



Billybala Holdings Limited

(incorporated in the Cayman Islands with limited liability)

Third Quarterly Report 2002



CHARACTERISTICS OF THE GROWTH ENTERPRISE MARKET (“GEM”) OF THE STOCK EXCHANGE OF HONG KONG LIMITED (THE “STOCK EXCHANGE”)

GEM has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. Furthermore, there may be risks arising out of the emerging nature of companies listed on GEM and the business sectors or countries in which the companies operate. Prospective investors should be aware of the potential risks of investing in such companies and should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

Given the emerging nature of companies listed on GEM, there is a risk that securities traded on GEM may be more susceptible to high market volatility than securities traded on the Main Board and no assurance is given that there will be a liquid market in the securities traded on GEM.

The principal means of information dissemination on GEM is publication on the Internet website operated by the Stock Exchange. Listed companies are not generally required to issue paid announcements in gazetted newspapers. Accordingly, prospective investors should note that they need to have access to the GEM website in order to obtain up-to-date information on GEM-listed issuers.

UNAUDITED RESULTS

The board of directors (the "Board") of Billybala Holdings Limited (the "Company") announces the unaudited condensed consolidated profit and loss account of the Company and its subsidiaries (the "Group") for the three months and nine months ended 30 September 2002 together with the comparative figures as follows:

| | Notes | Three months ended 30 September | | Nine months ended 30 September | |
|--|-------|------------------------------------|-------------|-----------------------------------|-------------|
| | | 2002 | 2001 | 2002 | 2001 |
| | | HK\$ | HK\$ | HK\$ | HK\$ |
| TURNOVER | 2 | 54,753 | 163,555 | 90,322 | 163,555 |
| Other revenue | | 44,771 | - | 181,319 | 45,016 |
| Staff costs, including directors' remuneration | | (1,338,603) | (508,349) | (3,598,203) | (1,330,464) |
| Depreciation | | (80,444) | (39,128) | (234,340) | (116,990) |
| Royalties for game contents | | (50,047) | - | (196,062) | - |
| Research and development costs | | (657,438) | (383,844) | (767,473) | (1,948,657) |
| Marketing and promotion expenses | | (149,518) | (752,320) | (285,399) | (786,120) |
| Other operating expenses | | (1,054,313) | (1,378,966) | (2,727,791) | (2,832,252) |
| LOSS FROM OPERATING ACTIVITIES BEFORE TAX | | (3,230,839) | (2,899,052) | (7,537,627) | (6,805,912) |
| Tax | 3 | - | - | - | - |
| LOSS BEFORE MINORITY INTERESTS | | (3,230,839) | (2,899,052) | (7,537,627) | (6,805,912) |
| Minority interests | | - | - | - | - |
| NET LOSS ATTRIBUTABLE TO SHAREHOLDERS | | (3,230,839) | (2,899,052) | (7,537,627) | (6,805,912) |
| DIVIDENDS | 4 | - | - | - | - |
| LOSS PER SHARE | | | | | |
| Basic (Hong Kong Cents) | 5 | 0.73 | 0.79 | 1.71 | 1.86 |

NOTES TO THE CONDENSED FINANCIAL STATEMENTS

1. Group reorganization and basis of presentation

Group reorganization

Pursuant to a group reorganization (the "Group Reorganization") to rationalize the structure of the Group in preparation for the listing of shares of the Company on the Growth Enterprise Market (the "GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 13 December 2001, the Company became the holding company of the companies now comprising the Group on 24 September 2001. Further details of the Group Reorganization are set out in the Company's prospectus dated 6 December 2001 (the "Prospectus").

Basis of presentation and consolidation

The Group Reorganization has been accounted for by the Company using the merger basis of accounting in accordance with the Statement of Standard Accounting Practice ("SSAP") 27 "Accounting for Group Reconstructions" issued by the Hong Kong Society of Accountants.

On this basis, the unaudited comparative figures for the nine months ended 30 September 2001 included the results of all of the companies now comprising the Group as if the current Group structure had been in existence throughout the periods or since their respective dates of incorporation, where this was a shorter period.

All significant transactions and balances among the companies comprising the Group are eliminated on consolidation.

2. Turnover and revenue

The Group's turnover for the periods represents the net invoiced value of services rendered, after allowances and discounts.

3. Tax

No Hong Kong profits tax has been provided as the Group did not generate any assessable profits in Hong Kong during the three months and nine months ended 30 September 2002 (three months and nine months ended 30 September 2001: Nil).

