



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

(incorporated in the Cayman Islands with limited liability)

THIRD QUARTERLY RESULTS REPORT
FOR THE NINE MONTHS ENDED
31ST DECEMBER, 2002

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

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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 nine months ended 31st December, 2002 amounted to approximately HK\$30.11 million (2001: approximately HK\$19.27 million).
- Profit attributable to shareholders amounted to approximately HK\$1,987,000 for the nine months ended 31st December, 2002 (2001: approximately HK\$3,825,000).
- 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.

THIRD QUARTERLY RESULTS FOR THE NINE MONTHS ENDED 31ST DECEMBER, 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 nine months ended 31st December, 2002, together with the unaudited comparative figures for the corresponding period in 2001, as follows:

		Three months ended 31st December,		Nine months ended 31st December,	
	<i>Note</i>	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	2	14,606	5,933	30,110	19,273
Cost of sales		(10,049)	(673)	(12,964)	(1,850)
		4,557	5,260	17,146	17,423
Gross profit		4,557	5,260	17,146	17,423
Other income/(expenses)		(47)	—	(47)	40
Operating expenses		(4,928)	(4,382)	(14,343)	(13,602)
		(418)	878	2,756	3,861
Profit from operations		(418)	878	2,756	3,861
Finance cost, net		(16)	(25)	(141)	(36)
		(434)	853	2,615	3,825
Profit/(loss) before tax		(434)	853	2,615	3,825
Income tax expense	3	—	—	—	—
		(434)	853	2,615	3,825
Profit/(loss) after tax		(434)	853	2,615	3,825
Minority interests		(628)	—	(628)	—
		(1,062)	853	1,987	3,825
Profit/(loss) attributable to shareholders		(1,062)	853	1,987	3,825
Earnings/(loss) per share	4				
-Basic (in cents)		(0.18)	0.18	0.35	0.84
		(0.18)	0.18	0.35	0.84
-Diluted (in cents)		(0.18)	0.16	0.33	0.76
		(0.18)	0.16	0.33	0.76
		(0.18)	0.16	0.33	0.76
Dividend per share		Nil	Nil	Nil	Nil

Notes:

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. 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.

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/(loss) per share

The calculation of basic earnings/(loss) per share for the nine months and three months ended 31st December, 2002, respectively, is based on the Group's unaudited profit/(loss) attributable to shareholders of approximately HK\$1,987,000 and HK\$(1,062,000), respectively (2001: profits of approximately HK\$3,825,000 and HK\$853,000, respectively), and on the weighted average number of 568,402,108 shares and 577,377,910 shares, respectively, in issue during the period (2001: 456,734,259 shares and 473,880,510 shares, respectively).

The calculation of diluted earnings/(loss) per share for the nine months and three months ended 31st December, 2002 is based on the Group's unaudited profit/(loss) attributable to shareholders of approximately HK\$1,987,000 and HK\$(1,062,000), respectively (2001: profits of approximately HK\$3,825,000 and HK\$853,000, respectively), and the weighted average number of 610,002,108 shares and 586,876,277 shares, respectively (2001: 502,097,700 shares and 519,243,951, 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.

5. Movements in reserves

	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
Shares issued on the Reorganisation	8,397	—	8,397
Issue of new shares	31,791	—	31,791
Share issue expenses	(7,855)	—	(7,855)
Capitalisation issue	(4,470)	—	(4,470)
Profit for the period	—	3,825	3,825
At 31st December, 2001	<u>38,730</u>	<u>(5,847)</u>	<u>32,883</u>
At 1st April, 2002	36,248	(6,191)	30,057
Issue of new shares	23,499	—	23,499
Share issue expenses	(1,404)	—	(1,404)
Profit for the period	—	1,987	1,987
At 31st December, 2002	<u>58,343</u>	<u>(4,204)</u>	<u>54,139</u>

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 People's Republic of China ("PRC") and software based on the Linux operating platform for various hardware appliances. While its products support personal computer applications, the Group is most 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.

