Xteam SOFTWARE

Xteam Software International Limited

(Incorporated in the Cayman Islands with limited liability)

Annual Report

2004

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.

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The principal means of information dissemination on GEM is publication on the Internet website operated by the Exchange. Listed companies are not generally required to issue paid announcement 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.

The Stock Exchange of Hong Kong Limited takes no responsibility for the contents of this annual report, makes no representation as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss however arising from or in reliance upon the whole or any part of the contents of this annual report.

This annual report, for which the directors of Xteam Software International Limited collectively and individually accept responsibilities, includes particulars given in compliance with the Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited for the purpose of giving information with regard to the Company. The directors, having made all reasonable enquires, confirm that, to the best of their knowledge and belief:– (1) the information contained in this annual 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 annual report misleading; and (3) all opinions expressed in this annual report have been arrived at after due and careful consideration and are founded bases and assumptions that are fair and reasonable.

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Corporate Information

EXECUTIVE DIRECTORS

Ren Yi
Peng Wen Sheng
Mak To Wai
Wu Meng Jie
Yang Feng

NON-EXECUTIVE DIRECTORS

Ma Gary Ming Fai
Liu Jun

INDEPENDENT NON-EXECUTIVE DIRECTORS

Cheng Shu Wing
Wang Shi Yu

COMPANY SECRETARY

Mak To Wai, ACCA, AHKSA

QUALIFIED ACCOUNTANT

Mak To Wai, ACCA, AHKSA

COMPLIANCE OFFICER

Mak To Wai

AUTHORISED REPRESENTATIVES

Ma Gary Ming Fai
Mak To Wai

AUDIT COMMITTEE

Cheng Shu Wing
Wang Shi Yu

AUDITORS

Moore Stephens

LEGAL ADVISORS

Sidley Austin Brown & Wood
Conyers Dill & Pearman

SPONSOR

First Shanghai Capital Limited

PRINCIPAL BANKERS

The Hongkong and Shanghai Banking Corporation Limited
The Hong Kong Chinese Bank Limited

HEAD OFFICE AND PRINCIPAL PLACE OF BUSINESS

Suite 1913, Asian House
1 Hennessy Road
Wanchai
Hong Kong

REGISTERED OFFICE

Century Yard, Cricket Square
Hutchins Drive
P.O. Box 2681 GT, George Town
Grand Cayman
British West Indies

PRINCIPAL SHARE REGISTRAR AND TRANSFER OFFICE

Bank of Butterfield International (Cayman) Ltd.
Butterfield House, Fort Street
P.O. Box 705, George Town
Grand Cayman
Cayman Islands
British West Indies

HONG KONG BRANCH SHARE REGISTRAR AND TRANSFER OFFICE

Computershare Hong Kong Investor Services Limited
19th Floor, Hopewell Centre
183 Queen's Road East
Hong Kong

GEM STOCK CODE

8178

WEB-SITE ADDRESS

xteamlinux.com.cn

Chairman's Statement

2003 was a year of challenges for the Group. Our operations in the early 2003 were affected by SARS outbreak and normal business activities were muted. Though the PRC economy picked up steadily after the SARS outbreak, the Group had to squeeze the gross profit margin of the products to capture the market share. The Group's consolidated turnover for the year ended 31 March 2004 was approximately HK$26,823,000, a slight increase compared with approximately HK$26,694,000 last year.

In view of changing market conditions, the Group decided to make significant impairment provisions. Management believes this reflects the appropriate current worth of the Group's assets and will provide a sound basis to generate value for shareholders in the future. The Group incurred approximately HK$16,296,000 in aggregate, provision against inventories and impairment loss in respect of intangible assets. These provisions have no impact on the Group's operating cash flows. The Group does not expect to incur further material impairments in 2004 and the foreseeable future.

As a result of the provisions, the Group recorded a consolidated loss attributable to shareholders of approximately HK$34,847,000 for the year ended 31 March 2004. This compares with a consolidated loss of approximately HK$10,589,000 last year.

EMERGING AS A KEY SOFTWARE PLAYER IN BEIJING

The Group was a pioneer in the world to have a Chinese Linux kernel and has pledged unwavering commitment in becoming the "Open Source Standard in the PRC". To accomplish the vision, the Group had already enjoyed top-of-the-class Linux technology, evident by the award for "IT Top 100 Enterprises of China E-Government" presented by China Internet Weekly in 2002 and 2003, as well as the "China's Best Listed Linux Enterprise Award" by China Information World in 2002.

Nevertheless, the Group's results for the past years did not fully reflect our leading-edge technology. The PRC Linux market was largely untapped, but its adoption was still in its infancy and not emulated with the same enthusiasm in US and other European countries. The Group tackled the difficult market conditions with numerous approaches before but the market prevalence took time to take off. In February 2004, the Group entered into a landmark agreement which dawned a new era for the Group to capitalize the opportunities available and foster the rapid deployment of Linux technology in the PRC.

In February 2004, the Group signed a conditional agreement with Beijing Development (Hong Kong) Limited ("Beijing Development") to acquire its Software Businesses. The Group has also announced to enter the conditional agreements to increase its stake in Snow Fair Co., Ltd. ("Snow Fair") and Pantosoft International Limited ("Pantosoft") to 100%. Upon the completion of the acquisitions, Beijing Development will become the largest shareholder of the Group. The transaction will provide a reliable revenue source for the Group as the Software Businesses of Beijing Development recorded net profit of approximately HK$41,329,000 for the year ended 31 December 2003. The injection of profitable business will also improve the Group's financial position for future R&D initiatives and expansion across the PRC. The Software Businesses of Beijing Development is the pre-eminent player in Beijing in provision of software and information management systems to various government departments in the PRC. It has already established a strong clientele from the Beijing Government, such as the Beijing Education Bureau, the Labour and Social Security and Tax Authorities in the PRC.

The new Xteam is set to provide Linux operating systems and software solutions to government authorities in four key sectors: social security, labour security, e-government and e-education. The PRC Government played an overriding role to urge the government departments to use Linux-based operation systems and application software. Such government-led initiatives will help Xteam to push the Linux adoption in the four key sectors and secure a solid revenue base from the Government. The Group will also leverage on Beijing Development's closer ties with various government departments, as well as the combined expertise in Linux and government systems, to expand the client base in government departments in Beijing and the rest of the PRC.

PROSPECTS

The Group saw burgeoning potential in PRC Government software market. In August 2003, the State Council in the PRC announced that all government ministries had to purchase only PRC-made software at their next upgrade. According to China Centre of Information Industry Development ("CCID"), the Beijing Municipal Government purchased 2,801 suites of Linux operating systems and 11,143 automation software from domestic software companies in 2002. The PRC software market is further boosted by the promotion of e-government and e-education by the PRC Government. IDC forecasts that the PRC government's expenditure in IT services will increase from US$1.8 billion in 1999 to US$4.94 billion in 2004. These converging forces will cement the Group's position to capture the growing demand of software solutions from the largest sector in the PRC.

Looking ahead, the well-established clientele from Beijing Development, with the combined efforts of Xteam's leading-edge Linux technology, will provide the critical mass for the Group to replicate the successful business models in other provinces and expand into other sectors of the government and enterprise markets. Our ultimate goal is to bring widespread prevalence of Chinese-based software across the PRC, starting from the government divisions to enterprises, and then the largest chunk in the market – 1.3 billion people in the PRC. Our unique Chinese Linux kernel stands us in good stead to work towards this goal and set the "Open Source Standard in the PRC". The Group is determined to becoming the largest open source platform and service centre in the PRC to embrace the enormous potential in the PRC Software market.

WORD OF APPRECIATION

Last but not least, I would like to take this opportunity to express my heartfelt gratitude to the members of the Board of Directors, senior management and our staff for their dedication and contribution in 2003. 2004 will be full of challenges again – but our management has entered the year with confidence and determination to succeed. We will all strive to become the "Open Source Standard in the PRC".

Ma Gary Ming Fai
Chairman

Hong Kong

FINANCIAL RESULTS FOR THE YEAR ENDED 31 MARCH 2004

The Group recorded a turnover of approximately HK$26,823,000 for the year ended 31 March 2004, compared with a turnover of approximately HK$26,694,000 last year. The slight increase in turnover was mainly attributable to the increase in sales of low-margin products after the SARS outbreak to maintain its market presence.

The loss attributable to shareholders of the Group was approximately HK$34,847,000 (2003: approximately HK$10,589,000). The loss was mainly due to the substantial impairment provisions of approximately HK$8,320,000 (2003: Nil) against certain intangible assets and provision against obsolete inventories of approximately HK$7,976,000 (2003: approximately HK$4,267,000). The Group's gross profit margin was approximately 13.6% (2003: approximately 49.6%). The drop in gross profit margin was mainly due to keen competition in software market and the relatively low margin of hardware products which contributed to approximately 69.9% (2003: approximately 16.8%) of the Group's total turnover for the year.

