited liability)



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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 (the “GEM Listing Rules”) for the purpose of giving information with regard to the Company. The directors, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: (1) the information contained in this report is accurate and complete in all material respects and not misleading; (2) there are no other matters the omission of which would make any statement in this report misleading; and (3) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.

SUMMARY

- The 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.
- Turnover for the six months ended 30th September, 2002 amounted to approximately HK\$15.50 million (2001: approximately HK\$13.34 million).
- Profit attributable to shareholders amounted to approximately HK\$3,049,000 for the six months ended 30th September, 2002 (2001: approximately HK\$2,972,000).
- The Board does not recommend the payment of an interim dividend for the period (2001: Nil).
- The Group successfully expanded its foothold in Shanghai, acquiring Snow Fair, an investment holding company of one of the largest education software vendors in the city.

INTERIM RESULTS FOR THE SIX MONTHS ENDED 30TH SEPTEMBER, 2002

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

| | <i>Note</i> | Three months ended | | Six months ended | |
|------------------------|-------------|---------------------------|--------------------|-------------------------|--------------------|
| | | 30th September, | | 30th September, | |
| | | 2002 | 2001 | 2002 | 2001 |
| | | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> | <i>HK\$'000</i> |
| | | <i>(Unaudited)</i> | <i>(Unaudited)</i> | <i>(Unaudited)</i> | <i>(Unaudited)</i> |
| Revenue | 3 | 7,871 | 4,490 | 15,504 | 13,340 |
| Cost of sales | | (2,085) | (637) | (2,915) | (1,177) |
| Gross profit | | 5,786 | 3,853 | 12,589 | 12,163 |
| Other income | | — | 1 | — | 40 |
| Operating expenses | | (5,208) | (3,709) | (9,415) | (9,220) |
| Profit from operations | | 578 | 145 | 3,174 | 2,983 |
| Finance costs | | (95) | (12) | (125) | (11) |
| Profit before tax | 4 | 483 | 133 | 3,049 | 2,972 |
| Taxation | 5 | — | — | — | — |
| Profit after tax | | 483 | 133 | 3,049 | 2,972 |
| Earnings per share | 6 | | | | |
| - Basic (in cents) | | 0.08 | 0.03 | 0.54 | 0.66 |
| - Diluted (in cents) | | 0.08 | N/A | 0.50 | N/A |
| Dividend per share | 7 | Nil | Nil | Nil | Nil |

CONSOLIDATED BALANCE SHEETS

| | | As at 30th September, 2002 <i>HK\$'000</i> <i>(Unaudited)</i> | As at 31st March, 2002 <i>HK\$'000</i> <i>(Audited)</i> |
|---|----|---|---|
| Fixed assets | 8 | 1,522 | 1,509 |
| Intangible assets | 9 | 17,133 | 18,963 |
| Current assets | | | |
| Inventories | 10 | 5,434 | 205 |
| Accounts receivable | 11 | 9,332 | 8,172 |
| Prepayments, deposits and other receivable | | 2,032 | 907 |
| Value added tax refundable | | 1,636 | 1,514 |
| Cash and bank balances | | 29,041 | 16,670 |
| | | <u>47,475</u> | <u>27,468</u> |
| Current liabilities | | | |
| Accounts payable | 12 | 1,070 | 150 |
| Other payables and accrued expenses | | 5,730 | 12,230 |
| | | <u>6,800</u> | <u>12,380</u> |
| Net current assets | | <u>40,675</u> | <u>15,088</u> |
| Net assets | | <u>59,330</u> | <u>35,560</u> |
| Share capital | 13 | 5,827 | 5,503 |
| Reserves | 14 | 53,503 | 30,057 |
| Shareholders' funds | | <u>59,330</u> | <u>35,560</u> |

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| | Share Capital <i>HK\$'000</i> | Share premium account <i>HK\$'000</i> | Accumulated losses <i>HK\$'000</i> | Total <i>HK\$'000</i> |
|--------------------------|---|---|--|---------------------------------|
| Consolidated (unaudited) | | | | |
| At 1st April, 2001 | — | 10,867 | (9,672) | 1,195 |
| Profit for the period | — | — | 2,972 | 2,972 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| At 30th September, 2001 | — | 10,867 | (6,700) | 4,167 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |
| At 1st April, 2002 | 5,503 | 36,248 | (6,191) | 35,560 |
| Issue of new shares | 324 | 21,714 | — | 22,038 |
| Share issue expenses | — | (1,317) | — | (1,317) |
| Profit for the period | — | — | 3,049 | 3,049 |
| | <hr/> | <hr/> | <hr/> | <hr/> |
| At 30th September, 2002 | 5,827 | 56,645 | (3,142) | 59,330 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |

