



**Xteam Software International Limited**

*(Incorporated in the Cayman Islands with limited liability)*

**INTERIM REPORT 2003/2004**

## **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 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 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 three months ended 30th September, 2003 amounted to approximately HK\$6,305,000, representing an increase of 116% from approximately HK\$2,913,000 for the three months ended 30th June, 2003. Turnover for the six months ended 30th September, 2003 amounted to approximately HK\$9,219,000 (2002: approximately HK\$15,504,000).
- Loss attributable to shareholders for the three months ended 30th September, 2003 narrowed to approximately HK\$3,687,000 compared to the loss attributable to shareholders for the three months ended 30th June, 2003 of approximately HK\$4,299,000. Loss attributable to shareholders amounted to approximately HK\$7,916,000 for the six months ended 30th September, 2003 (2002: profit of approximately HK\$3,049,000).
- The Group expanded its products range and geographic reach to widen its customer base in the PRC Linux market.
- The Board does not recommend the payment of an interim dividend for the period (2002: Nil).

## INTERIM RESULTS FOR THE SIX MONTHS ENDED 30TH SEPTEMBER, 2003

The board of Directors (the “Board”) of 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, 2003, together with the unaudited comparative figures for the corresponding period in 2002, as follows:

		Three months ended 30th September,		Six months ended 30th September,	
		2003	2002	2003	2002
Note		HK\$'000	HK\$'000	HK\$'000	HK\$'000
		<i>(Unaudited)</i>	<i>(Unaudited)</i>	<i>(Unaudited)</i>	<i>(Unaudited)</i>
Revenue	2	6,305	7,871	9,219	15,504
Cost of sales		(5,389)	(2,085)	(7,904)	(2,915)
Gross profit		916	5,786	1,315	12,589
Other income		405	-	548	-
Operating expenses		(4,738)	(5,208)	(9,341)	(9,415)
(Loss)/profit from operations		(3,417)	578	(7,478)	3,174
Finance income/(cost), net		34	(95)	40	(125)
(Loss)/profit before tax	3	(3,383)	483	(7,438)	3,049
Income tax expense	4	(65)	-	(102)	-
(Loss)/profit after tax		(3,448)	483	(7,540)	3,049
Minority interests		(239)	-	(376)	-
(Loss)/profit attributable to shareholders		(3,687)	483	(7,916)	3,049
(Loss)/earnings per share	6				
- Basic (in cents)		(0.59)	0.08	(1.31)	0.54
- Diluted (in cents)		(0.59)	0.08	(1.31)	0.50
Dividend per share	7	Nil	Nil	Nil	Nil

## CONSOLIDATED BALANCE SHEETS

		As at 30th September, 2003 <i>HK\$'000</i> <i>(Unaudited)</i>	As at 31st March, 2003 <i>HK\$'000</i> <i>(Audited)</i>
	<i>Note</i>		
Fixed assets	8	2,148	2,063
Goodwill	9	14,251	14,813
Intangible assets	10	12,573	14,881
Current assets			
Inventories	11	9,476	9,036
Accounts receivable	12	3,386	1,635
Prepayments, deposits and other receivable		9,590	11,746
Value added tax refundable		1,302	1,343
Cash and bank balances		8,405	11,931
		<b>32,159</b>	35,691
Current liabilities			
Accounts payable	13	1,594	1,936
Short-term bank loan (unsecured)		–	1,415
Other payables and accrued expenses		11,570	14,216
		<b>13,164</b>	17,567
Net current assets		<b>18,995</b>	18,124
Non-current liabilities			
Minority interests		1,753	1,377
		<b>46,214</b>	48,504
Capital and reserves			
Share capital	14	6,400	5,883
Reserves	15	39,814	42,621
		<b>46,214</b>	48,504