4. Dividends

The Board does not recommend the payment of an interim dividend in respect of the three months and nine months ended 30 September 2002 (three months and nine months ended 30 September 2001: Nil).

5. Loss per share

The calculation of basic loss per share is based on the unaudited consolidated net loss attributable to shareholders for the three months and nine months ended 30 September 2002 of HK\$3,230,839 and HK\$7,537,627, respectively (three months and nine months ended 30 September 2001: HK\$2,899,052 and HK\$6,805,912, respectively) and the weighted average number of 440,000,000 ordinary shares in issue during the three months and nine months ended 30 September 2002 (three months and nine months ended 30 September 2001:

366,666,000 ordinary shares), deemed to have been in issue during the respective periods. The weighted average number of shares used to calculate the prior period's loss per share includes the pro forma issued share capital of the Company of 366,666,000 deemed to have been in issue prior to the new issue of shares by way of placing as further described in the Prospectus. The weighted average number of shares used in the loss per share calculation for the three months and nine months ended 30 September 2002 also includes the 73,334,000 shares issued by way of placing in connection with the public listing of the Company's shares on 13 December 2001.

No diluted loss per share amounts for the three months and nine months ended 30 September 2002 have been presented because the share options outstanding had an anti-dilutive effect on the basic loss per share for these periods.

The diluted loss per share amounts for the three months and nine months ended 30 September 2001 have not been presented since there were no potential ordinary shares in existence during the periods.

6. Capital and reserves

| | Share capital HK\$ | Share premium account# HK\$ | Accumulated losses HK\$ | Total HK\$ |
|---|--------------------------|--------------------------------------|-------------------------------|-------------------|
| At 1 January 2001 | 1,817,900 | 8,182,100 | (5,890,762) | 4,109,238 |
| Issue of share of a subsidiary | - | 7,329,450 | - | 7,329,450 |
| Loss for the nine months ended 30 September 2001 | - | - | (6,805,912) | (6,805,912) |
| At 30 September 2001 | 1,817,900 | 15,511,550 | (12,696,674) | 4,632,776 |
| At 1 January 2002 | 2,200,000 | 33,527,560 | (15,580,349) | 20,147,211 |
| Loss for the nine months ended 30 September 2002 | - | - | (7,537,627) | (7,537,627) |
| At 30 September 2002 | 2,200,000 | 33,527,560 | (23,117,976) | 12,609,584 |

The share premium account of the Group includes the difference between the nominal value of the share capital and share premium of the subsidiaries acquired pursuant to the Group Reorganization as set out in note 1, over the nominal value of the share capital of the Company issued in exchange therefor.

MANAGEMENT DISCUSSION AND ANALYSIS

Business review

During the period under review, the Group continued to be engaged in the provision of Internet game platform licensing, game-on-demand (“GOD”) and Massive Multiplayer Online Game (MMOG) services.

The unaudited loss from operating activities before tax for the period under review increased from approximately HK\$6,805,912 to HK\$7,537,627 over the corresponding period in the previous year. The increase in loss was mainly due to the increase in royalties for game contents and staff costs, including directors’ remuneration, in accordance with the increase in staff count from 14 to 23. Notwithstanding the above results, it has been our objective to adopt stringent cost control and maintain a thin but effective overhead structure.

The Group was also granted exclusive rights of a new MMOG known as “Ihorse2”, which is a more advanced, sophisticated and entertaining version of Ihorse1. Ihorse2, with over 3,000 existing members, has contributed income to the Group during the period under review.

Apart from new product development, during the period under review, the Group also signed various cooperation agreements with local partners so as to create immense synergistic and further strengthen its capabilities in the People’s Republic of China (the “PRC”) online game arena. The group signed agreements with CERNET (「賽爾網絡有限公司」) in Beijing in September 2002, 上海聚友寬頻網絡投資有限公司 in Shanghai and 南京長豐數碼信息技術有限公司 in Nanjing in October 2002, other partners include a game developer and distributor which a Memorandum of Understanding was signed in Shenzhen in September 2002, and several ICPs and ISPs based in Shenzhen, Guangzhou and Shanghai.

During the period under review, the Group reported an unaudited turnover of HK\$90,322, after deducting all related fees, for the nine months ended 30 September 2002 (2001: HK\$163,555).

The Company was listed on GEM of the Stock Exchange through a placement of 110,000,000 shares. The net proceeds from the placement, after deductions for relevant expenses, were approximately HK\$16,300,000. The Group intended to apply these proceeds in the manner disclosed in the Prospectus dated 6 December 2001. For the period under review, the Group financed its operations with its own listing proceeds and working capital and did not have any bank borrowings. As of 30 September 2002, the Group had total assets of approximately HK\$14,382,000, including cash and bank balances of approximately HK\$10,753,000. Taking into consideration the existing financial resources available to the Group including the net proceeds from listing, it is anticipated that the Group should have adequate financial resources to meet its ongoing operations and development requirements.