CONSOLIDATED CASH FLOW STATEMENT

| | For the six months ended 30th September, | |
|---|--|---------------------|
| | 2002 | 2001 |
| | HK\$'000 | HK\$'000 |
| | (Unaudited) | (Unaudited) |
| Net cash outflow from operating activities | <u>(8,147)</u> | <u>(1,423)</u> |
| Investing activities | | |
| Purchase of fixed assets | (203) | (12) |
| Purchase of intangible assets | <u>—</u> | <u>(8,561)</u> |
| Net cash outflow from investing activities | <u>(203)</u> | <u>(8,573)</u> |
| Net cash outflow before financing | <u>(8,350)</u> | <u>(9,996)</u> |
| Financing activities | | |
| Issue of convertible bond | — | 6,000 |
| Issue of new shares | 22,038 | — |
| Share issue expenses | <u>(1,317)</u> | <u>—</u> |
| Net cash inflow from financing | <u>20,721</u> | <u>6,000</u> |
| Increase in cash and cash equivalents | 12,371 | (3,996) |
| Cash and cash equivalents at 1st April, | <u>16,670</u> | <u>6,318</u> |
| Cash and cash equivalents at 30th September, | <u><u>29,041</u></u> | <u><u>2,322</u></u> |
| Analysis of the balances of cash and cash equivalents | | |
| Cash and bank balances | <u><u>29,041</u></u> | <u><u>2,322</u></u> |

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. The shares of the Company have been listed on GEM of the Stock Exchange since 11th December 2001.

Pursuant to a group re-organization (the "Reorganization") 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. Details of the Reorganization and corporate structure were set out in the prospectus of the Company dated 30th November, 2001 ("Prospectus").

The Company is an investment holding company. The Group is principally engaged in the provision of the Chinese Linux operating system with kernel rewritten to cater for Chinese users and software based on the Linux operating platform for various hardware appliances including servers and personal computers in the PRC. It also provides technical support and after-sales services to its customers.

2. Principal accounting policies

The unaudited interim financial statements have been prepared in accordance with Hong Kong Statement of Standard Accounting Practice 25 "Interim Financial Reporting", and on a basis consistent with the accounting policies adopted by the Group in preparation of its financial statements for the year ended 31st March, 2002.

The financial statements are prepared on historical convention and in accordance with the disclosure requirements of the Hong Kong Companies Ordinance and the GEM Listing Rules.

3. Turnover and revenue

Turnover represents the invoiced value of goods sold and services rendered, net of value added tax and business tax in the PRC, and after allowances for goods returned and trade discounts.

Turnover consisted of:

| | Three months ended | | Six months ended | |
|--|--------------------|--------------|------------------|---------------|
| | 30th September, | | 30th September, | |
| | 2002 | 2001 | 2002 | 2001 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| Sales of computer software | 7,871 | 4,490 | 14,921 | 13,340 |
| Provision of software development and related services | — | — | 583 | — |
| | <u>7,871</u> | <u>4,490</u> | <u>15,504</u> | <u>13,340</u> |

4. Profit before taxation

Profit before taxation was arrived at after crediting and charging the following:

| | Three months ended 30th September, | | Six months ended 30th September, | |
|-----------------------------------|---------------------------------------|-------------|-------------------------------------|-------------|
| | 2002 | 2001 | 2002 | 2001 |
| | HK\$'000 | HK\$'000 | HK\$'000 | HK\$'000 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| Crediting: | | | | |
| Interest income on bank deposits | 39 | 10 | 52 | 48 |
| | <u>39</u> | <u>10</u> | <u>52</u> | <u>48</u> |
| Charging: | | | | |
| Depreciation of fixed assets | 97 | 95 | 190 | 181 |
| Amortization of intangible assets | 916 | 633 | 1,830 | 1,149 |
| Provision of bad debts | — | 930 | — | 930 |
| | <u>—</u> | <u>930</u> | <u>—</u> | <u>930</u> |

5. 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.