## 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, 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
	<u>5,827</u>	<u>56,645</u>	<u>(3,142)</u>	<u>59,330</u>
At 30th September, 2002	<u>5,827</u>	<u>56,645</u>	<u>(3,142)</u>	<u>59,330</u>
At 1st April, 2003	5,883	59,401	(16,780)	48,504
Issue of new shares	517	5,581	-	6,098
Share issue expenses	-	(472)	-	(472)
(Loss) for the period	-	-	(7,916)	(7,916)
	<u>6,400</u>	<u>64,510</u>	<u>(24,696)</u>	<u>46,214</u>
At 30th September, 2003	<u>6,400</u>	<u>64,510</u>	<u>(24,696)</u>	<u>46,214</u>

## CONSOLIDATED CASH FLOW STATEMENT

*For the six months ended 30th September,*

	2003 <i>HK\$'000</i> <i>(Unaudited)</i>	2002 <i>HK\$'000</i> <i>(Unaudited)</i>
Net cash used in operating activities	(8,704)	(8,147)
Net cash used in investing activities	(448)	(203)
Net cash from financing activities	5,626	20,721
Net (decrease) / increase in cash and cash equivalents	(3,526)	12,371
Cash and cash equivalents at beginning of the period	11,931	16,670
Cash and cash equivalents at end of the period	<u>8,405</u>	<u>29,041</u>
Analysis of the balances of cash and cash equivalent		
Cash and bank balances	<u>8,405</u>	<u>29,041</u>

Notes:

## 1. Basis of presentation

The unaudited interim financial statements have been prepared in accordance with Hong Kong Statement of Standard Accounting Practice (“SSAP”) No. 25 “Interim Financial Reporting”, issued by the Hong Kong Society of Accountants and Chapter 18 of Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (the “GEM Listing Rules”).

The principal accounting policies and methods of computation used in the preparation of the unaudited interim financial statements are consistent with those adopted in the latest annual financial statements of the Group.

## 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.

Turnover consisted of:

	Three months ended		Six months ended	
	30th September,		30th September,	
	2003	2002	2003	2002
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Sales of computer software	1,412	7,871	3,044	14,921
Provision of software development, integration and related services	4,893	-	6,175	583
	<u>6,305</u>	<u>7,871</u>	<u>9,219</u>	<u>15,504</u>

## 3. (Loss)/profit before taxation

(Loss)/profit before taxation was arrived at after crediting and charging the following:

	Three months ended		Six months ended	
	30th September,		30th September,	
	2003	2002	2003	2002
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Crediting:				
Interest income on bank deposits	<u>34</u>	<u>39</u>	<u>40</u>	<u>52</u>
Charging:				
Depreciation of fixed assets	189	97	363	190
Amortization of goodwill	281	-	562	-
Amortization of intangible assets	<u>1,154</u>	<u>916</u>	<u>2,308</u>	<u>1,830</u>

#### **4. Taxation**

- (i) No provision for profits tax has been made as no income was earned or derived from Hong Kong for both periods.
- (ii) No provision for profits tax has been provided in respect of the Cayman Islands or the British Virgin Islands as there were no assessable tax for both periods in those jurisdictions. The tax expenses for both periods represents tax charges on the assessable profits of certain subsidiaries operating in the PRC calculated at the applicable rates.
- (iii) No provision for deferred tax 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.

#### **5. Goodwill**

Positive goodwill arising on consolidation represents the excess of the cost of the acquisition over the Group's share of the fair value of the identifiable assets and liabilities acquired. Goodwill is recognized as an asset and amortised on a straight-line basis over its estimated useful life of 13.5 years.

On disposal of a subsidiary, any attributable amount of purchased goodwill not previously amortised is included in the calculation of the profit and loss on disposal.

#### **6. (Loss)/earnings per share**

The calculation of basic loss per share for the six months and three months ended 30th September, 2003 is calculated based on the Group's unaudited loss attributable to shareholders of approximately HK\$7,916,000 and HK\$3,687,000, respectively (2002: profits of approximately HK\$3,049,000 and HK\$483,000, respectively), and on the weighted average number of 605,554,605 shares and 622,594,025 shares, respectively, in issue during the period (2002: 561,233,231 shares and 572,093,882 shares, respectively).