Outlook

GOD is an innovative concept in Greater China and the Company will fully utilize its first mover advantage. According to the latest statistics, one in four Internet users in the PRC is a game player. We will leverage on the exponential growth of Internet users in Greater China and the popularity of online games among Internet users in the PRC to explore our business opportunities. The most recent detailed progress in our business development is as follows:—

(a) *MMOG*

Besides Ihorse2, the Group has actively sought cooperation with an electronic video game designer and supplier in Taiwan that are deemed to possess huge market potential. In October 2002, two MOUs have been signed with such game developer whose will grant the exclusive distribution right of 2 MMOGs developed in Hong Kong and the PRC through Internet. The Board expects that MMOG will be another star for the Group's business development.

(b) *Geographical expansion*

On the distribution side, besides allying with PCCW IMS Limited, a subsidiary of PCCW Limited in Hong Kong, the Group has also devised concrete plans to develop markets outside Hong Kong and to explore other revenue channels. Agreements have been signed with ISPs and ICPs in the PRC. Moreover, the Group also signed agreements with two ICPs (深圳市深大長通通信服務有限公司, subsidiary of China Telecom, and 廣東盈信信息投資有限公司) during the period to provide our services in two major cities in the PRC, namely Shenzhen and Guangzhou. Negotiations in other major cities in the PRC are already underway and the Group will keep a close eye on Greater China, especially in major PRC cities such as Chengdu and Zhengzhou, on potential prospects.

In terms of geographical expansion, our target is to expand our platform to other major cities in the PRC. Towards this end, the Group signed three cooperation agreements with ICP and ISP based in Shenzhen, Guangzhou and Shanghai, respectively. Under the agreement with 上海東方網股份有限公司, the Group will provide the arcade GOD platform to 上海東方網股份有限公司 which operates over 250 Internet cafes in Shanghai. Arcade GOD services in Shanghai will be launched in November 2002 and the Board expects to see revenue generation after its official launch.



Union Net – 上海聚友寬頻網絡投資有限公司 is a leading Internet service provider with more than 1.5 million subscribers in the PRC. With extensive distribution network nationwide, Union Net has established more than 10 regional offices and partnered with over 100 local developers and property management companies in the PRC. During the period under review, the Group has been further extended its cooperation with Union Net and jointly developed a game portal website, www.pilitiandi.com.cn (霹靂天地), which will be launched exclusively on November 2002.

Cernet - CERNET Corporation is an Internet corporation backed by the China Education and Research Network. Authorized by The Ministry of Education, CERNET Corp. is responsible for the operation and management of one of the largest Internet networks in the PRC. CERNET, one of the earliest computer networks in the PRC, possess a nationwide fiber-optic transmission network. Established in 1994, CERNET is a nationwide academic Internet funded by the government of the PRC and managed by The Ministry of Education. Some major Chinese universities, including Tsinghua University, share responsibility in the construction, operation and day-to-day maintenance of CERNET. In 1996, CERNET was recognized by the State Council as one of four key Internet backbone networks in the PRC. CERNET was the earliest network of its kind in the PRC, the first to offer a full range of information and educational resources. After eight years, CERNET has developed to become the one of the largest educational information network in the PRC. By the end of 2001, CERNET reached more than 160 cities in the PRC, connecting over 900 universities and tertiary institutions together. With more than 8 million end users, CERNET is one of the largest broadband Internet networks in the PRC.

Nanjing Chang Feng Digital Information Technology (“Chang Feng”) (南京長豐數碼信息技術有限公司) – engages in the provision of educational information and arcade GOD via such educational websites and over 400 Cyber Cafes operated by Chang Feng in Nanjing, Wuhan, Chengdu and Chongqing. Industry estimates have shown that there are 1 million end users in such educational websites. Capitalizing on its loyal customers, the Group believes that there is tremendous growth potential in this market, and the Group is fully geared toward this direction.

The Board remains confident that through our dedication and efforts, the Group will become the leading online game service provider in Greater China region.