6. Earnings per share

The calculation of basic earnings per share for the six months and three months ended 30th September, 2002 is based on the Group's unaudited profits after tax of approximately HK\$3,049,000 and HK\$483,000, respectively (2001: HK\$2,972,000 and HK\$133,000, respectively), and on the weighted average number of 561,233,231 shares and 572,093,882 shares, respectively, in issue during the period (2001: 448,114,286 shares and 448,114,286 shares, respectively).

The calculation of diluted earnings per share for the six months and three months ended 30th September, 2002 is based on the Group's unaudited profit after tax of approximately HK\$3,049,000 and HK\$483,000, respectively, and the weighted average number of 611,206,113 shares and 595,854,993 shares, respectively, taking into account the options granted to certain executive directors of the Company and employees of the Group to subscribe for a total of 91,000,000 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.

7. Dividend

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

8. Fixed assets

As at 30th September, 2002 (*unaudited*):

| | Leasehold improvements <i>HK\$'000</i> | Computer equipment <i>HK\$'000</i> | Furniture and fixtures <i>HK\$'000</i> | Office equipment <i>HK\$'000</i> | Motor vehicles <i>HK\$'000</i> | Total <i>HK\$'000</i> |
|-------------------------------------|--|--|---|--|--------------------------------------|--------------------------|
| Cost | | | | | | |
| 1st April, 2002 | 49 | 1,442 | 18 | 337 | 391 | 2,237 |
| Additions | — | 195 | — | 8 | — | 203 |
| | <u>49</u> | <u>1,637</u> | <u>18</u> | <u>345</u> | <u>391</u> | <u>2,440</u> |
| 30th September, 2002 | 49 | 1,637 | 18 | 345 | 391 | 2,440 |
| Depreciation | | | | | | |
| 1st April, 2002 | 19 | 440 | 7 | 128 | 134 | 728 |
| Charges for the period | 5 | 124 | 1 | 24 | 36 | 190 |
| | <u>24</u> | <u>564</u> | <u>8</u> | <u>152</u> | <u>170</u> | <u>918</u> |
| 30th September, 2002 | 24 | 564 | 8 | 152 | 170 | 918 |
| Net book value | | | | | | |
| 30th September, 2002 | <u>25</u> | <u>1,073</u> | <u>10</u> | <u>193</u> | <u>221</u> | <u>1,522</u> |
| 31st March, 2002 (<i>audited</i>) | <u>30</u> | <u>1,002</u> | <u>11</u> | <u>209</u> | <u>257</u> | <u>1,509</u> |

9. Intangible assets

As at 30th September, 2002 (*unaudited*):

| | Internet platform <i>HK\$'000</i> | Trademarks <i>HK\$'000</i> | Computer software <i>HK\$'000</i> | Total <i>HK\$'000</i> |
|-------------------------------------|---|-------------------------------|---|--------------------------|
| Cost | | | | |
| 1st April, 2002 | 2,782 | 2,366 | 16,758 | 21,906 |
| Additions | — | — | — | — |
| | <u>2,782</u> | <u>2,366</u> | <u>16,758</u> | <u>21,906</u> |
| 30th September, 2002 | 2,782 | 2,366 | 16,758 | 21,906 |
| Amortization | | | | |
| 1st April, 2002 | — | 241 | 2,702 | 2,943 |
| Charges for the period | 70 | 55 | 1,705 | 1,830 |
| | <u>70</u> | <u>296</u> | <u>4,407</u> | <u>4,773</u> |
| 30th September, 2002 | 70 | 296 | 4,407 | 4,773 |
| Net book value | | | | |
| 30th September, 2002 | <u>2,712</u> | <u>2,070</u> | <u>12,351</u> | <u>17,133</u> |
| 31st March, 2002 (<i>audited</i>) | <u>2,782</u> | <u>2,125</u> | <u>14,056</u> | <u>18,963</u> |

10. Inventories

| | As at 30th September, 2002 <i>HK\$'000</i> <i>(Unaudited)</i> | As at 31st March, 2002 <i>HK\$'000</i> <i>(Audited)</i> |
|---|---|---|
| Raw materials and low value consumables — at cost | 5,282 | 97 |
| Finished goods — at net realizable value | 152 | 108 |
| | <u>5,434</u> | <u>205</u> |

11. Accounts receivable

An ageing analysis of accounts receivable is set out as follows:

| | As at 30th September, 2002 <i>HK\$'000</i> <i>(Unaudited)</i> | As at 31st March, 2002 <i>HK\$'000</i> <i>(Audited)</i> |
|--------------|---|---|
| 0 — 30 days | 8,101 | 72 |
| 31 — 60 days | — | 2,279 |
| 61 — 90 days | — | 4,232 |
| Over 90 days | 1,231 | 1,589 |
| | <u>9,332</u> | <u>8,172</u> |

Generally, the Group grants credit terms to its customers, which range from 30 to 90 days.