The diluted loss per share for the six months and three months ended 30th September, 2003 is based on the weighted average number of 605,554,605 shares and 622,594,025 shares, respectively, taking into account the options granted to certain executive directors of the Company to subscribe for a total of 80,000,000 shares of the Company under the Pre-IPO Share Option Scheme (2002: 611,206,113 shares and 595,854,993 shares, respectively).

#### **7. Dividend**

The Board does not recommend the payment of an interim dividend for the period (2002: Nil).



## 8. Fixed assets

As at 30th September, 2003 (*unaudited*):

	Leasehold improvements	Computer equipment	Furniture and fixtures	Office equipment	Motor vehicles	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cost						
1st April, 2003	86	2,330	48	558	664	3,686
Additions	14	129	-	6	299	448
30th September, 2003	100	2,459	48	564	963	4,134
Depreciation						
1st April, 2003	28	1,014	18	294	269	1,623
Charges for the period	12	229	4	52	66	363
30th September, 2003	40	1,243	22	346	335	1,986
Net book value						
30th September, 2003	60	1,216	26	218	628	2,148
31st March, 2003	58	1,316	30	264	395	2,063

## 9. Goodwill

As at 30th September, 2003 (*unaudited*)

	HK\$'000
Cost	
1st April, 2003	15,188
Additions	-
30th September, 2003	15,188
Amortization	
1st April, 2003	375
Charges for the period	562
30th September, 2003	937
Net book value	
30th September, 2003	14,251
31st March, 2003	14,813

## 10. Intangible assets

As at 30th September, 2003 (*unaudited*)

	<b>Internet platform</b>	<b>Trademarks</b>	<b>Computer software</b>	<b>Total</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
<b>Cost</b>				
1st April, 2003	3,255	2,371	16,823	22,449
Additions	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
30th September, 2003	3,255	2,371	16,823	22,449
	<hr/>	<hr/>	<hr/>	<hr/>
<b>Amortization</b>				
1st April, 2003	1,085	362	6,121	7,568
Charges for the period	542	59	1,707	2,308
	<hr/>	<hr/>	<hr/>	<hr/>
30th September, 2003	1,627	421	7,828	9,876
	<hr/>	<hr/>	<hr/>	<hr/>
<b>Net book value</b>				
30th September, 2003	<u>1,628</u>	<u>1,950</u>	<u>8,995</u>	<u>12,573</u>
31st March, 2003	<u>2,170</u>	<u>2,009</u>	<u>10,702</u>	<u>14,881</u>

## 11. Inventories

	<b>As at 30th September, 2003</b>	<b>As at 31st March, 2003</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>
	<i>(Unaudited)</i>	<i>(Audited)</i>
Raw materials and low value consumables - at cost	<b>11,988</b>	12,826
Work in progress	<b>246</b>	243
Finished goods - at net realizable value	<b>1,974</b>	234
	<hr/>	<hr/>
	<b>14,208</b>	13,303
Less: Provisions	<b>(4,732)</b>	(4,267)
	<hr/>	<hr/>
	<b>9,476</b>	9,036
	<hr/>	<hr/>

## 12. Accounts receivable

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

	As at 30th September, 2003 <i>HK\$'000</i> <i>(Unaudited)</i>	As at 31st March, 2003 <i>HK\$'000</i> <i>(Audited)</i>
0 - 30 days	2,384	315
31 - 60 days	72	135
61 - 90 days	14	36
Over 90 days	916	1,149
	<u>3,386</u>	<u>1,635</u>

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

## 13. Accounts payable

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

	As at 30th September, 2003 <i>HK\$'000</i> <i>(Unaudited)</i>	As at 31st March, 2003 <i>HK\$'000</i> <i>(Audited)</i>
0 - 30 days	721	210
31 - 60 days	20	-
61 - 90 days	45	24
Over 90 days	808	1,702
	<u>1,594</u>	<u>1,936</u>