LIQUIDITY, FINANCIAL RESOURCES AND DEBT RATIO

As at 31 March 2004, the Group has no outstanding bank loans (2003: HK$1,415,000). The loan as at 31 March 2003 was primarily used to finance short-term cash flows for the Group's operations in Shanghai, China. This loan carried a fixed interest rate of 5.31% per annum and has been fully repaid on 3 June 2003.

The gearing ratio (defined as total liabilities over equity) of the Group as at 31 March 2004 was approximately 44.4% (2003: approximately 39.1%).

The debt ratio (defined as total liabilities over total assets) of the Group as at 31 March 2004 was approximately 30.8% (2003: approximately 28.1%).

CAPITAL STRUCTURE, EXPOSURE TO EXCHANGE RATES FLUCTUATION

As at 31 March 2004, the number of issued share capital of the Company was 693,007,938 (2003: 588,327,938). During the year, a total of 104,680,000 new ordinary shares of the Company were issued to raise funds for product development, advertising and marketing activities and general working capital of the Group.

As at 31 March 2004, 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 YEAR AND FUTURE PLANS FOR MATERIAL INVESTMENTS

On 10 February 2004, the Group entered into several share purchase agreements as follows:

(a) Snow Fair entered into a share purchase agreement to acquire 49 shares of Pantosoft from its minority shareholder, Fortune Leo Investment Limited ("Fortune Leo"), at a consideration of approximately HK$16,000,000, to be satisfied partly by cash of HK$312,000 and partly by the Company issuing 105,422,000 new shares to Fortune Leo. After the completion of this transaction, the Company will own 100% of Pantosoft and its subsidiary, Shanghai Pantosoft Company Limited.

(b) The Company entered into two share purchase agreements to acquire a total of 31 shares of Snow Fair from its minority shareholders, MC Capital B.V. and Cosmo Town Limited, for total considerations of approximately HK$4,921,000, to be satisfied by the allotment of 33,938,000 new shares of the Company. After the completion of this transaction, the Company will own 100% of Snow Fair.

(c) A deed was entered into by the Company and Beijing Development pursuant to which the Company has agreed to purchase 680 shares of Astoria Innovations Limited ("Astoria"), representing 68% interest in Astoria, and 100 shares of Wisdom Elite Limited ("Wisdom"), representing 100% interest in Wisdom. Astoria and Wisdom are subsidiaries of Beijing Development and are engaged in the software business. The considerations will be satisfied by the Company issuing new shares to Beijing Development.

For details of the acquisitions, please refer to the announcement of the Company dated 19 May 2004.

SEGMENTAL INFORMATION

No analysis of the Group's turnover and its contribution to profit before taxation by principal activities for the year were presented as 100% (2003: 100%) of the Group's turnover and operating results arose from the sales of computer software and rendering of software development, system integration and related services in the PRC.

STAFF

As at 31 March 2004, the Group employed 104 employees, including directors of the Company (2003: 112) at market remuneration and benefits such as defined retirement/pension contributions, employee share options and medical insurance, etc. Total staff costs for the reported year were approximately HK$10,496,000 (2003: approximately HK$6,789,000). The increase was mainly due to the acquisition of a subsidiary in 2003.

CHARGE OF ASSETS

As at 31 March 2004, the Group did not have any charge on its assets (2003: Nil).

CONTINGENT LIABILITIES

As at 31 March 2004, the Group did not have any material contingent liabilities (2003: Nil).

COMPARISON OF USE OF PROCEEDS

The net proceeds raised from the placing on 11 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 30 November 2001 and are detailed below:

	From the date listed on GEM on 11 December 2001 to 31 March 2004	
	Proposed	**Actual**
	HK$'million	*HK$'million*
For product development or related investment through, among other things, acquisition, direct or indirect investment in other Linux based product developers	6.37	6.37
For enhancement of the Group's distribution channels through, among other things, acquisition, direct or indirect investment in other distributors	2.00	2.00
For setting up of a laboratory for e-solution project in Beijing, the PRC	2.50	2.50
For setting up Linux Training and Certificate Programme in Beijing, the PRC	1.00	1.00
For setting up the Group's Shanghai sales office	1.50	1.50
For advertising and marketing activities of the Group to promote the brand awareness and products of the Group	3.07	3.07
General working capital	0.80	0.80

Unused net proceeds were placed with licensed banks in Hong Kong and the PRC.

Management Discussion and Analysis

REVIEW OF BUSINESS OBJECTIVES

	Business Objectives	Actual Business Progress
Product launches, sales and marketing	• Continue to co-operate with the hardware vendors and distributors to deploy more embedded system	The Group is working with hardware vendors and distributors to deploy more embedded systems
	• Improve e-solution through strengthening its collaboration with software vendors and distributors	The Group is working with software vendors and distributors to provide e-solutions
	• Enhance sales and distribution channels	The Group had improved sales and distribution channels
	• Launch upgraded XteamServer series	In progress
Business development	• Further improve Xteam Companion	In progress
	• Improve support services and explore opportunities to provide enterprise consulting services	In progress
	• 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	In progress
Research and development	• Upgrade XteamServer series	In progress

	Business Objectives	Actual Business Progress
Human resources, operations and administration	• Recruit additional development engineers • Strengthen the Group's support services and start to provide enterprise consulting services	The Group will access the Group's development strategy from time to time in order to meet the human resources requirement
Strategic acquisitions and alliances	• Explore opportunities to acquire or form alliances with companies providing synergies and technological support	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

MAJOR SUPPLIERS AND CUSTOMERS

The percentage of purchases and sales for the year ended 31 March 2004 attributable to the Group's major suppliers and customers are as follows:

Purchases	
– the largest supplier	18.0%
– five largest suppliers combined	54.2%
Sales	
– the largest customer	13.7%
– five largest customers combined	46.0%

None of the directors, their associates or any shareholder (which to the knowledge of the directors owns more than 5% of the Company's share capital) had an interest in the major suppliers or customers stated above.

Biographical Information of Directors and Senior Management

Executives Directors and Senior Management

REN Yi, aged 31, is the chief executive officer and chief technical officer of the Company. Mr. Ren has in-depth knowledge of software development. Mr. Ren graduated from the Department of Computer Science of the 北京工業大學 (Beijing Polytechnic University) in Beijing, the PRC in 1994. He joined the Group in January 2000.

PENG Wen Sheng, aged 35, is the general manager of Shanghai Pantosoft Company Limited. Mr. Peng graduated from 南京理工大學機械系 in 1987 with a bachelor degree in Science. He also obtained a master degree in Science in 華中理工大學 in 1994. He joined the Group in December 2002.

MAK To Wai, aged 37, the chief financial officer, qualified accountant, company secretary and compliance officer of the Company, joined the Company in August 2000. Prior to joining the Company, Mr. Mak was an audit manager with both the Hong Kong and Beijing offices of KPMG Peat Marwick. Mr. Mak is an associate member of the Association of Chartered Certified Accountants of the United Kingdom and the Hong Kong Society of Accountants. Mr. Mak graduated from Baptist University of Hong Kong in 1990 with a bachelor degree in Business Administration.

WU Meng Jie, aged 31, is the senior vice president of the Company. He joined the Company in June 2000 as the sales director. Mr. Wu has several years of experience in distributing computer products. Mr. Wu graduated from 中山大學化學系 (Chemistry Department of Guangzhou Chung Shan University) with a bachelor degree in Chemistry.

YANG Feng, aged 32, a director of the Company. Prior to establishing Beijing Infotech in May 1999, Mr. Yeng worked for the Policy Research Bureau of the People's Government of Beijing Municipality for Several years. Mr. Yang graduated from the Business Administration Department of the Beijing Economic College in Beijing, the PRC in 1994 with a bachelor degree in Economics. He joined the Group in January 2000.

Non-executive Director

MA Gary Ming Fai, aged 40, is the chairman of the Company. He is the founder or early investor in a number of technology projects both in the PRC and Hong Kong. Mr. Ma is a member of the Institute of Chartered Accountants of Ontario in Canada by training and has worked for several years with an international accounting firm. Mr. Ma received his Bachelor of Commerce degree from the University of Calgary, Canada in 1985. He joined the Group in December 1999.

LIU Jun, aged 38, has extensive experience in the investment industry in the PRC. Mr. Liu graduated from the Department of Management of 北京理工大學. He is also the chairman of an investment management company in Beijing. He joined the Group in April 2002.