12. Accounts payable

An ageing analysis of accounts payable is set out as follows:

| | As at 30th September, 2002 <i>HK\$'000</i> <i>(Unaudited)</i> | As at 31st March, 2002 <i>HK\$'000</i> <i>(Audited)</i> |
|--------------|---|---|
| 0 — 30 days | 940 | 4 |
| 31 — 60 days | — | — |
| 61 — 90 days | — | — |
| Over 90 days | 130 | 146 |
| | <u>1,070</u> | <u>150</u> |

13. Share capital

| | 30th September, 2002 | | 31st March, 2002 | |
|---|----------------------|--------------------------|----------------------|--------------------------|
| | <i>(Unaudited)</i> | | <i>(Audited)</i> | |
| | Number of shares | Nominal value HK\$ | Number of shares | Nominal value HK\$ |
| Authorized: | | | | |
| Ordinary shares of HK\$0.01 each | <u>1,000,000,000</u> | <u>10,000,000</u> | <u>1,000,000,000</u> | <u>10,000,000</u> |
| Issued and fully paid: | | | | |
| As at 1st April | 550,253,233 | 5,502,532 | — | — |
| Shares issued during the period/year | <u>32,408,705</u> | <u>324,087</u> | <u>550,253,233</u> | <u>5,502,532</u> |
| As at 30th September, 2002 | <u>582,661,938</u> | <u>5,826,619</u> | <u>550,253,233</u> | <u>5,502,532</u> |

Details of changes of share capital during the Interim Period are as follows:

On 26th July, 2002, 30,408,705 and 2,000,000 new ordinary shares of HK\$0.01 each in the capital of the Company were issued to Webberton Investments Limited (“Webberton”) and Angle Ventures II Limited (“Angel Ventures”), respectively, at HK\$0.68 each pursuant to a subscription agreement entered into between Webberton, Angel Ventures and the Company on 12th June, 2002. These shares were issued upon the completion of the placing of 32,408,705 existing ordinary shares of the Company registered in the name of Webberton (as to 30,408,705 ordinary shares) and Angel Ventures (as to 2,000,000 ordinary shares) to not fewer than six independent places pursuant to a placing agreement entered into between Christfund Securities Limited as the placing agent, Webberton and Angel Ventures on 12th June, 2002.

14. Reserves

| | Share premium account HK\$'000 | Accumulated losses HK\$'000 | Total HK\$'000 |
|---------------------------------|---|-----------------------------------|-------------------|
| <i>Consolidated (unaudited)</i> | | | |
| At 1st April, 2001 | 10,867 | (9,672) | 1,195 |
| Profit for the period | <u>—</u> | <u>2,972</u> | <u>2,972</u> |
| At 30th September, 2001 | <u>10,867</u> | <u>(6,700)</u> | <u>4,167</u> |
| At 1st April, 2002 | 36,248 | (6,191) | 30,057 |
| Issue of new shares | 21,714 | — | 21,714 |
| Share issue expenses | (1,317) | — | (1,317) |
| Profit for the period | <u>—</u> | <u>3,049</u> | <u>3,049</u> |
| At 30th September, 2002 | <u>56,645</u> | <u>(3,142)</u> | <u>53,503</u> |

15. Subsequent events

On 2nd October, 2002, the Company entered into the Sale and Purchase Agreement with Cosmos Town Limited ("Vendor"), a company incorporated in the British Virgin Islands ("BVI") in relation to the acquisition of 51% of the issued share capital of Snow Fair Co., Ltd. ("Snow Fair"), a company incorporated in the BVI held by the Vendor at a consideration of HK\$12,224,000, comprising (i) an amount equivalent to HK\$9,391,000; and (ii) the allotment and issued by the Company of the Consideration Shares (i.e. 5,666,000 shares of HK\$0.01 par value each of the Company), credited as fully paid, to the Vendor.

