



S O F T W A R E

Xteam Software International Limited

(Incorporated in the Cayman Islands with limited liability)

INTERIM REPORT 2004/2005

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

SUMMARY

- The Group is one of the early movers in the development of the Chinese Linux operating system with kernel rewritten to specifically cater for Chinese users in the People’s Republic of China (“PRC”) and software based on the Linux operating platform for various hardware appliances. While its products support personal computer applications, the Group is also widely recognized for its efficient operating system that leads the server, Internet and Intranet markets. The Group also provides technical support and after-sales services to its customers.
- Turnover for the three months ended 30th September, 2004 amounted to approximately HK\$28,808,000 representing an increase of 357% from approximately HK\$6,305,000 in the corresponding period last year. Turnover for the six months ended 30th September, 2004 amounted to approximately HK\$31,364,000 (2003: approximately HK\$9,219,000).
- Profit attributable to shareholders for the three months ended 30th September, 2004 amounted to approximately HK\$7,205,000 compared to the loss attributable to shareholders for the three months ended 30th June, 2004 of approximately HK\$2,873,000. Profit attributable to shareholders for the six months ended 30th September, 2004 amounted to approximately HK\$4,332,000 (2003: loss of approximately HK\$7,916,000).
- The Group expanded its product range and geographic reach to widen its customer base in the PRC Linux market.
- The Board does not recommend the payment of an interim dividend for the period (2003: Nil).

INTERIM RESULTS FOR THE SIX MONTHS ENDED 30TH SEPTEMBER, 2004

The board of Directors (the “Board”) of the Company announces the unaudited results of the Company and its subsidiaries (collectively, the “Group”) for the three months and six months ended 30th September, 2004, together with the unaudited comparative figures for the corresponding period in 2003, as follows:

	Note	Three months ended 30th September,		Six months ended 30th September,	
		2004 HK\$'000 (Unaudited)	2003 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited)	2003 HK\$'000 (Unaudited)
Revenue	2	28,808	6,305	31,364	9,219
Cost of sales		(12,791)	(5,389)	(14,174)	(7,904)
Gross profit		16,017	916	17,190	1,315
Other income		194	405	454	548
Operating expenses		(8,046)	(4,738)	(12,308)	(9,341)
Profit/(loss) from operations		8,156	(3,417)	5,336	(7,478)
Finance income, net		6	34	10	40
Profit/(loss) before tax	3	8,171	(3,383)	5,346	(7,438)
Income tax expense	4	(84)	(65)	(86)	(102)
Profit/(loss) after tax		8,087	(3,448)	5,260	(7,540)
Minority interests		(882)	(239)	(928)	(376)
Profit/(loss) attributable to shareholders		7,205	(3,687)	4,332	(7,916)
Earnings/(loss) per share					
– Basic (in cents)	6	0.32	(0.59)	0.30	(1.31)
– Diluted (in cents)		0.32	(0.59)	0.30	(1.31)
Dividend per share	7	Nil	Nil	Nil	Nil

CONSOLIDATED BALANCE SHEETS

	Note	As at 30th September, 2004 HK\$'000 (Unaudited)	As at 31st March, 2004 HK\$'000 (Audited)
Fixed assets	8	4,034	2,477
Goodwill	9	276,647	13,688
Intangible assets	10	1,853	1,920
Current assets			
Inventories	11	5,967	1,747
Accounts receivable	12	33,994	4,199
Prepayments, deposits and other receivable		20,742	4,695
Value added tax refundable		–	1,259
Cash and bank balances		17,852	9,184
		78,555	21,084
Current liabilities			
Accounts payable	13	1,496	1,315
Short-term bank loan (unsecured)		7,547	–
Value added tax payable		807	–
Tax payable		–	97
Other payables and accrued expenses		23,059	7,832
		32,909	9,244
Net current assets		45,646	11,840
Non-current liabilities			
Minority interests		2,439	2,801
		325,741	27,124
Capital and reserves			
Share capital	14	37,585	6,930
Reserves		288,156	20,194
		325,741	27,124