Independent non-executive Directors

CHENG Shu Wing, aged 54, has extensive experience in the banking and securities industries in Hong Kong and has been active in financing, investment advisory and fund management activities. Mr. Cheng is a director of an investment bank in Hong Kong. Mr. Cheng holds a Bachelor Degree in Business Administration from The Chinese University of Hong Kong. He joined the Group in November 2001.

WANG Shi Yu, aged 46, has extensive experience in the investment banking and financial industry in the PRC. Mr. Wang is also a general manager of Youlian Strategic Company (友聯戰略管理公司), one of the largest domestic company in the PRC. He joined the Group in November 2001.

Report of the Directors

The board of Directors ("Board") of Xteam Software International Limited (the "Company") presents their annual report together with the audited financial statements for the year ended 31 March 2004.

PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The principal activities of the Company is investment holding. The activities of the subsidiaries are set out in note 14 to the financial statements. The Group is principally engaged in software development and 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.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31 March 2004 are set out on pages 30-60.

The Board does not recommend the payment of a final dividend for the year ended 31 March 2004 (2003: Nil).

SUMMARY FINANCIAL INFORMATION

A summary of the results and of the assets, liabilities and minority interests of the Group for the last four financial years, as extracted from the published audited financial statements and reclassified as appropriate, are set out below.

RESULTS

	2004	2003	2002	23 November 1999 to 31 December 2001
	HK$'000	HK$'000	HK$'000	HK$'000
Turnover	**26,823**	26,694	21,835	19,671
Cost of sales and services	**(23,176)**	(13,463)	(2,734)	(2,566)
Gross profit	**3,647**	13,231	19,101	17,105
Other revenue	**1,687**	542	159	432
Selling and marketing expenses	**(5,087)**	(4,035)	(1,978)	(12,973)
General and administrative expenses	**(14,203)**	(10,371)	(7,468)	(6,920)
Research and development costs	**(2,817)**	(5,227)	(6,100)	(6,976)
Provision against inventories	**(7,976)**	(4,267)	–	–
Impairment loss in respect of intangible assets	**(8,320)**	–	–	–
(Loss)/profit from operating activities	**(33,069)**	(10,127)	3,714	(9,332)
Finance costs	**(36)**	(200)	(236)	(166)
(Loss)/profit before taxation	**(33,105)**	(10,327)	3,478	(9,498)
Taxation	**(318)**	(117)	–	–
(Loss)/profit for the year	**(33,423)**	(10,444)	3,478	(9,498)
Minority interests	**(1,424)**	(145)	–	–
(Loss)/profit attributable to shareholders	**(34,847)**	(10,589)	3,478	(9,498)

ASSETS, LIABILITIES AND MINORITY INTERESTS

	2004	2003	2002	2001
TOTAL ASSETS	**39,169**	67,448	47,940	19,324
TOTAL LIABILITIES	**(9,244)**	(17,567)	(12,380)	(9,721)
MINORITY INTERESTS	**(2,801)**	(1,377)	–	–
	27,124	48,504	35,560	9,603

RESERVES

Movements in the reserves of the Group and the Company during the year are set out in the consolidated statement of changes in equity and note 21 to the financial statements, respectively.

DONATIONS

No charitable and other donations were made by the Group during the year.

FIXED ASSETS

Details of the movements in fixed assets of the Group and the Company are set out in note 13 to the financial statements.

SHARE CAPITAL

Details of the movements in share capital of the Company are set out in note 20 to the financial statements.

PRE-EMPTIVE RIGHTS

There are no provisions of pre-emptive rights under the Company's Article of Association of the laws of the Cayman islands which would oblige the Company to offer new shares on a pro rata basis to existing shareholding.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN SECURITIES

As at 31 March 2004, 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

	Number of shares of the Company				
Name of directors	**Personal interests**	**Family interests**	**Corporate interests**	**Total**	**% of issued share capital**
Mr. Ma Gary Ming Fai *(note 1)*	–	–	116,681,821	116,681,821	16.84%
Mr. Ren Yi *(note 2)*	–	–	1,481,507	1,481,507	0.21%
Mr. Wu Meng Jie	6,219,962	–	–	6,219,962	0.90%

Notes:

1. These shares are held by Upwise Investments Ltd. and Princeton Venture Partners Limited. 74,821,349 shares are held by Upwise Investment Ltd. and the entire issued share capital of Upwise Investment 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% voting equity interest 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 30 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 11 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	14 November 2001	11 June 2002 to 13 November 2011	50,000,000	HK$0.266
Mr. Mak To Wai	14 November 2001	11 June 2002 to 13 November 2011	30,000,000	HK$0.266
			80,000,000	

Up to 31 March 2004, no options under the Pre-IPO Share Option Scheme have been exercised.

(b) *Post-IPO share options*

On 21 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.

On 19 December 2003, 63,000,000 post-IPO share options were granted and accepted at an exercise price of HK$0.14 per share.

Details of the outstanding post-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. Cheng Shu Wing	19 December 2003	19 December 2003 to 18 December 2013	1,000,000	HK$0.14
Mr. Wang Shi Yu	19 December 2003	19 December 2003 to 18 December 2013	1,000,000	HK$0.14
			2,000,000	

Up to 31 March 2004, no options under the Share Option Scheme have been exercised.

Details of the 61,000,000 outstanding post-IPO share options granted to individuals other than Directors were set out in the sub-section headed "Post-IPO Share Option Scheme" under the section headed "Share Option Scheme".

Save as disclosed above, as at 31 March 2004, 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 year, 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 Reorganisation prior to the listing of the Company's shares on the 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 31 March 2004, 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:

Name	**Number of shares**	**Percentage of issued share capital**
Hung Fung King Margaret	116,681,821 *(note 1)*	16.84%
Hung Fung King Margaret	50,000,000 *(note 2)*	7.21%
Upwise Investments Ltd.	74,821,349 *(note 3)*	10.80%
Princeton Venture Partners Limited	41,860,472 *(note 4)*	6.04%
PVP Limited	41,860,472 *(note 5)*	6.04%
Olympic Glory Limited	41,860,472 *(note 6)*	6.04%
Omnicorp Limited	42,340,472 *(note 7)*	6.11%
Innovative Group Ltd.	41,860,472 *(note 8)*	6.04%

Notes:

1. These shares were held by Upwise Investments Ltd. and Princeton Venture Partners Limited. 74,821,349 shares were held by Upwise Investments Ltd. and the entire issued capital of Upwise Investments Ltd. is beneficially owned by Mr. Ma Gary Ming Fai. 41,860,472 shares were 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% voting equity interest by Innovative Group Ltd. Innovative Group Ltd. is in turn wholly owned by Mr. Ma Gary Ming Fai. Mr. Ma Gary Ming Fai was taken to be interested in 74,821,349 Shares and 41,860,472 Shares by virtue of his interests in Upwise Investments Ltd. and Innovative Group Ltd. respectively. Ms. Hung Fung King Margaret is the spouse of Mr. Ma Gary Ming Fai and accordingly she was deemed to be interested in these shares.

2. These shares represent the number of shares to be allotted and issued to Mr. Ma Gary Ming Fai upon the exercise in full of the share options granted to him on 14 November 2001 pursuant to the Pre-IPO Share Option Scheme. These share options are exercisable from 11 June 2002 to 13 November 2011 at the exercise price of HK$0.266 per share. Ms. Hung Fung King Margaret is the spouse of Mr. Ma Gary Ming Fai and accordingly she was deemed to be interested in these shares.

3. The entire issued share capital of Upwise Investments Ltd. is beneficially owned by Mr. Ma Gary Ming Fai, the Chairman of the Company.

4. Princeton Venture Partners Limited is wholly owned by PVP Limited. PVP Limited is in turn owned as to 43.56% voting equity interest by Innovative Group Ltd. and as to 37.22% voting equity interest 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.

5. PVP Limited is deemed to be interested in 41,860,472 shares by virtue of its corporate interests in Princeton Venture Partners Limited.

6. Olympic Glory Limited is deemed to be interested in 41,860,472 shares by virtue of its corporate interests in PVP Limited.

7. 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.

8. 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 31 March 2004, 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". There is no outstanding pre-IPO share options granted to other executives and full time employees as at 31 March 2004.

(b) Post-IPO Share Option Scheme

On 21 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.

On 19 December 2003, 63,000,000 post-IPO share options were granted and accepted at an exercise price of HK$0.14 per share.

Details of the outstanding post-IPO share options granted to are as follows:

Type of grantees	**Date granted**	**Exercise period**	**No. of shares eligible for subscription under the post-IPO share option**	**Exercise price per share**
Directors	19 December 2003	19 December 2003 to 18 December 2013	2,000,000	HK$0.14
Employees, advisers and consultants	19 December 2003	19 December 2003 to 18 December 2013	61,000,000	HK$0.14
			63,000,000	

Up to 31 March 2004, no options under the Share Option Scheme have been exercised.