The details of the above transactions have been disclosed in the announcement of the Company dated 2nd October, 2002 on the GEM website and the circular of the Company dated 28th October, 2002 to its shareholders.

MANAGEMENT DISCUSSION AND ANALYSIS

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 each.

Market Overview

China is opening its doors to the world; its economy is being liberalized. This brings new business opportunities as well as new challenges to the domestic market. Inefficient companies will lose market share as they compete with more modernized companies that embrace the competitive advantages of information technology. That is why effective database management, customized software and servers are now in-demand business tools. And that demand for advanced information technology is rising, creating room for the Group's business expansion.

The PRC software market is unique. Unlike the more mature US software market where vendors seldom approach end-users, PRC vendors need to reach out to secure Chinese software users.

Xteam, with its in-depth understanding of the unique PRC software market, has a long-term strategic goal of securing clients from different sectors. The Group has identified end-users in education, utilities and government departments.

Focused Strategy

Strategic Expansion

As detailed in the Prospectus, one of the Group's primary business objectives is to increase its client base in diverse business sectors. The Group will do this by expanding from our Beijing headquarters into Shanghai and other major cities. The Group will also work in collaboration with other technology companies to create synergies, resulting in the national expansion of our sales and distribution channels.

A significant achievement in the period under review was the acquisition of Snow Fair, the holding company that has a controlling interest in Shanghai Pantosoft.

On 2nd October, 2002, the Group entered into a conditional Sales and Purchase Agreement for the acquisition of a 51% shareholding in Snow Fair for an aggregate consideration of HK\$12,224,000. The acquisition of Shanghai Pantosoft allows the Group to tap the education sector — a new market for the Group — as a category leader. Shanghai Pantosoft is the leading vendor in Shanghai's education software market. Its present clientele numbers approximately 100 educational institutions, representing approximately 30% market share.

The acquisition is in line with the Group's long-term expansion strategy of increasing market share and securing clients in diverse business sectors through mergers and acquisitions.

There are over 700,000 schools in China. Only a small fraction of these have been digitalized. The PRC government is committed to digitalizing all schools in the country. To further penetrate the education market, the Group is now leveraging Shanghai Pantosoft's pre-eminent position by negotiating with entities that have strong government connections.

In addition to the business opportunities made possible by the close relationship between education and government, this acquisition is likely to boost business in the server market — the Group's core business. Currently, the digitalization of schools usually only extends to administrative support, such as the management of students' data, fee collection and expense management. The full digitalization of schools will create a demand for server products that is on a par with any corporate client.

Shanghai Pantosoft is also actively expanding its software portfolio to cover other market segments, such as the digitalization of libraries.

Stronger Footbold

Xteam is headquartered in Beijing and has a national network of 100 system integrators and software vendors. As Beijing is the administrative heart of China, the Group will continue to maintain a strong presence in the capital, even when it expands nationally.

Xteam has become an established software brand through innovation. The Group launched the first Chinese Linux Operating System in China, literally "creating" the Chinese Linux market. Our groundbreaking software set an industry record, selling 100,000 licensed copies in four months.

As our brand has won recognition, so too has the Group's senior management. In August 2002, Mr. Ren Yi, Co-chairman of Xteam Software International Limited, was awarded the "Invaluable Contribution Award" (博大貢獻獎) by the Developing Zone (開發區) of the Beijing Government. The award was bestowed for Mr. Ren Yi's contributions in the advancement of economic development and technology research and development.

Excelling in the Server Market

Linux, because of its stability, safety and competitive pricing, is becoming the preferred technology for servers. Linux currently has less than 1% market share in the PRC. Based on its success in the US market, where it has captured the second largest market share after Windows, there is potential for further growth in the PRC's server market.

The Group's server application software enjoys market recognition among Internet service providers, Internet data centers and e-commerce companies. The Group's turnover for the six months and three months ended 30th September, 2002 enjoyed 16% and 75% growth respectively, compared with the same period last year.

The Group's key strengths lie in server application software. The Group will continue to target this market. There are compelling business reasons behind this strategy. Firstly, corporate clients have stronger spending power when compared with individual PC users. Secondly, the server market's corporate clientele face minimal intellectual property infringement issues. And thirdly, the opening up of the PRC's economy will stimulate further demand for server products, especially from small to medium-sized enterprises.

Service Commitment

Xteam strongly believes that a modern product is not just about superior quality; it should also include premier value-added services. That is what our customers expect — software with excellent after-sales and technical support. And that is what the Group will always provide.