#### 14. Share capital

	30th September, 2003 (Unaudited)		31st March, 2003 (Audited)	
	Number of shares	Nominal value HK\$	Number of shares	Nominal value HK\$
Authorized:				
Ordinary shares of HK\$0.01 each	<b>1,000,000,000</b>	<b>10,000,000</b>	1,000,000,000	10,000,000
Issued and fully paid:				
As at 1st April	<b>588,327,938</b>	<b>5,883,279</b>	550,253,233	5,502,532
Shares issued during the period/year	<b>51,680,000</b>	<b>516,800</b>	38,074,705	380,747
As at 30th September, 2003	<b>640,007,938</b>	<b>6,400,079</b>	<b>588,327,938</b>	<b>5,883,279</b>

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

On 21st July, 2003, the Company entered into a placing agreement with Christfund Securities Limited to place 51,680,000 new ordinary shares of HK\$0.01 each in the share capital of the Company (the "Placing Shares"). On 31st July, 2003, approval from the GEM Listing Committee for the listing of, and permission to deal in, the Placing Shares was obtained and the placing of the Placing Shares was completed on 4th August, 2003.

The details of the above placing have been disclosed in the announcements of the Company dated 21st July, 25th July and 4th August, 2003 on the GEM website and the circular dated 11th August, 2003 to its shareholders.

On 23rd September, 2003, the Company entered into a placing agreement with Christfund Securities Limited to place 53,000,000 new ordinary shares of HK\$0.01 each in the share capital of the Company (the "Placing Shares"). On 3rd October, 2003, approval from the GEM Listing Committee for the listing of, and permission to deal in, the Placing Shares was obtained and the placing of the Placing Shares was completed on 8th October, 2003.

The details of the above placing have been disclosed in the announcements of the Company dated 23rd September, 26th September and 8th October, 2003 on the GEM website and the circular dated 13th October, 2003 to its shareholders.

## 15. Reserves

	<b>Share premium account</b>	<b>Accumulated losses</b>	<b>Total</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
<i>Consolidated (unaudited)</i>			
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	-	3,049	3,049
	<u>56,645</u>	<u>(3,142)</u>	<u>53,503</u>
At 30th September, 2002			
At 1st April, 2003	59,401	(16,780)	42,621
Issue of new shares	5,581	-	5,581
Share issue expenses	(472)	-	(472)
Profit for the period	-	(7,916)	(7,916)
	<u>64,510</u>	<u>(24,696)</u>	<u>39,814</u>
At 30th September, 2003			

## 16. Subsequent events

On 23rd September, 2003, the Company entered into a placing agreement with Christfund Securities Limited to place 53,000,000 new ordinary shares of HK\$0.01 each in the share capital of the Company. On 3rd October, 2003, approval from the GEM Listing Committee for the listing of, and permission to deal in, the Placing Shares was obtained and the placing of the Placing Shares was completed on 8th October, 2003.

The details of the above placing have been disclosed in the announcements of the Company dated 23rd September, 26th September and 8th October, 2003 on the GEM website and the circular dated 13th October, 2003 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 most widely recognized for its efficient operating system and its diversified software applications that leads the server, Internet, Intranet and mobile markets. The Group also provides technical support and after-sales services to its customers.

## **Market Overview**

The business environment in the PRC picked up steadily after the Severe Acute Respiratory Syndrome (“SARS”) outbreak which was detrimental to the Group’s business activities in the first quarter. During the second quarter, the Group re-initiated new product launches and sales and marketing activities progressed at an encouraging pace.

The PRC’s entry into the World Trade Organization posed a threat to domestic software companies. In anticipation of the intensified competition from multinational software companies, the PRC Government promulgated a raft of new policies to advocate the development of domestic software companies.

The Government Office Administration of the State Council announced the Government Purchasing Ordinance (政府採購法) in August 2003 to protect the domestic software companies. All government departments are urged to use operation systems and application software, mainly Linux-based, developed by local PRC software companies by the end of 2003. By the year 2010, the percentage of using PRC-made software will increase from the existing 33% to 100%. The growing demand for domestic software will unleash tremendous opportunities for the Group to tap on.