Details of the post-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".

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

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the year.

COMPETING INTERESTS

During the year 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 30 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 11 December 2001 to 31 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 16 January 2002.

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

DIRECTORS

The Directors of the Company during the year were:

Executive Directors

Ren Yi
Peng Wen Sheng (appointed on 11 November 2003)
Mak To Wai
Wu Meng Jie
Yang Feng

Non-Executive Directors

Ma Gary Ming Fai
Liu Jun

Independent Non-Executive Directors

Cheng Shu Wing
Wang Shi Yu

In accordance with Article 87(1) & (2) of the Company's Articles of Association, Mr. Ren Yi and Mr. Yang Feng will retire by rotation, and being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

DIRECTORS' SERVICE CONTRACTS

Each of the Executive Directors has entered into a service contract with the Company for a term of 3 years from 21 November 2001 which may be terminated by either party thereto giving to the other not less than six calendar month's prior notice in writing, which notice period shall not expire until after the first year.

Each of the Non-Executive Directors and independent Non-Executive Directors was appointed for a period of two years commencing from their appointment dates.

None of the Directors who are proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable within one year without payment of compensation, other than statutory compensation.

DIRECTORS' INTEREST IN CONTRACTS AND CONTROLLING SHAREHOLDER'S INTEREST IN CONTRACTS

There are no contracts of significance in relations to the Group's business to which the Company was a party and in which a director of the Company or a controlling shareholder or any of its subsidiaries, had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

CONNECTED TRANSACTIONS

During the year, there were no transactions which need to be disclosed as connected transaction in accordance with the requirements of the GEM Listing Rules. Details of the related party transactions are set out in note 25 to the financial statements.

MANAGEMENT CONTRACTS

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

BOARD PRACTICES AND PROCEDURES

The Company has complied with the Board Practices and Procedures as set out in rules 5.34 to 5.45 of the GEM Listing Rules since listed on the GEM on the Stock Exchange.

AUDIT COMMITTEE

As required by Rule 5.23 of the GEM Listing Rules, the Company has established an audit committee on 21 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 system of the Group and provide advice and comments to the board of Directors.

The following sets out the members of the Group's audit committee:

Name	Position in the audit committee	Position in the Board of Directors
Cheng Shu Wing	Chairman	Independent Non-executive Director
Wang Shi Yu		Independent Non-executive Director

AUDITORS

The financial statements have been audited by Moore Stephens who retire, and being eligible, offer themselves for re-appointment.

On behalf of the Board

Ma Gary Ming Fai
Chairman

Hong Kong, 21 June 2004

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the 2004 Annual General Meeting of the Company will be held at the Boardroom, Basement II, The Wharney Hotel Hong Kong, 57-73 Lockhart Road, Wanchai, Hong Kong on Friday, 23 July 2004 at 10:00 a.m. for the following purposes:

1. To consider and adopt the audited consolidated financial statements and the reports of the directors and auditors for the year ended 31 March 2004;

2. To re-elect retiring directors and to authorise the Directors to fix their remuneration;

3. To re-appoint auditors and to authorise the Directors to fix their remuneration;

4. As Special Business, to consider and, if thought fit, pass the following resolutions with or without amendments as Ordinary Resolutions:

   A. "**THAT**

      (a) subject to paragraph (c) of this Resolution, the exercise by the Directors of the Company during the Relevant Period (as hereinafter defined) of all powers of the Company to allot, issue and deal with additional shares in the capital of the Company or securities convertible into such shares or options, warrants, or similar rights to subscribe for any shares or convertible securities and to make or grant offers, agreements and options which might require the exercise of such powers be and is hereby generally and unconditionally approved;

      (b) the approval in paragraph (a) of this Resolution shall authorise the Directors during the Relevant Period to make or grant offers, agreements and options which might require the exercise of such power after the end of the Relevant Period;

      (c) the aggregate nominal value of share capital allotted or agreed conditionally or unconditionally to be allotted (whether pursuant to an option or otherwise), issued or dealt with by the Directors pursuant to the approval in paragraph (a) of this Resolution, otherwise than pursuant to (i) a Rights Issue (as defined in paragraph (d) of this Resolution), (ii) the exercise of rights of subscription or conversion under the terms of any warrants issued by the Company or any securities which are convertible into shares of the Company, (iii) the exercise of any options granted under any option scheme or similar arrangement for the time being adopted for the grant or issue to eligible persons of options to subscribe for, or rights to acquire, shares of the Company or, (iv) any scrip dividend or similar arrangement providing for the allotment of shares in the capital of the Company in lieu of the whole or part of the cash payment for any dividend on shares of the Company pursuant to the Articles of Association of the Company from time to time, shall not in aggregate exceed 20 per cent of the aggregate nominal amount of the share capital of the Company in issue at the date of passing this Resolution and the said approval shall be limited accordingly; and

(d) for the purpose of this Resolution:-

"Relevant Period" means the period from the passing of this Resolution until whichever is the earliest of:-

(i) the conclusion of the next annual general meeting of the Company;

(ii) the expiration of the period within which the next annual general meeting of the Company is required by the Articles of Association of the Company or any applicable law of the Cayman Islands to be held; or

(iii) the revocation or variation of the authority given under this Resolution by an ordinary resolution of the shareholders of the Company in a general meeting; and

"Rights Issue" means the allotment, issue or grant of shares in the capital of the Company pursuant to an offer of shares open for a period fixed by the Directors made to holders of shares of the Company or any class thereof whose names appear on the Register of Members of the Company on a fixed record date in proportion to their then holdings of such shares or class thereof (subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to fractional entitlements or having regard to any restrictions or obligations under the laws of, or the requirements of any recognised regulatory body or any stock exchange in or in any territory applicable to the Company)."

B. "**THAT**

(a) subject to paragraph (b) of this Resolution, the exercise by the Directors of the Company during the Relevant Period (as defined in paragraph (c) of this Resolution) of all the powers of the Company to repurchase its own issued shares in the capital of the Company in accordance with laws and requirements and regulations of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") or on any other stock exchanges on which the shares of the Company may be listed and recognised by the Securities and Futures Commission and the Stock Exchange for this purpose, subject to and in accordance with all applicable laws and requirements of the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange or rules of any other stock exchange as amended from time to time, be and is hereby generally and unconditionally approved;

(b) the aggregate nominal amount of shares of the Company to be repurchased by the Company pursuant to the approval in paragraph (a) of this Resolution shall not exceed 10 per cent of the aggregate nominal amount of the share capital of the Company in issue as at the date of passing of this Resolution and the said approval shall be limited accordingly; and

(c) for the purpose of this Resolution:-

"Relevant Period" means the period from the passing of this Resolution until whichever is the earliest of:-

(i) the conclusion of the next annual general meeting of the Company;

(ii) the expiration of the period within which the next annual general meeting of the Company is required by the Articles of Association of the Company or any applicable law of the Cayman Islands to be held; or

(iii) the revocation or variation of the authority given under this Resolution by an ordinary resolution of the shareholders of the Company in a general meeting."

C. "**THAT** subject to the passing of the Ordinary Resolution Nos. 4A and 4B, the general mandate granted to the Directors to allot, issue and deal with additional securities pursuant to Resolution No. 4A be and is hereby extended by the addition thereto of an amount representing the aggregate nominal amount of shares repurchased by the Company under the authority granted pursuant to Resolution No. 4B, provided that such amount of shares so repurchased shall not exceed 10 per cent of the aggregate nominal amount of the share capital of the Company in issue as at the date of the passing this Resolution."

D. "**THAT** the number of share of the Company in respect of which options may be granted under the share option scheme or any other option, scheme or similar arrangement for the time being adopted for the grant or issue to officers and/or employees of the Company and/or any of its subsidiaries of share or rights to acquire shares of the Company be renewed to an aggregate of 10% of the entire share capital of the Company in issue on the date of passing of this Resolution."

As of the date of this report, the Board comprises the following directors;

Executive directors:
Ren Yi
Peng Wen Sheng
Mak To Wai
Wu Meng Jie
Yang Feng

Non-executive directors:
Ma Gary Ming Fai
Liu Jun

Independent non-executive directors:
Cheng Shu Wing
Wang Shi Yu

By Order of the Board
Xteam Software International Limited
Mak To Wai
Company Secretary

Hong Kong, 21 June 2004

Head office and principal place of business:
Suite 1913, Asian House
1 Hennessy Road
Wanchai
Hong Kong

Notice of Annual General Meeting

Notes:

1. Any member of the Company entitled to attend and vote at the Meeting shall be entitled to appoint another person (who must be an individual) as his proxy to attend and vote instead of him and a proxy so appointed shall have the same right as the member to speak at the Meeting. A proxy need not be a member of the Company.