The Group has built a solid reputation as a reliable Linux product developer. This reputation has been based on a combination of technology and service that has helped our clients to run their organizations more efficiently and effectively.

Our focus on service is also part of Xteam's strategy to expand into higher margin services, including consultancy services. The Group will only realize this business objective by being true to our philosophy of "high-quality products and exceptional service."

The Group has almost completed the setting up of a laboratory for the e-solution project in Beijing as planned. A team of engineers, technical experts and consultants in the laboratory will dedicate their efforts to developing e-solutions that combine products and services, including enterprise-level electronic business solutions, Intranet and Internet solutions and database solutions, to meet customer needs.

Prospects

When China joined the WTO pledges were made by the PRC government respecting Intellectual Properties Rights. A law was passed in 2001 that sanctioned rigorous penalties, including jail sentences, for the use of pirated goods.

Last December, Beijing police raided illegal vendors and confiscated pirated software. The enforcement of intellectual property laws had a positive impact on Xteam's sales. Continued diligence and firm, swift action in enforcing intellectual property rights is crucial for the healthy development of the software industry.

Moreover, the PRC government is actively encouraging the domestic software industry with the recent introduction of the "Government Purchasing Ordinance" (政府採購法). Under this ordinance, Government departments will favor PRC-developed software when investing in new information technology.

With the PRC government's committed support in advancing the information technology industry, Linux's foothold in the increasingly sophisticated PRC software market is more secure.

According to data released in July by the Ministry of Information Industry's CCID, Linux sales in the PRC for the first half of 2002 reached RMB58 million, growing by 65.7% when compared with the same period last year. It is expected that the high growth rate will continue. By 2005, Linux sales in the PRC will reach RMB427 million, representing a compound annual growth rate of 40.4%.

In addition to the increasing popularity of Linux, the Internet and e-commerce sectors have the potential to be strong drivers of growth for Xteam.

According to data released by China Internet Network Information Center, the number of host computers reached 16.13 million units for the first half of 2002, growing by 61.0% when compared with the same period last year. The number of Internet users in China reached 45.8 million, growing by 72.8% when compared with the same period last year. This represents a penetration rate of less than 4% of China's total population while the penetration rate for the U.S. is believed to be about 60%.

China's economy is changing. Entry into the WTO is accelerating Chinese companies' conversion into electronic enterprises in readiness for globalization. This is stimulating demand for software and server solutions. Xteam, as a vendor with an established brand, is poised to capitalize on new opportunities. Our operating systems for Chinese users, the strategic acquisition of domestic software leaders, our diversification into areas of growth, and our high-quality products and services position us as a prime mover in the emerging Chinese software market.

FINANCIAL REVIEW

The Group reports an unaudited consolidated turnover of approximately HK\$15.50 million for the six months ended 30th September, 2002, representing an increase of approximately 16.2% over the corresponding period in 2001 (2001: approximately HK\$13.34 million).

Profit attributable to shareholders for the six months ended 30th September, 2002 was approximately HK\$3,049,000 (2001: approximately HK\$2,972,000).

LIQUIDITY, FINANCIAL RESOURCES AND DEBT RATIO

As at 30th September, 2002, the Group has no outstanding bank loans (as at 31st March, 2001: Nil).

The debt ratio (defined as total liabilities over total assets) of the Group as at 30th September, 2002 was approximately 10.3% (as at 31st March, 2002: 25.8%). The significant improvement was due to additional proceeds received from the issue of new shares during the period.

CAPITAL STRUCTURE, EXPOSURE TO EXCHANGE RATES FLUCTUATION

As at 30th September, 2002 the Group held cash and cash equivalents denominated in Hong Kong Dollars and Renminbi.

Substantially all of the revenue-generating operations of the Group are transacted in Renminbi, which is not freely convertible into foreign currencies. The Group had prudent policy to manage currency and interest rate exposures, and as most of the Group's monetary assets and liabilities are denominated in Renminbi and Hong Kong Dollars, the exchange rate risks of the Group is considered minimal.

FINANCIAL INSTRUMENTS

The carrying amounts of the Group's cash and cash equivalents, trade receivables and payable, other receivables and payables, approximately their fair values because of the short maturity of these instruments.

The Group did not enter into any foreign exchange forward contracts to hedge against fluctuations.