In line with the unwavering commitment to digitalizing education, the Ministry of Education will implement a new credit system (學分制) in January 2004, which will be introduced to all technical institutions to replace the existing school year system (學年制). 5,000 state and provincial institutions out of a total of 30,000 existing technical institutions in the PRC will need the credit system educational software installation in the next 5 years.

## **Business Overview**

### *Clientele Expansion*

The Group is one of the few software companies endorsed by the PRC government in provision of credit system educational software. The Group is also the only software provider with sales network throughout the PRC, with a market share of over 50%. The Group successfully expanded its geographic reach to secure over 200 technical institutions in 16 provinces and municipalities including Beijing, Shanghai and Chongqing, and expects to reach about 1,500 technical institutions in next 5 years.

During the six months ended 30th September, 2003 (the “Review Period”), the Group signed with Shanghai Telecom Company Limited (“Shanghai Telecom”), a subsidiary of China Telecom Corporation Limited (“China Telecom”), to become the only e-learning software supplier in provision of virtual lecture session, distant learning and e-messages, to Shanghai Telecom’s clients. The initial contract covered the first phase of the entire project. Upon successful delivery of the products and services in early 2004, the Group is confident to be awarded the remaining three

phases of the entire project and other software solution projects from Shanghai Telecom and more importantly from China Telecom, as a result of the established profile. Coupled with the clientele of technical institutions, the Group will actively research into other high-value software and products to the existing clients to generate recurring income.

### *Product Innovation*

The Group launched the Postal Server 6.0 which carries more value-added functions and higher stability, during the LinuxWorld China 2003 which was held in Beijing in August 2003. The Postal Server 6.0 is equipped with a leading filter and anti-virus function which has received favorable market response during the Review Period.

### *Geographical Expansion*

During the Review Period, the Group underwent a business reshuffle to diversify its client base and explore new revenue sources. The Beijing Headquarters will devote its resources to product research and development, while the Shanghai office will become the Group's sales office. During the Review Period, the Group further augmented its geographic reach into Chongqing, Chengdu and Jinan cities to strengthen the sales and marketing force. The Group has already established an extensive sales network throughout the PRC, with representative offices in Beijing, Shanghai, Guangzhou, Qingdao and Wuhan. The nationwide sales network provides a strong backbone for the Group's expanded sales activities to cope with the growing demand of the Group's software and value-added products.

### **Prospects**

The SARS impact on the PRC economy will gradually diminish in the coming months. The increase of the Group's turnover in second quarter compared with the first quarter is a positive sign of the recovery of the Group's business activities which are expected to further accelerate in the second-half year.

The Group's extensive sales and marketing network, underpinned by the PRC Government's policies, will be key to expanding the Group's market share in the PRC software sector. The Group will focus on research and development in provision of new and value-added products to existing clients. This will help generate recurring income in long run, which will outweigh the short-term impact of selling low-margin products.

In recognition of the Group's research and development efforts, 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) for the second year by China Internet Weekly in October 2003.

The Group continues to pursue growth via organic development as well as strategic acquisitions. Given the burgeoning potential ahead in the PRC software sector, the Group will make concerted efforts to sustain revenue growth and become the leading Linux software provider in the PRC.

## **FINANCIAL REVIEW**

The Group recorded a turnover of approximately HK\$9,219,000 for the interim period ended 30th September, 2003, compared with a turnover of approximately HK\$15,504,000 in the same period last year. The decrease in turnover was mainly attributable to the slowdown of the Group's business activities amidst the SARS outbreak during the first quarter. The resumption of the Group's business activities during the second quarter has contributed to a turnover of approximately HK\$6,305,000, representing an increase of 116% compared with approximately HK\$2,913,000 in the first quarter. The Group's gross profit margin dropped to 14.3% during the interim period ended 30th September, 2003 as compared with 81.2% for the same period last year. The decrease in gross profit margin was due to the Group's increased sales activities of low-margin products during the second quarter to pick up the sales revenue after the SARS outbreak.