2. To be valid, a form of the proxy and the power of attorney or other authority, if any, under which it is signed, or a notarially certified copy of such power or authority, must be delivered at the Company's branch registrar in Hong Kong, Computershare Hong Kong Investor Services Limited, at 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong not less than forty-eight hours before the appointed time for holding the Meeting.

3. An Explanatory Statement containing further details regarding Ordinary Resolution No. 4 above as required by the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange will be dispatched to members of the Company together with the 2003 Annual Report.

Auditors' Report to the Shareholders of Xteam Software International Limited

(Incorporated in the Cayman Islands with limited liability)

We have audited the financial statements on pages 30 to 60 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

Respective responsibilities of directors and auditors

The company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 March 2004 and of the loss and cash flows of the Group for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

Moore Stephens

Certified Public Accountants

Hong Kong

21 June 2004

Consolidated Profit and Loss Account

For the year ended 31 March 2004

	Notes	2004 HK$'000	2003 HK$'000
Turnover	3	**26,823**	26,694
Cost of sales and services		**(23,176)**	(13,463)
Gross profit		**3,647**	13,231
Other revenue	3	**1,687**	542
Selling and marketing expenses		**(5,087)**	(4,035)
General and administrative expenses		**(14,203)**	(10,371)
Research and development costs		**(2,817)**	(5,227)
Provision against inventories		**(7,976)**	(4,267)
Impairment loss in respect of intangible assets		**(8,320)**	–
Loss from operating activities	5	**(33,069)**	(10,127)
Finance costs	8	**(36)**	(200)
Loss before taxation		**(33,105)**	(10,327)
Taxation	9	**(318)**	(117)
Loss for the year		**(33,423)**	(10,444)
Minority interests		**(1,424)**	(145)
Loss attributable to shareholders	10	**(34,847)**	(10,589)
Loss per share	12		
– Basic		**(5.38 cents)**	(1.84 cents)
– Diluted		**(5.36 cents)**	(1.75 cents)

Consolidated Balance Sheet

31 March 2004

	Notes	2004 HK$'000	2003 HK$'000
Fixed assets	13	**2,477**	2,063
Goodwill	15	**13,688**	14,813
Intangible assets	16	**1,920**	14,881
Current assets			
Inventories	17	**1,747**	9,036
Accounts receivable	18	**4,199**	1,635
Prepayments, deposits and other receivables		**4,695**	11,746
Value added tax refundable		**1,259**	1,343
Cash and bank balances		**9,184**	11,931
		21,084	35,691
Current liabilities			
Accounts payable	19	**1,315**	1,936
Short-term bank loan (unsecured)		**–**	1,415
Tax payable		**97**	–
Other payables and accrued expenses		**7,832**	14,216
		9,244	17,567
Net current assets		**11,840**	18,124
Non-current liabilities			
Minority interests		**2,801**	1,377
		27,124	48,504
Share capital	20	**6,930**	5,883
Reserves		**20,194**	42,621
		27,124	48,504

Ma Gary Ming Fai
Director

Mak To Wai
Director

Consolidated Statement of Changes in Equity

For the year ended 31 March 2004

	Share capital	Share premium account	Statutory reserve fund	Accumulated losses	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
1 April 2002	5,503	36,248	–	(6,191)	35,560
Issue of new shares	380	23,499	–	–	23,879
Adjustment for over-accrued share issue expense in prior year	–	1,058	–	–	1,058
Share issue expenses	–	(1,404)	–	–	(1,404)
Loss for the year	–	–	–	(10,589)	(10,589)
31 March 2003 and 1 April 2003	5,883	59,401	–	(16,780)	48,504
Issue of new shares	1,047	13,531	–	–	14,578
Share issue expenses	–	(1,111)	–	–	(1,111)
Transfer	–	–	60	(60)	–
Loss for the year	–	–	–	(34,847)	(34,847)
31 March 2004	**6,930**	**71,821**	**60**	**(51,687)**	**27,124**

Consolidated Cash Flow Statement

For the year ended 31 March 2004

	Note	2004 HK$'000	2003 HK$'000
Operating activities			
Loss before taxation		**(33,105)**	(10,327)
Adjustment for:			
Bank interest income		**(60)**	(138)
Gain on disposal of fixed assets		**(12)**	–
Amortisation of goodwill		**1,125**	375
Amortisation of intangible assets		**4,641**	4,625
Depreciation		**808**	485
Impairment loss in respect of intangible assets		**8,320**	–
Provision against inventories		**7,976**	4,267
Provision for bad and doubtful debts		**1,217**	41
Decrease/(increase) in prepayments, deposits and other receivables		**7,051**	(9,610)
Decrease in value added tax refundable/payable		**84**	169
Decrease in other payable and accrued expenses		**(6,384)**	(3,448)
Operating cash flows before working capital changes		**(8,339)**	(13,561)
Increase in inventories		**(687)**	(10,412)
(Increase)/decrease in accounts receivable		**(3,781)**	7,635
Decrease in accounts payable		**(621)**	(280)
Cash used in operations		**(13,428)**	(16,618)
Income tax paid		**(221)**	(117)
Net cash used in operating activities		**(13,649)**	(16,735)
Investing activities			
Interest received		**60**	138
Proceeds from disposal of fixed assets		**94**	–
Purchase of fixed assets		**(1,304)**	(326)
Purchase of intangible assets		**–**	(476)
Acquisition of a subsidiary (net of cash acquired)	*22*	**–**	(7,974)
Net cash outflow from investing activities		**(1,150)**	(8,638)
Financing activities			
Issue of new shares		**14,578**	22,038
Repayment of short-term bank loan		**(1,415)**	–
Share issue expenses		**(1,111)**	(1,404)
Net cash inflow generated from financing		**12,052**	20,634
Net decrease in cash and cash equivalents		**(2,747)**	(4,739)
Cash and cash equivalents at beginning of year		**11,931**	16,670
Cash and cash equivalents at end of year, representing cash and bank balances		**9,184**	11,931

Balance Sheet

31 March 2004

	Notes	2004 HK$'000	2003 HK$'000
Interests in subsidiaries	14	**30,267**	53,447
Current assets			
Prepayments, deposits and other receivables		**798**	324
Cash and bank balances		**10**	10
		808	334
Current liabilities			
Other payables and accrued expenses		**2,983**	3,190
Net current liabilities		**(2,175)**	(2,856)
		28,092	50,591
Share capital	20	**6,930**	5,883
Reserves	21	**21,162**	44,708
		28,092	50,591

Ma Gary Ming Fai
Director

Mak To Wai
Director

31 March 2004

1. Corporate information

The Company was incorporated in the Cayman Islands on 24 May 2001 as an exempted company with limited liability under the Companies Law (2001 Second Revision) of the Cayman Islands. The shares of the Company have been listed on the Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited ("Stock Exchange") since 11 December 2001.

During the year, the Group was principally engaged in software development and 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 People's Republic of China ("PRC"). It also provided technical support and after-sales services to its customers.

2. Basis of preparation of financial statements and principal accounting policies

The financial statements have been prepared in accordance with accounting policies generally accepted in Hong Kong and under the historical cost convention and in compliance with the Companies Ordinance. The principal accounting policies are set out below. The accounting policies and methods of computation used in the preparation of the financial statements for the year ended 31 March 2004 are consistent with those adopted in the 2003 financial statements except for the change in accounting policy as explained below.

a) Adoption of Statement of Standard Accounting Practice

In the current year, the Group has adopted, for the first time, Hong Kong Financial Reporting Standard ("HKFRS") – Statement of Standard Accounting Practice ("SSAP") 12 (Revised) "Income Taxes" issued by the Hong Kong Society of Accountants ("HKSA"). The term HKFRS is inclusive of SSAPs and Interpretations approved by the HKSA.

The principal effect of the implementation of SSAP 12 (Revised) is in relation to deferred tax. In prior years, deferred tax was provided using the income statement liability method on all significant differences to the extent it was probable that the liability would crystallise in the foreseeable future. A deferred tax asset was not recognised until its realisation was assured beyond reasonable doubt. SSAP 12 (Revised) requires the adoption of the balance sheet liability method, whereby deferred tax is recognised in respect of all temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, with limited exceptions. In the absence of any specific transitional requirements in SSAP 12 (Revised), the new accounting policy has been applied retrospectively. The adoption of SSAP 12 (Revised) has had no material effect on the results for the current or prior periods.