Directors' interests in shares

As at 30 September 2002, the interests of the directors and their associates in the share capital of the Company or its associated corporations as recorded in the register of the Company required to be kept under Section 29 of the Securities (Disclosure of Interest) Ordinance (the "SDI Ordinance") or as otherwise notified to the Company and the Stock Exchange pursuant to the minimum standards of dealings by directors of listed issuer as referred to in rule 5.40 of the GEM Listing Rules are set out below:

| Name of directors | Notes | Number of shares held | |
|---------------------------|-------|-----------------------|-------------------|
| | | Corporate interest | Personal interest |
| Mr. Cheng Kar Shing | (a) | 281,268,118 | – |
| Mr. Leung Wai Keung | (b) | 14,658,362 | – |
| Mr. Fung Hoo Wing, Thomas | (c) | 17,670,550 | – |
| Mr. Tung Wai Wa, Wallace | | – | 4,909,290 |
| Mr. Li Ka Kui | | – | 2,944,954 |

Notes:

- (a) By virtue of Mr. Cheng Kar Shing's interest in Potassium Corp., a company incorporated in the British Virgin Islands and beneficially owned by Mr. Cheng Kar Shing, Mr. Cheng Kar Shing is deemed to be interested in the 39,268,118 shares held by Potassium Corp. and the 242,000,000 shares held by Romson Limited, a wholly-owned subsidiary of Poly Planning Limited, which is owned as to 46.24% by Potassium Corp..
- (b) These shares are held by Perfect Sun Development Limited, a company whose entire issued share capital is beneficially owned by Mr. Leung Wai Keung.
- (c) These shares are held by Kateman International Limited, a company in which Mr. Fung Hoo Wing, Thomas owns a 33% equity holding.

In addition to the above, certain directors have non-beneficial personal equity interests in certain subsidiaries held for the benefit of the Company solely for the purpose of complying with the minimum company membership requirements.

Save as disclosed above, none of the directors or their associates had any personal, family, corporate or other interests in the equity of debt securities of the Company or any of its associated corporations as defined in the SDI Ordinance.

Substantial shareholders

As at 30 September 2002, the following interests of 10% or more of the share capital of the Company were recorded in the register of interests in shares required to be kept by the Company pursuant to Section 16(1) of the SDI Ordinance:

| Name | Notes | Number of shares held | Percentage of holding |
|-----------------------|--------------|------------------------------|------------------------------|
| Potassium Corp. | (a) | 281,268,118 | 63.9% |
| Mr. Cheng Kar Shing | (b) | 281,268,118 | 63.9% |
| Poly Planning Limited | (c) | 242,000,000 | 55.0% |
| Romson Limited | (d) | 242,000,000 | 55.0% |

Notes:

- (a) Potassium Corp. is a limited liability company incorporated in the British Virgin Islands and is wholly owned by Mr. Cheng Kar Shing. Potassium Corp. is interested directly in 39,268,118 shares following the completion of the placing. By virtue of its interests in Poly Planning Limited, Potassium Corp. is deemed to be interested in the 242,000,000 shares held by Romson Limited.
- (b) By virtue of his interest in Potassium Corp., Mr. Cheng Kar Shing is deemed to be interested in the 39,268,118 shares held by Potassium Corp. and the 242,000,000 shares held by Romson Limited.
- (c) By virtue of its interest in Romson Limited, Poly Planning Limited is deemed to be interested in the 242,000,000 shares.
- (d) Romson Limited is an investment holding company incorporated in the British Virgin Islands all of whose issued shares are held by Poly Planning Limited, a company incorporated in the Hong Kong with limited liability.

The substantial shareholdings are duplicated in the directors' interests in shares disclosed above.

Save as disclosed above, no person, other than the directors whose interests are set out above, had registered an interest in the share capital of the Company that was required to be recorded under Section 16(1) of the SDI Ordinance as at 30 September 2002.

Directors' rights to acquire shares

Pursuant to a pre-IPO share option scheme (the "Pre-Scheme") adopted by the Company on 28 November 2001, the Company had granted pre-IPO share options on the Company's ordinary shares in favour of certain of its directors, details of which are as follows:

| Name of directors | Number of share options granted on 28 November 2001 | Exercise period of share options | Exercise price per share HK\$ |
|---------------------------|---|--------------------------------------|----------------------------------|
| Mr. Cheng Kar Shing | 1,760,000 | 14 December 2002 to 27 November 2011 | 0.24 |
| | 1,760,000 | 14 December 2003 to 27 November 2011 | 0.24 |
| Mr. Leung Wai Keung | 7,920,000 | 14 December 2002 to 27 November 2011 | 0.24 |
| | 7,920,000 | 14 December 2003 to 27 November 2011 | 0.24 |
| Mr. Li Ka Kui | 1,760,000 | 14 December 2002 to 27 November 2011 | 0.24 |
| | 1,760,000 | 14 December 2003 to 27 November 2011 | 0.24 |
| Mr. Ng, Kenny Chi Kin | 1,760,000 | 14 December 2002 to 27 November 2011 | 0.24 |
| | 1,760,000 | 14 December 2003 to 27 November 2011 | 0.24 |
| Mr. Fung Hoo Wing, Thomas | 1,760,000 | 14 December 2002 to 27 November 2011 | 0.24 |
| | 1,760,000 | 14 December 2003 to 27 November 2011 | 0.24 |
| Mr. Tung Wai Wa, Wallace | 1,760,000 | 14 December 2002 to 27 November 2011 | 0.24 |
| | 1,760,000 | 14 December 2003 to 27 November 2011 | 0.24 |

The purpose of the Pre-Scheme was to recognize the contribution of the directors to the growth of the Group and/or the listing of the Company's shares on the GEM. The granting of the pre-IPO share options is limited to the directors (excluding independent non-executive directors).

As the Company's shares have only been listed on the GEM since 13 December 2001, the directors do not consider it appropriate to disclose a theoretical value of the share options granted during the period because there would not be sufficient historical price performance data to produce reasonable valuations using commonly used methodologies.

None of these share options were exercised during the nine months ended 30 September 2002. Following the resignation of Mr. Derek Shuen Lee on 25 June 2002, 10,560,000 share options held by him had been cancelled in accordance with the terms of the Pre-Scheme.

As at 30 September 2002, the Company had 33,440,000 share options outstanding under the Pre-Scheme. The exercise in full of the pre-IPO share options would, under the present capital structure of the Company, result in the issue of 33,440,000 additional shares of the Company of HK\$0.005 each.

On the same date as the adoption of the aforesaid Pre-Scheme, a further share option scheme (the "Post-Scheme") was also approved by the Company. The purpose of the Post-Scheme is to provide incentives and rewards to eligible participants who contribute to the success of the Group's operations. Under the terms of the Post-Scheme, the board of directors may, at their discretion, grant options to any full-time employee and any director of the Company or its subsidiaries, including any executive, non-executive or independent non-executive directors. The total number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Post-Scheme and other schemes (including the Pre-Scheme) of the Company must not exceed 30% of the shares in issue from time to time. No share options were granted by the Company under the Post-Scheme up to the date of approval of this report.

Save as disclosed above, and other than in connection with the Group Reorganization in preparation for the Company's placing, at no time since its incorporation was the Company, any of its holding companies or subsidiaries a party to any arrangement to enable the Company's directors, their respective spouse or children under 18 years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

Competition and conflict of interests

As at 30 September 2002, none of the directors, the management shareholders or substantial shareholders of the Company or any of their respective associates has engaged in any business that competes or may compete with the business of the Group, or has any other conflict of interests with the Group.

Audit committee

The Company established an audit committee with written terms of reference in compliance with Rules 5.23 and 5.24 of the GEM Listing Rules. The primary duties of the audit committee are to review and supervise the financial reporting process and internal control systems of the Group. The audit committee comprises two members, Mr. Cheung Hon Kit and Mr. Ma Ching Nam, who are the independent non-executive directors of the Company. The Group's unaudited results for the three months and nine months ended 30 September 2002 have been reviewed by the audit committee, which was of the opinion that the preparation of such results complies with applicable accounting standards and requirements, and the adequate disclosures have been made.

Sponsor's interest

As at 30 September 2002, neither Tai Fook Capital Limited (the "Sponsor"), nor any of its respective directors, employees or associates (as referred to in Note 3 to Rule 6.35 of the GEM Listing Rules) had any interests in the securities of the Company or of any members of the Group, or had any right to subscribe for or to nominate persons to subscribe for the securities of the Company of any members of the Group.

Pursuant to a Sponsor Agreement dated 5 December 2001 between the Company and the Sponsor, the Sponsor is entitled to receive a fee for acting as the Company's sponsor for the period from 13 December 2001 to 31 December 2003.

Purchase, redemption or sale of listing securities

The Company's shares were listed on the GEM on 13 December 2001. Neither the Company, nor any of its subsidiaries purchased, redeemed or sold any of the Company's listed securities between that date and 30 September 2002.

Compliance with Rules 5.28 to 5.39 of the GEM Listing Rules

The Company has complied with the board practices and procedures as set out in Rules 5.28 to 5.39 of the GEM Listing Rules since the listing of the Company's shares on the GEM on 13 December 2001.

By Order of the Board
Cheng Kar Shing
Chairman

Hong Kong, 8 November 2002