During the Review Period, the loss attributable to shareholders of the Group was approximately HK\$7,916,000 (2002: profit of approximately HK\$3,049,000).

Despite the decrease in turnover during the Review Period, the Group's operating expenses stood steadily at approximately HK\$9,341,000 (2002: approximately HK\$9,415,000). It was mainly attributable to the expansion of sales and marketing expenses to capture a larger market share.

## **LIQUIDITY, FINANCIAL RESOURCES AND DEBT RATIO**

As at 30th September, 2003, the Group has no outstanding bank loans (as at 31st March, 2003: HK\$1,415,000). The loan was primarily used to finance short-term cash flows for the Group's operations in Shanghai, China. This loan bears fixed interest rate of 5.31% per annum and has been fully repaid on 3rd June, 2003).

The gearing ratio (defined as total liabilities over equity) of the Group as at 30th September, 2003 was approximately 32.3% (as at 31st March, 2003: approximately 39.1%).

The debt ratio (defined as total liabilities over total assets) of the Group as at 30th September, 2003 was approximately 24.4% (as at 31st March, 2002: approximately 28.1%).

## **CAPITAL STRUCTURE, EXPOSURE TO EXCHANGE RATES FLUCTUATION**

As at 30th September, 2003, the number of issued share capital of the Company was 640,007,938 (as at 31st March, 2003: 588,327,938). During the period, a total of 51,680,000 new ordinary shares of the Company were issued to raise funds for general working capital.



On 23rd September, 2003, the Company entered into a placing agreement with Christfund Securities Limited to place 53,000,000 new ordinary shares of HK\$0.01 each in the share capital of the Company. On 3rd October, 2003, approval from the GEM Listing Committee for the listing of, and permission to deal in, the Placing Shares was obtained and the placing of the Placing Shares was completed on 8th October, 2003. Approximately HK\$3 million of the net proceeds from the placing will be used for product(s) development, mainly for educational use, approximately HK\$1 million will be used for advertising and marketing activities to promote the aforementioned new product(s) and the remaining of approximately HK\$4 million will be used as general working capital for daily operations.

As at 30th September, 2003 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**

There were no material acquisitions and disposals or subsidiaries in the course of the six months ended 30th September, 2003.

## **SEGMENTAL INFORMATION**

No analysis of the Group's turnover and its contribution to profit before taxation by principal activities for the period were presented as 100% (2002: approximately 90%) of the Group's turnover and operating results arose from the sales of computer software and rendering of software development and related services in PRC.

## STAFF

As at 30th September, 2003, the Group employed 109 employees, including directors of the Company, (2002: 65) at market remuneration and benefits such as defined retirement/pension contributions, employee share options and medical insurance, etc. Total staff costs for the reported period were approximately HK\$4.17 million (2002: approximately HK\$2.98 million). The increase was mainly due to the acquisition of a subsidiary in 2003.

## CHARGE OF ASSETS

As at 30th September, 2003, the Group did not have any charge on its assets (2002: Nil).

## CONTINGENT LIABILITIES

As at 30th September, 2003 the Group did not have any material contingent liabilities (2002: Nil).

## COMPARISON 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, 2003		From the date listed on GEM on 11th December, 2001 to 30th September, 2003	
	Proposed <i>HK\$'million</i>	Actual <i>HK\$'million</i>	Proposed <i>HK\$'million</i>	Actual <i>HK\$'million</i>
For product development or related investment through, among other things, acquisition, direct or indirect investment in other Linux based product developers	0.50	0.50	5.87	5.87
For enhancement of the Group's distribution channels through, among other things, acquisition, direct or indirect investment in other distributors	0.00	0.00	2.00	2.00
For setting up of a laboratory for e-solution project in Beijing, the PRC	0.00	0.00	2.50	2.50