31 March 2004

2. Basis of preparation of financial statements and principal accounting policies

(Continued)

b) Consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31 March. Apart from the subsidiaries acquired as part of the group reorganisation in preparation for the listing of the Group on the GEM, the results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from their effective date of acquisition to 31 March, or up to the effective date of disposal, as appropriate.

All significant inter-company transactions and balances within the Group are eliminated on consolidation.

c) Subsidiaries

A subsidiary is a company whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities. In the Company's balance sheet, the interests in subsidiaries are stated at cost less impairment loss, if any. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

d) 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 recognised 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.

e) Fixed assets

Fixed assets are stated at cost, less provisions for depreciation and any impairment losses. Details are set out in note 13 to the financial statements. The cost of an asset comprises its purchase price and any directly attributable cost of bringing the asset to its working condition and location for its intended use. Expenditure incurred after the fixed asset has been put into operation, such as repairs and maintenance and overhaul costs, is normally charged to the profit and loss account in the year in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of the fixed asset, the expenditure is capitalised as an additional cost of the fixed asset.

31 March 2004

2. Basis of preparation of financial statements and principal accounting policies

(Continued)

e) Fixed assets *(Continued)*

The gain or loss on retirement or disposal of a fixed asset recognised in the profit and loss account is the difference between the net sales proceeds on disposal or retirement and the carrying amount of the relevant asset.

Depreciation is calculated on the straight-line basis to write off the cost of each asset, less its estimated residual value, which is estimated at 10% of the cost over its estimated economic useful life. The effective annual rates used for this purpose are as follows:–

Leasehold improvements	18% – $33^1/_3$%
Computer equipment	18% – 20%
Furniture and fixtures	18% – 25%
Office equipment	18% – $33^1/_3$%
Motor vehicles	18% – 20%

f) Intangible assets

Intangible assets represent the costs of acquiring Internet platform, trademarks and computer software. They are stated at cost less accumulated amortisation and any impairment losses.

Amortisation is calculated on the straight-line basis over the estimated economic life of the individual intangible assets as follows:–

Internet platform	$33^1/_3$% per annum
Trademarks	5% per annum
Computer software	20% per annum

g) Impairment of assets

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

31 March 2004

2. Basis of preparation of financial statements and principal accounting policies *(Continued)*

g) Impairment of assets *(Continued)*

Recoverable amount is the greater of net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately, unless the relevant asset is land or buildings other than investment property carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

h) Research and development costs

All research costs are charged to the profit and loss account as incurred.

Expenditure incurred on projects to develop new products is capitalised and deferred only when the projects are clearly defined; the expenditure is separately identifiable and can be measured reliably; there is reasonable certainty that the projects are technically feasible, and the products have commercial value. Product development expenditure which does not meet these criteria is expensed when incurred.

Development costs recognised as assets are amortised using the straight-line basis over a period of not exceeding five years from the commencement of the commercial phase of the project. The unamortised balance of development costs is reviewed at the end of each year and is written off to the extent that the unamortised balance, taken together with further development and directly related costs, is no longer likely to be recovered.

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2. Basis of preparation of financial statements and principal accounting policies

(Continued)

i) Leased assets

Leases that transfer substantially all the rewards and risks of ownership of assets to the Group, other than legal title, are accounted for as finance leases. At the inception of a finance lease, the cost of the leased asset is capitalised at the present value of the minimum lease payments and recorded together with the obligation, excluding the interest element, to reflect the purchase and financing.

Assets held under capitalised finance leases are included in fixed assets and depreciated over the estimated useful lives of the assets. The finance costs of such leases are charged to the profit and loss account so as to provide a constant periodic rate of charge over the lease terms.

Leased items where substantially all the rewards and risks of ownership of assets remain with the lessors are accounted for as operating leases. Rentals applicable, to such operating leases are charged to the profit and loss account on the straight-line basis over the lease terms.

j) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of finished goods, comprises direct materials, subcontracting charges and an appropriate proportion of overheads. Net realisable value is based on estimated selling prices less further costs expected to be incurred to completion and disposal.

k) Accounts receivable

Accounts receivable are stated at face value, after provision for doubtful debts, if any.

l) Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash equivalents represent cash at bank and on hand, demand deposits with banks and other financial institutions, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value having been within three months of maturity when acquired.

2. Basis of preparation of financial statements and principal accounting policies

(Continued)

m) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable rates of exchange ruling at that date. All foreign currency translations during the year are converted at the exchange rates existing on the respective transaction dates. All exchange differences are credited or charged, respectively, to the consolidated profit and loss account.

The exchange differences arising from the translation of the balance sheets of foreign subsidiaries using the closing rates of exchange prevailing on the balance sheet date are taken directly to reserve. Profit and loss accounts of foreign subsidiaries accounted for under the net investment method are translated into Hong Kong dollars using average rate for the year. The differences between the profit and loss account translated at average rate and at closing rate are taken directly to the reserve.

n) Taxation

Taxation represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years, and it further excludes items that are never taxable or deductible.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill (or negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

31 March 2004

2. Basis of preparation of financial statements and principal accounting policies

(Continued)

n) Taxation *(Continued)*

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited in the profit and loss account, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

o) Revenue

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

(i) on the sale of goods, when the significant risks and rewards of ownership have been transferred to the buyer provided that the Group maintains neither managerial involvement to the degree usually associated with ownership, nor effective control over the goods sold;

(ii) on the rendering of services, when the relevant services have been rendered; and

(iii) interest income, on a time proportion basis taking into account the principal amounts outstanding and the effective interest rates applicable.

p) Borrowing costs

Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds.

All borrowing costs are charged to the profit and loss account in the year in which they are incurred.

q) Contributions to pension and retirement schemes

Contributions to pension and retirement schemes are charged to the profit and loss account in the year to which they relate.

31 March 2004

2. Basis of preparation of financial statements and principal accounting policies *(Continued)*

r) Contingencies

Contingent liabilities are not recognised but are disclosed in the financial statements unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is not recognised but is disclosed in the financial statements when an inflow of economic benefits is probable.

s) Provisions

A provision is recognised when, and only when an enterprise has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. When the effect of the time value of money is material, the amount of a provision is the present value of the expenditure expected to be required to settle the obligation.

t) Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party, or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

31 March 2004

3. Turnover and revenue

The Group's 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.

Revenue recognised during the year is as follows:–

	Group	
	2004	2003
	HK$'000	*HK$'000*
Turnover		
Sales of computer software	**8,060**	21,596
Income from provision of system integration and related services	**18,763**	4,500
Income from provision of software development and related services	**–**	598
	26,823	26,694
Other revenue		
Bank interest income	**60**	138
Gain on disposal of fixed assets	**12**	–
Gain on disposal of listed investments	**87**	–
PRC tax subsidy	**782**	363
Sundry income	**746**	41
	1,687	542
Total revenue recognised	**28,510**	27,236

4. Segmental information

No analysis of the Group's turnover and its contribution to loss before taxation by principal activities for the year ended 31 March 2004 is presented as 100% (2003: 100%) of the Group's turnover and operating results arose from the sales of computer software and rendering of system integration, software development and related services in the PRC.

5. Loss from operating activities

Loss from operating activities is arrived at after charging/(crediting):–

	Group	
	2004	2003
	HK$'000	*HK$'000*
Amortisation of goodwill	**1,125**	375
Amortisation of intangible assets	**4,641**	4,625
Auditors' remuneration		
– current year provision	**324**	420
– overprovision in prior year	**–**	(109)
Bad and doubtful debts	**1,217**	41
Cost of inventories sold	**17,666**	9,126
Depreciation of fixed assets	**808**	485
Operating lease rentals in respect of land and buildings	**1,760**	1,202
Staff costs:		
Wages and salaries (including directors' emoluments)	**10,496**	6,789
Contributions to retirement/pension schemes and other benefits	**683**	309

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6. Directors' and senior management's emoluments

(a) Directors' emoluments

Details of the emoluments paid to the directors during the year are as follows:–

	Group	
	2004	2003
	HK$'000	*HK$'000*
Fees	**1,270**	540
Salaries and allowances	**1,534**	1,672
Retirement/pension contributions	**32**	53
Bonuses	**427**	101
	3,263	2,366

Emoluments of the directors fell within the following band:

	2004	2003
	No. of directors	No. of directors
Nil – HK$1,000,000	**9**	9

All the above were paid to five (2003: four) executive directors and four (2003: five) non-executive directors.