Financial

The Group reported an unaudited, consolidated turnover of approximately HK\$14.61 million for the three months ended 31st December, 2002, representing an increase of approximately 146% over the corresponding period in 2001 (2001: approximately HK\$5.93 million). The Group reported an unaudited gross profit of approximately HK\$4.56 million for the three months ended 31st December, 2002 (2001: approximately HK\$5.26 million). The loss attributable to shareholders for the three months ended 31st December, 2002 was approximately HK\$1.06 million (2001: Profit attributable to shareholders amounting approximately HK\$853,000).

Despite the total turnover increased, gross profit margin fell significantly when compared to the same period in the previous year, in part as a result of the acquisition of Snow Fair Co., Ltd. ("Snow Fair"), a group of companies which engaged in the sale of both hardware and software, reduced gross profit margin. Hardware has a lower profit margin than software. In addition, the increase in the distribution of third parties' software during the period also lowered the gross profit margin of the Group.

Business Review

The Group is focused on the exciting growth opportunities in the rapidly developing Internet and e-business markets in the PRC. It will realize this unprecedented business potential through strategic expansion, seeking vertical growth opportunities in diverse business segments, particularly in the education, government, security, banking and insurance sectors.

During the quarter, the Group successfully acquired 69% of the issued share capital of Snow Fair which holds 51% interest in Shanghai Pantosoft Co., Ltd. ("Shanghai Pantosoft"). Shanghai Pantosoft is the leading vendor in Shanghai's education software market.

The acquisition carries strategic significance for the Group's business development; it allows the Group to capitalize on the tremendous business opportunities in a largely untapped sector.

According to reports from CCID's Taiwan operation, the education sector accounted for 13.3% of the PC market in the PRC in the first half of 2002. The demand for PCs from this sector is expected to further accelerate as the PRC government is committed to digitalizing education. As a key city, Shanghai will lead the reform and is crucial to the popularization of Linux in the PRC.

The Group already enjoys an established presence in Beijing. The acquisition of Snow Fair is a major step in the cost-effective expansion of the Group's business into Shanghai and Eastern China. Shanghai Pantosoft is also actively expanding its software portfolio to cover other market segments, such as the digitalization of libraries and e-government application projects. This presents the Group with another tremendous opportunity to tap into new business sectors. According to the China Computer User Association, RMB1,000 billion will be invested in the PRC IT infrastructure market in the next five years. It is estimated that the PRC government's IT procurement will increase by over 30% each year.

The Group has developed a suite of Linux-based e-government applications. These have been adopted and well-received by government divisions in some cities in the PRC. In recognition of its advocacy of e-government applications in the PRC market, the Group was selected as one of the "Top 100 E-government IT Enterprises in China" (中國電子政務 IT 100 強) by China Internet Weekly in October 2002.

The Group's key strengths lie in server application software. These applications, targeting SMEs, have been well-received, acquiring significant market share. The Group developed XteamServer 4.0 *d*-class, which was launched at the end of 2002. In January 2003, XteamServer 4.0 *d*-class received the "Editor's Choice" Award from China Information World, one of the leading IT publications in the PRC, jointly run by the Ministry of Information Industry and CCID in the PRC. The award was in recognition of the Group's outstanding IT products and software specifically developed for the PRC market.

Prospects

The International Data Corporation forecasts that worldwide server sales will grow on average by 3% annually to create a US\$63.4 billion market in 2006. Linux-based server operating systems are expected to be major market drivers, and sales are projected to reach US\$6.5 billion in 2006. The Group is poised to capitalize on the opportunities created by consistent industry growth in this category.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN SECURITIES

As at 31st December, 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 Omnicorp Limited (formerly known as Omnitech Group 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 31st December, 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 31st December, 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>)	19.78%
One Focus Group Limited	81,481,507 (<i>note 2</i>)	13.85%

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 nine months from the date of listing of the Company on GEM on 11th December, 2001.

As at 31st December, 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 nine months 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 31st December, 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 31st December, 2002, no options have been granted under the Share Option Scheme.

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

During the nine months ended 31st December, 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 31st December, 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 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
Ren Yi
Co-chairman

Hong Kong, 12th February, 2003