	For the six months ended 30th September, 2003		From the date listed on GEM on 11th December, 2001 to 30th September, 2003	
	Proposed	Actual	Proposed	Actual
	<i>HK\$ million</i>	<i>HK\$ million</i>	<i>HK\$ million</i>	<i>HK\$ million</i>
For setting up Linux Training and Certificate Programme in Beijing, the PRC	0.00	0.00	1.00	1.00
For setting up the Group's Shanghai sales office	0.00	0.00	1.50	1.50
For advertising and marketing activities of the Group to promote the brand awareness and products of the Group	0.10	0.10	2.97	2.97
General working capital	0.10	0.10	0.70	0.70

Unused net proceeds of approximately HK\$ 2.42 million 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"> <li>Continue to co-operate with the hardware vendors and distributors to deploy more embedded system</li> <li>Improve e-solution through strengthening its collaboration with software vendors and distributors</li> <li>Enhance sales and distribution channels</li> <li>Launch upgraded XteamServer series</li> </ul>	<p>The Group is working with hardware vendors and distributors to deploy more embedded systems</p> <p>The Group is working with software vendors and distributors to provide e-solutions</p> <p>The Group had improved sales and distribution channels</p> <p>In progress</p>

	<b>Business Objectives</b>	<b>Actual Business Progress</b>
Business development	<ul style="list-style-type: none"> <li>• Improve Xteam Companion</li> <li>• Improve support services and explore opportunities to provide enterprise consulting services</li> <li>• Establish Xteam Companion which is based on Internet sales and service consultancy business to provide tailor-made all-round support to sales network and end-users</li> </ul>	<p>In progress</p> <p>In progress</p> <p>In progress</p>
Research and development	<ul style="list-style-type: none"> <li>• Continue research and development for embedded system and e-solution</li> <li>• Upgrade XteamServer series</li> </ul>	<p>In progress</p> <p>In progress</p>
Human resources, operations and administration	<ul style="list-style-type: none"> <li>• Recruit additional development engineers</li> <li>• Strengthen the Group's support services and start to provide enterprise consulting services</li> </ul>	<p>The Group will evaluate the Group's development strategy from time to time in order to meet the human resources requirement</p>
Strategic acquisitions and alliances	<ul style="list-style-type: none"> <li>• Explore opportunities to acquire or form alliances with companies providing synergies and technological support</li> </ul>	<p>The Group has successfully acquired a software company in Shanghai which can also provide certain technological support. In addition, the Group is still continuing to explore opportunities to acquire or form alliances with companies providing synergies and technological support</p>

## DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS OR SHORT POSITIONS IN THE SHARES AND UNDERLYING SHARES

As at 30th September, 2003, the interests or short positions of the Directors and chief executives of the Company in the shares and underlying shares of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO")) which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which were required, pursuant to Rules 5.40 to 5.58 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange, were as follows:

### (1) Interests in shares

Name of directors	Number of shares of the Company				% of issued share capital
	Personal interests	Family interests	Corporate interests	Total	
Mr. Ma Gary Ming Fai (note 1)	-	-	116,681,821	116,681,821	18.23%
Mr. Ren Yi (note 2)	-	-	1,481,507	1,481,507	0.23%
Mr. Wu Meng Jie	6,219,962	-	-	-	0.97%

Notes:

- 1 These shares are held by Upwise Investments Ltd. and Princeton Venture Partners Limited. 74,821,349 shares are held by Upwise Investments Ltd. and the entire issued share capital of Upwise Investments Ltd. is beneficially owned by Mr. Ma Gary Ming Fai. 41,860,472 shares are held by Princeton Venture Partners Limited. Princeton Venture Partners Limited is wholly owned by PVP Limited. PVP Limited is in turn owned as to 43.56% by Innovative Group Ltd. Innovative Group Ltd. is in turn wholly owned by Mr. Ma Gary Ming Fai. Mr. Ma Gary Ming Fai is taken to be interested in 74,821,349 shares and 41,860,472 shares by virtue of his corporate interests in Upwise Investments Ltd. and Innovative Group Ltd. respectively.
- 2 The 1,481,507 shares are held by One Focus Group Limited, a company incorporated in the British Virgin Islands, the issued capital of which is beneficially owned by Mr. Ren Yi.