	2004	2003
	HK$'000	*HK$'000*
Executive director A	**820**	717
Executive director B	**663**	463
Executive director C	**557**	349
Executive director D	**195**	297
Executive director E*	**308**	–
Non-executive director F	**230**	120
Non-executive director G	**210**	100
Non-executive director H	**170**	60
Non-executive director I	**110**	–
Non-executive director J#	**–**	260
Total	**3,263**	2,366

* *appointed during the year*

\# *resigned during the prior year*

6. Directors' and senior management's emoluments

(a) Directors' emoluments *(Continued)*

There was no arrangement under which a director waived or agreed to waiver any emoluments during the year.

During the year, 2,000,000 share options were granted to the directors in respect of their services to the Group, further details of which are set out in note 20 to the financial statements. No value in respect of the share options granted during the year has been charged to the profit and loss account, or is otherwise included in the above directors' remuneration disclosures.

(b) Five highest paid employees

The five highest paid individuals included four (2003: four) executive directors whose emoluments are detailed above. The emoluments of the remaining highest paid individuals for 2004 and 2003 are analysed as follows:–

	Group	
	2004	2003
	HK$'000	*HK$'000*
Salaries and allowances	**250**	251
Retirement/pension contributions	**83**	14
Bonuses	**–**	74
	333	339

Emoluments of the above individuals, who were not directors of the Company, fell within the following band:

	2004	2003
	No. of individuals	No. of individuals
Nil – HK$1,000,000	**1**	1

During the year, 6,000,000 share options were granted to the non-director, highest paid employee in respect of her service to the Group, further details of which are set out in note 20 to the financial statements. No value in respect of the share options granted during the year has been charged to the profit and loss account, or is otherwise included in the above non-director, highest-paid employees' remuneration disclosures.

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7. Retirement and pension benefits

The Group has implemented a Mandatory Provident Fund Scheme ("MPF Scheme") in accordance with the Mandatary Provident Fund Scheme Ordinance in Hong Kong for its employees in Hong Kong. Under the MPF Scheme, the Group makes mandatory contribution of 5% of the relevant employee's gross earnings each month, subject to the statutory maximum of HK$1,000 per person.

For employees in the PRC, according to the relevant PRC regulations, the Group is required to participate in the pension scheme operated by the relevant local government bureau in the PRC (the "Pension Scheme") and to make contributions for its eligible employees. The contributions to be borne by the Group are calculated at a certain percentage of the salaries and wages for those eligible employees.

The retirement and pension benefit costs charged to the profit and loss account during the year amounted to HK$683,000 (2003: HK$309,000).

8. Finance costs

	Group	
	2004	2003
	HK$'000	*HK$'000*
Bank charges and interest	**24**	22
Foreign exchange loss	**12**	178
	36	200

9. Taxation

The amount of taxation in the consolidated profit and loss account represents:

	Group	
	2004	2003
	HK$'000	*HK$'000*
Hong Kong profits tax *(Note (a))*	**–**	–
Overseas taxation *(Note (b))*	**318**	117
	318	117

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9. Taxation *(Continued)*

(a) No provision for profits tax has been made as no income was earned in or derived from Hong Kong during the year.

(b) No provision for profits tax has been provided in respect of the Cayman Islands or the British Virgin Islands as there were no assessable profits for the year in those jurisdictions. Overseas taxation represents tax charges on the assessable profits of certain subsidiaries operating in the PRC calculated at the applicable rates.

A reconciliation of tax expense to loss before taxation is as follows:–

	Group	
	2004	2003
	HK$'000	*HK$'000*
Loss before taxation	**(33,105)**	(10,327)
Tax at applicable Hong Kong tax rates of 17.5% (2003: 16%)	**(1,142)**	(881)
Tax at applicable PRC tax rates (15%)	**(3,987)**	(705)
Tax effect of expenses that are not deductible in determining taxable profits	**3,444**	782
Tax effect of income that is not taxable in determining taxable profits	**(85)**	(19)
Unused tax losses carried forward	**2,088**	940
	318	117

Details of the estimated deferred taxation full potential liability/(asset) are as follows:–

	2004	2003
	HK$'000	*HK$'000*
Excess of tax allowances over depreciation	**(2)**	3
Tax losses	**(3,705)**	(1,617)
	(3,707)	(1,614)

No deferred tax asset has been recognised due to the unpredictability of future profit streams.

10. Loss for the year attributable to shareholders

The net loss attributable to shareholders dealt with in the financial statements of the Company amounted to HK$35,966,000 (2003: HK$2,670,000).

11. Dividend

No dividend has been paid or declared by the Company in respect of the current year (2003: Nil).

12. Loss per share

The basic loss per share is calculated based on the Group's loss attributable to shareholders of HK$34,847,000 (2003: HK$10,589,000) and on the weighted average of 648,122,801 (2003: 574,075,967) ordinary shares in issue during the year.

The diluted loss per share is based on 649,648,509 (2003: 604,696,820) ordinary shares which is the weighted average number of ordinary shares in issue during the year plus the weighed average of 1,525,708 (2003: 30,620,853) ordinary shares deemed to be issued if all outstanding options had been exercised at the date they were granted.

13. Fixed assets

	Leasehold improvements	Computer equipment	Furniture and fixtures	Office equipment	Motor vehicles	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Group						
Cost						
1 April 2003	86	2,330	48	558	664	3,686
Additions	242	207	–	21	834	1,304
Disposals	–	–	–	–	(147)	(147)
31 March 2004	**328**	**2,537**	**48**	**579**	**1,351**	**4,843**
Depreciation						
1 April 2003	28	1,014	18	294	269	1,623
Charge for the year	95	432	24	102	155	808
On disposals	–	–	–	–	(65)	(65)
31 March 2004	**123**	**1,446**	**42**	**396**	**359**	**2,366**
Net book value						
31 March 2004	**205**	**1,091**	**6**	**183**	**992**	**2,477**
31 March 2003	58	1,316	30	264	395	2,063

14. Interests in subsidiaries

	Company	
	2004	2003
	HK$'000	*HK$'000*
Unlisted shares/registered capital, at cost	**24,263**	24,263
Amounts due from subsidiaries	**38,672**	31,098
Amounts due to subsidiaries	**(590)**	(1,914)
Less: Provision	**(32,078)**	–
	30,267	53,447

The amounts due from/to subsidiaries are unsecured, interest-free and they are not repayable within next 12 months.

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14. Interests in subsidiaries *(Continued)*

Particulars of the subsidiaries are as follows:–

Name	Place of incorporation/ registration/ operation	Issued and fully paid-up capital/ registered capital	Effective equity interest	Principal activities
Directly held				
Surfing Platform Software International Limited	British Virgin Islands/ Hong Kong	1,080,668 Ordinary shares of US$1 each	100%	Investment holding
Snow Fair Company Limited	British Virgin Islands/ Hong Kong	100 Ordinary shares of US$1 each	69%	Investment holding
Indirectly held				
Xteam Software (China) Co. Limited	People's Republic of China	US$2,000,000	100%	Sale of computer software and provision of related services
Xteam Software (Hong Kong) Limited	Hong Kong	100 Ordinary shares of HK$1 each	100%	Software distributor
Pantosoft International Limited	British Virgin Islands/ Hong Kong	100 Ordinary shares of US$1 each	35.19%	Investment holding
Shanghai Pantosoft Company Limited	People's Republic of China	HK$10,000,000	35.19%	Sale of computer software and provision of related services
Top Hero Investments Limited	British Virgin Islands/ Hong Kong	1 Ordinary share share of US$1 each	100%	Investment holding

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15. Goodwill

	HK$'000
Group	
Cost	
1 April 2003 and 31 March 2004	15,188
Amortisation	
1 April 2003	375
Charge for the year	1,125
31 March 2004	1,500
Net book value	
31 March 2004	**13,688**
31 March 2003	14,813

16. Intangible assets

Group	Internet platform HK$'000	Trademarks HK$'000	Computer software HK$'000	Total HK$'000
Cost				
1 April 2003 and 31 March 2004	3,255	2,371	16,823	22,449
Amortisation				
1 April 2003	1,085	362	6,121	7,568
Charges for the year	1,085	119	3,437	4,641
Impairment	1,085	–	7,235	8,320
31 March 2004	3,255	481	16,793	20,529
Net book value				
31 March 2004	**–**	**1,890**	**30**	**1,920**
31 March 2003	2,170	2,009	10,702	14,881

As of 31 March 2004, the formal registration of certain trademarks had yet to be issued by the relevant government authorities in the PRC.

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17. Inventories

	Group	
	2004	2003
	HK$'000	*HK$'000*
Raw materials and low value consumables	**13,612**	12,826
Work in progress	**125**	243
Finished goods	**253**	234
	13,990	13,303
Less: Provision	**(12,243)**	(4,267)
	1,747	9,036

The carrying amount of inventories carried at net realisable value included in the above was HK$62,000 (2003: HK$234,000).