PROSPECTS OF NEW PRODUCTS

The Group considers that the server market is the main target market; therefore, the Group intends to put more efforts in developing and creating new features and in the enhancement of its server application software.

MATERIAL ACQUISITIONS AND DISPOSALS DURING THE PERIOD AND FUTURE PLANS FOR MATERIAL INVESTMENTS

On 2nd October, 2002, the Company entered into the Sale and Purchase Agreement with the Vendor, a company incorporated in the BVI in relation to the acquisition of 51% of the issued share capital of Snow Fair, a company incorporated in the BVI held by the Vendor at a consideration of HK\$12,224,000, comprising (i) an amount equivalent to HK\$9,391,000; and (ii) the allotment and issued by the Company of the Consideration Shares (i.e. 5,666,000 shares of HK\$0.01 par value each of the Company), credited as fully paid, to the Vendor. Snow Fair is an investment holding company whose sole asset comprises in Pantosoft International Limited, a company incorporated in the BVI, which in turns holds the entire equity interest in Shanghai Pantosoft, a company established in the PRC, as its sole assets. Shanghai Pantosoft is principally engaged in the development of education software as well as digital campus in the PRC.

The details of the above transactions have been disclosed in the announcement of the Company dated 2nd October, 2002 on the GEM website and the circular of the Company dated 28th October, 2002 to its shareholders.

SEGMENTAL INFORMATION

No analysis of the Group's turnover and its contribution to profit before taxation by principal activities for the year were presented as more than 90% of the Group's turnover and operating results were arising from the sales of computer software and rendering of software development and related services in PRC.

STAFF

As at 30th September, 2002, the Group employed 65 employees, including directors of the Company, (2001: 60) at market remuneration and benefits such as defined retirement contributions, employee share options and medical insurance, etc. Total staff costs for the reported year were approximately HK\$2.98 million (2001: approximately HK\$2.38 million). The decrease is mainly due to the introduction of a new salaries and benefits policy ("New Policy") in March 2001. Under the New Policy, various performance criteria were introduced in the calculation of staff salaries and benefits, including meeting objectives, teamwork, sales and efficiencies. The purpose of the New Policy is mainly to motivate the staff members to be efficient and sales driven and to provide value added service to the Group.

CHARGE OF ASSETS

As at 30th September, 2002, the Group did not have any charge on its assets (as at 31st March, 2002: Nil).

CONTINGENT LIABILITIES

As at 30th September, 2002 the Group did not have any material contingent liabilities (as at 31st March, 2002: Nil).

COMPARASION OF USE OF PROCEEDS

The net proceeds raised from the placing on 11th December, 2001 were approximately HK\$18.96 million (based on HK\$0.38 placing price). The proceeds had been applied to achieve the business objectives as set out in the prospectus dated 30th November, 2001 and are detailed below:

| | For the six months ended 30th September, 2002 | | From the date listed on GEM on 11th December, 2001 to 30th September, 2002 | |
|---|---|------------------------|---|------------------------|
| | Proposed HK\$'million | Actual HK\$'million | Proposed HK\$'million | Actual HK\$'million |
| For product development or related investment through, among other things, acquisition, direct or indirect investment in other Linux based product developers | 1.50 | 1.50 | 4.00 | 4.00 |
| For enhancement of the Group's distribution channels through, among other things, acquisition, direct or indirect investment in other distributors | 1.00 | 1.00 | 1.00 | 1.00 |
| For setting up of a laboratory for e-solution project in Beijing, the PRC | 1.00 | 1.75 | 2.50 | 1.80 |
| For setting up Linux Training and Certificate Programme in Beijing, the PRC | 0.00 | 0.00 | 1.00 | 0.02 |
| For setting up the Group's Shanghai sales office | 0.00 | 0.50 | 1.50 | 0.55 |
| For advertising and marketing activities of the Group to promote the brand awareness and products of the Group | 1.00 | 0.74 | 2.00 | 1.03 |
| General working capital | 0.20 | 0.10 | 0.40 | 0.65 |
| | 4.70 | 5.59 | 12.40 | 9.05 |

Unused net proceeds were placed with licensed banks in Hong Kong and PRC, and would be used to achieve objectives as stated in the prospectus.