### (2) Interests in underlying shares

#### (a) Pre-IPO share options

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

Details of the pre-IPO share options granted to certain Directors are as follows:

Name of Director	Date granted	Exercise period	No. of shares eligible for subscription under the pre-IPO share option	Exercise price per share
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
			80,000,000	

Up to 30th September, 2003, no options under the Pre-IPO Share Option Scheme have been exercised.

(b) Post-IPO share options

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, 2003, no options have been granted under the Share Option Scheme.

Save as disclosed above, as at 30th September, 2003, none of the Directors, chief executive of the Company and their associates had any personal, family, corporate or other interest or short positions in the shares and underlying shares of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein, or which were required, pursuant to Rules 5.40 to 5.58 of the GEM Listing Rules, to be notified to the Company and the Stock Exchange. During the reporting period, there were no debt securities issued by the Group.

## **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.

## **INTERESTS DISCLOSEABLE UNDER THE SFO AND SUBSTANTIAL SHAREHOLDERS**

As at 30th September, 2003, the following persons (other than the Directors and chief executive of the Company) had interests or short position in the shares and underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO and/or were directly or indirectly interested in 10% or more of the issued share capital carrying rights to vote in all circumstances at general meetings of any other members of the Group:

<b>Name</b>	<b>Number of shares</b>	<b>Percentage of issued share capital</b>
Upwise Investments Ltd.	74,821,349 ( <i>note 1</i> )	11.69%
Princeton Venture Partners Limited	41,860,472 ( <i>note 2</i> )	6.54%
PVP Limited	41,860,472 ( <i>note 3</i> )	6.54%
Olympic Glory Limited	41,860,472 ( <i>note 4</i> )	6.54%
Omnicorp Limited	42,340,472 ( <i>note 5</i> )	6.62%
Innovative Group Ltd.	41,860,472 ( <i>note 6</i> )	6.54%
Positivism Securities Limited	33,173,133	5.18%

### *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. Princeton Venture Partners Limited is wholly owned by PVP Limited. PVP Limited is in turn owned as to 43.56% by Innovative Group Ltd. and as to 37.22% by Olympic Glory Limited. Olympic Glory Limited is wholly owned by Omnicorp Limited (formerly Omnitech Group Limited), a company incorporated in Bermuda with limited liability and the securities of which are listed on the Main Board of the Exchange.
3. PVP Limited is deemed to be interested in 41,860,472 shares by virtue of its corporate interests in Princeton Venture Partners Limited.
4. Olympic Glory Limited is deemed to be interested in 41,860,472 shares by virtue of its corporate interests in PVP Limited.
5. Omnicorp Limited is deemed to be interested in 41,860,472 shares by virtue of its corporate interests in Olympic Glory Limited. 480,000 shares are held by Clever United Holdings Limited, which is wholly owned by Omnicorp Limited. Omnicorp Limited is deemed to be interested in 480,000 shares by virtue of its corporate interests in Clever United Holdings Limited.
6. Innovative Group Ltd. is deemed to be interested in 41,860,472 shares by virtue of its corporate interests in PVP Limited.

Save as disclosed above, as at 30th September, 2003, the Directors were not aware of any other person (other than the Directors and chief executive of the Company) who had an interest or short position in the shares and underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO and/or were directly or indirectly interested in 10% or more of the issued share capital carrying rights to vote in all circumstances at general meetings of any other members of the Group.

## **SHARE OPTIONS SCHEME**

### **(a) Pre-IPO Share Option Scheme**

Details of the pre-IPO share options granted to Directors are set out in the sub-section headed “Interests in underlying shares” under the section headed “Directors’ and chief executives’ interests or short position in the shares and underlying shares”. During the Review Period, 11,000,000 outstanding pre-IPO share options were lapsed due to the resignation of an employee. Therefore, there is no outstanding pre-IPO share options granted to other executives and full time employees as at 30th September, 2003.

### **(b) Post-IPO 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, 2003, 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, 2003, 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.

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, 2003.

## **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**  
**Mak To Wai**  
*Director*

Hong Kong, 10th November, 2003