18. Accounts receivable

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

	Group	
	2004	2003
	HK$'000	*HK$'000*
0 – 30 days	**1,806**	315
31 – 60 days	**297**	135
61 – 90 days	**215**	36
Over 90 days	**3,207**	1,258
	5,525	1,744
Less: Provision	**(1,326)**	(109)
	4,199	1,635

Generally, the Group has granted credit terms to its customers, with range from 30 to 90 days.

19. Accounts payable

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

	Group	
	2004	2003
	HK$'000	*HK$'000*
0 – 30 days	**470**	210
31 – 60 days	**32**	–
61 – 90 days	**3**	24
Over 90 days	**810**	1,702
	1,315	1,936

20. Share capital and share options

(i) Share capital

	Number of shares	**Nominal value** *HK$*
Authorised share capital (HK$0.01 each)		
31 March 2003 and 2004	1,000,000,000	10,000,000
Issued and fully paid (HK$0.01 each)		
1 April 2002	550,253,233	5,502,532
Issue of new shares	32,408,705	324,087
Issue of new shares for acquisition of a Subsidiary *(note 22)*	5,666,000	56,660
31 March 2003 and 1 April 2003	588,327,938	5,883,279
Issue of new shares	104,680,000	1,046,800
31 March 2004	**693,007,938**	**6,930,079**

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20. Share capital and share options *(Continued)*

(i) Share capital *(Continued)*

During the year, the Company entered into two placing agreements with Christfund Securities Limited to place 51,680,000 and 53,000,000 new ordinary shares at HK$0.118 and HK$0.16, respectively, on 21 July 2003 and 23 September 2003. The board of directors consider the placements a good opportunity to raise further capital for the Company while at the same time broadening its shareholder and capital base.

(ii) Share options

(a) Pre-IPO Share Option Scheme

As at 31 March 2004, there were 80,000,000 (2003: 91,000,000) outstanding share options granted under the Pre-IPO Share Option Scheme, adopted by the Company on 30 May 2001. During the year, 11,000,000 (2003: 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 31 March 2004 are summarised as follows:

Name of grantee	**Dated granted**	**Exercise period**	**No. of shares eligible for subscription under the share option**	**Exercise price**
Directors				
Mr. Ma Gary Ming Fai	14 November 2001	11 June 2002 to 13 November 2011	50,000,000	HK$0.266
Mr. Mak To Wai	14 November 2001	11 June 2002 to 13 November 2011	30,000,000	HK$0.266

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

None of the option granted under any of the Pre-IPO Share Option Scheme has been exercised or cancelled (other than disclosed above) during the year.

20. Share capital and share options *(Continued)*

(ii) Share options *(Continued)*

(b) Share Option Scheme

On 21 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 adviser, consultant of or to any member of the Group to take up options to subscribe for shares in the Company.

On 19 December 2003, 63,000,000 share options were granted under the Share Option Scheme.

Details of the outstanding share options granted under the Share Option Scheme as at 31 March 2004 are summarised as follows:

Name of grantee	Dated granted	Exercise period	No. of shares eligible for subscription under the share option	Exercise price
Directors				
Mr. Cheng Shu Wing	19 December 2003	19 December 2003 to 18 December 2013	1,000,000	HK$0.14
Mr. Wang Shi Yu	19 December 2003	19 December 2003 to 18 December 2013	1,000,000	HK$0.14
Employees, advisers and consultants	19 December 2003	19 December 2003 to 18 December 2013	61,000,000	HK$0.14

None of the options granted under the Share Option Scheme has been exercised or cancelled during the year.

21. Reserves

The details of movements in the Group's reserves are set out in the consolidated statement of changes in equity on Page 32.

The details of the movements in the Company's reserves are set out as follows:–

	Share premium account	Accumulated losses	Total
	HK$'000	*HK$'000*	*HK$'000*
Company			
1 April 2002	25,381	(1,156)	24,225
Issue of new shares	23,499	–	23,499
Adjustment for over accrued share issue expenses	1,058	–	1,058
Share issue expenses	(1,404)	–	(1,404)
Loss for the year	–	(2,670)	(2,670)
31 March 2003 and 1 April 2003	48,534	(3,826)	44,708
Issue of new shares	13,531	–	13,531
Share issue expenses	(1,111)	–	(1,111)
Loss for the year	–	(35,966)	(35,966)
31 March 2004	**60,954**	**(39,792)**	**21,162**

Distributable reserves of the Company at 31 March 2004, determined in accordance with section 34 of the Companies law (2001 Second Revision) of the Cayman Island, amounted to approximately HK$21,162,000 (2003: HK$44,708,000).

The share premium account of the Group as set out on Page 32 differs from the Company's share premium account above owing to merger accounting being used by the Company upon its listing in 2001.

22. Acquisition of a subsidiary

In the prior year, the Group acquired a 69% interest in Snow Fair Company Limited ("Snow Fair") for a consideration of approximately HK$15.5 million (approximately HK$13.7 million in cash and approximately HK$1.8 million fair value of the ordinary shares of the Company). Snow Fair is an investment holding company whose sole asset comprises a 51% shareholding interest in Pantosoft International Limited, which in turn holds the entire equity interest in Shanghai Pantosoft Company Limited ("Shanghai Pantosoft"). Shanghai Pantosoft is a company established in the PRC which is principally engaged in the development of educational software as well as digital campus in the PRC. This acquisition had been accounted for using the acquisition method of accounting and the effective date of the acquisition for accounting purposes was 1 December 2002.

	2004	2003
	HK$'000	*HK$'000*
Net assets acquired:		
Fixed assets	–	713
Intangible assets	–	67
Accounts receivables	–	1,139
Prepayments, deposits and other receivables	–	1,229
Inventories	–	2,686
Bank balances and cash	–	5,717
Accounts payable	–	(2,066)
Short-term bank loan (unsecured)	–	(1,415)
Other payables and accrued expenses	–	(6,171)
Minority interests	–	(933)
Net assets	–	966

Analysis of net outflow of cash and cash equivalents in connection with the acquisition of a subsidiary:

	2004	2003
	HK$'000	*HK$'000*
Cash consideration paid	–	13,691
Bank balances and cash acquired	–	(5,717)
Net outflow of cash and cash equivalents	–	7,974

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23. Operating lease commitments

As of 31 March 2004, the Group had outstanding minimum commitments under non-cancellable operating leases in respect of land and buildings which fall due as follows:–

	Group	
	2004	2003
	HK$'000	*HK$'000*
Expiring:–		
Within one year	**1,477**	1,148
In the second to fifth years, inclusive	**535**	904
	2,012	2,052

24. Capital commitments

On 10 February 2004, the Group entered into several share purchase agreements as follows subject to, inter alia, approval by the Listing Division of the Stock Exchange of Hong Kong Limited and the shareholders of the Company:–

(a) Snow Fair entered into a share purchase agreement to acquire 49 shares of Pantosoft International Limited ("Pantosoft") from its minority shareholder, Fortune Leo Investment Limited ("Fortune Leo"), at a consideration of approximately HK$16,000,000, to be satisfied partly by cash of HK$312,000 and partly by the Company issuing 105,422,000 new shares to Fortune Leo. After the completion of this transaction, Snow Fair will own 100% of Pantosoft and its subsidiary, Shanghai Pantosoft.

(b) The Company entered into two share purchase agreements to acquire a total of 31 shares of Snow Fair from its minority shareholders, MC Capital B.V. and Cosmo Town Limited, for total considerations of approximately HK$4,921,000, to be satisfied by the allotment of 33,938,000 new shares of the Company. After the completion of this transaction, the Company will own 100% of Snow Fair.

(c) A deed was entered into by the Company and Beijing Development (Hong Kong) Limited ("Beijing Development") pursuant to which the Company has agreed to purchase 680 shares of Astoria Innovations Limited ("Astoria"), representing 68% interest in Astoria, and 100 shares of Wisdom Elite Limited ("Wisdom"), representing 100% interest in Wisdom. Astoria and Wisdom are subsidiaries of Beijing Development and are engaged in the software business. The considerations will be satisfied by the Company issuing new shares to Beijing Development.

31 March 2004

25. Related party transactions

During the year, the Company paid financial advisory services fees of HK$200,000 (2003: Nil) to a company controlled by a director of the Company. Such fees were agreed by both parties in the normal course of business.

26. Comparative amounts

The comparative figure for provision against inventories for the year ended 31 March 2003 has been reclassified from cost of sales and services to show as a separate item in the consolidated profit and loss account as, in the opinion of the directors, such presentation provides a more appropriate presentation of the Group's operating results.

27. Approval of the audited financial statements

The audited financial statements were approved and authorised for issue by the board of directors on 21 June 2004.