REVIEW OF BUSINESS OBJECTIVES

| | Business Objectives | Actual Business Progress |
|---------------------------------------|---|--|
| Product launches, sales and marketing | <ul style="list-style-type: none"> Continue to launce additional series of XteamServer and e-solutions to cover more sectors | The Group continues to expand XteamServer series |
| | <ul style="list-style-type: none"> Continue to co-operate with the hardware vendors and distributors to deploy more embedded systems | The Group is seeking co-operation opportunities with the hardware vendors and distributors to deploy more embedded systems |
| | <ul style="list-style-type: none"> Improve e-solution through strengthening its collaboration with software vendors and distributors | The Group is seeking co-operation opportunities with the software vendors and distributors to provide e-solutions |
| | <ul style="list-style-type: none"> Expand its sales and distribution channels | The Group had improved sales and distribution channels |
| | <ul style="list-style-type: none"> Launch upgraded XteamLinux series | In progress |
| Business development | <ul style="list-style-type: none"> Develop a program for applications development and marketing | In progress |
| | <ul style="list-style-type: none"> Explore opportunities to set up consulting business | |
| | <ul style="list-style-type: none"> Co-operate with more software vendors and distributors to provide more solutions for clients in different sectors | The Group had entered into various co-operation with different software vendors and distributors to provide solutions for clients in different sectors |
| | <ul style="list-style-type: none"> Co-operate with more distributors to deploy more e-solutions | The Group had entered into various co-operation with different distributors to deploy more e-solutions |

| | Business Objectives | Actual Business Progress |
|--|---|---|
| Research and development | <ul style="list-style-type: none"> Continue research and development for embedded system and e-solution | In progress |
| | <ul style="list-style-type: none"> Upgrade XteamLinux series | In progress |
| | <ul style="list-style-type: none"> Upgrade XteamServer series | |
| Human resources, operations and administration | <ul style="list-style-type: none"> Recruit additional development engineers | In progress |
| | <ul style="list-style-type: none"> Strengthen the Group's support services and start to provide enterprise consulting services | In progress |
| | <ul style="list-style-type: none"> Recruit additional dedicated sales staff in Hong Kong to cover overseas markets | In progress |
| Strategic acquisitions and alliances | <ul style="list-style-type: none"> Explore opportunities to acquire or form alliances with companies providing synergies and technological support | The Group entered into a Sale and Purchase Agreement with a company which has software development and distribution operation in Shanghai. The Group is still continuing to explore opportunities to acquire or form alliances with companies providing synergies and technological support |
| | <ul style="list-style-type: none"> Explore opportunities to acquire suitable software distributors | The Group entered into a Sale and Purchase Agreement with a company which has software development and distribution operation in Shanghai. The Group is still continuing to explore opportunities to acquire suitable software distributors |

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN SECURITIES

As at 30th September, 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 <i>(note 3)</i> | — | 116,371,349 <i>(note 1)</i> | — |
| | — | — | 51,860,472 <i>(note 2)</i> | — |
| Mr. Ren Yi | — | — | 81,481,507 <i>(note 3)</i> | — |
| 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 September, 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 September, 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>) | 19.97% |
| One Focus Group Limited | 81,481,507 (<i>note 2</i>) | 13.98% |

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

Pursuant to the pre-IPO share option scheme (the "Pre-IPO Share Option Scheme") of the Company adopted on 30th May, 2001, the Directors and employees of the Group may be granted share options to subscribe for shares of the Company at an exercise price of HK\$0.266 each. All options have a duration of 10 years from the date of grant of the options and exercisable after six months from the date of listing of the Company on GEM on 11th December, 2001.

As at 30th September, 2002, there were 91,000,000 (as at 31st March, 2002: 106,000,000) outstanding share options granted under the Pre-IPO Share Option Scheme, with option period from 14th November, 2001 to 13th November, 2011. During the Interim Period, 15,000,000 outstanding share options were lapsed due to the resignation of an employee. Details of the outstanding share options granted under the Pre-IPO Share Option Scheme as at 30th September, 2002 are summarized as follows:

| 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>Employee</i> | | | | |
| 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.

No share options were exercised under the Pre-IPO Share Option Scheme since its adoption.

(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 September, 2002, no options have been granted under the Share Option Scheme.

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

During the six months ended 30th September, 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 September, 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.

BOARD PRACTICES AND PROCEDURES

The Company has complied with Board Practices and Procedures as set out in Rules 5.28 to 5.39 of the GEM Listing Rules since listed on GEM of the Stock Exchange.

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

Hong Kong, 8th November, 2002