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share Capital HK\$'000	Share premium account HK\$'000	Statutory reserve fund HK\$'000	Accumulated losses HK\$'000	Total HK\$'000
Consolidated (unaudited)					
At 1st April, 2003	5,883	59,401	–	(16,780)	48,504
Issue of new shares	517	5,581	–	–	6,098
Share issue expenses	–	(472)	–	–	(472)
Loss for the period	–	–	–	(7,916)	(7,916)
	<u>6,400</u>	<u>64,510</u>	<u>–</u>	<u>(24,696)</u>	<u>46,214</u>
At 30th September, 2003	<u>6,400</u>	<u>64,510</u>	<u>–</u>	<u>(24,696)</u>	<u>46,214</u>
At 1st April, 2004	6,930	71,821	60	(51,687)	27,124
Issue of new shares	30,655	263,630	–	–	294,285
Profit for the period	–	–	–	4,332	4,332
	<u>37,585</u>	<u>335,451</u>	<u>60</u>	<u>(47,355)</u>	<u>325,741</u>
At 30th September, 2004	<u>37,585</u>	<u>335,451</u>	<u>60</u>	<u>(47,355)</u>	<u>325,741</u>

CONSOLIDATED CASH FLOW STATEMENT*For the six months ended 30th September,*

	2004 HK\$'000 (Unaudited)	2003 <i>HK\$'000</i> (Unaudited)
Net cash used in operating activities	(12,603)	(8,704)
Net cash from/(used in) investing activities	13,724	(448)
Net cash from financing activities	7,547	5,626
Net increase/(decrease) in cash and cash equivalents	8,668	(3,526)
Cash and cash equivalents at beginning of the period	9,184	11,931
Cash and cash equivalents at end of the period	17,852	8,405
Analysis of the balances of cash and cash equivalents		
Cash and bank balances	17,852	8,405

Notes:

1. Basis of presentation

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

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

2. Turnover and revenue

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

Turnover consisted of:

	Three months ended		Six months ended	
	30th September,		30th September,	
	2004	2003	2004	2003
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Sales of computer software	12,829	1,412	14,200	3,044
Provision of software development, integration and related services	15,979	4,893	17,164	6,175
	28,808	6,305	31,364	9,219

3. Profit/(loss) before taxation

Profit/(loss) before taxation was arrived at after crediting and charging the following:

	Three months ended 30th September,		Six months ended 30th September,	
	2004 HK\$'000 (Unaudited)	2003 HK\$'000 (Unaudited)	2004 HK\$'000 (Unaudited)	2003 HK\$'000 (Unaudited)
<i>Crediting:</i>				
Interest income on bank deposits	6	34	10	40
<i>Charging:</i>				
Depreciation of fixed assets	193	189	509	363
Amortization of goodwill	2,560	281	2,841	562
Amortization of intangible assets	34	1,154	67	2,308

4. Taxation

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

5. Goodwill

Positive goodwill arising on consolidation represents the excess of the cost of the acquisition over the Group's share of the fair value of the identifiable assets and liabilities acquired. Goodwill is recognized as an asset and amortised on a straight-line basis over its estimated useful life of 13.5 to 20 years.

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

6. Earnings/(loss) per share

The calculation of basic earnings per share for the six months and three months ended 30th September, 2004 is calculated based on the Group's unaudited profit attributable to shareholders of approximately HK\$4,332,000 and HK\$7,205,000, respectively (2003: loss of approximately HK\$7,916,000 and HK\$3,687,000, respectively), and on the weighted average number of 1,463,561,684 shares and 2,225,739,845 shares, respectively, in issue during the period (2003: 605,554,605 shares and 622,594,025 shares, respectively).

The diluted earnings per share for the six months and three months ended 30th September, 2004 is based on the weighted average number of 1,463,641,233 shares and 2,225,739,845 shares, respectively, taking into account the ordinary shares deemed to be issued if all outstanding options had been exercised at the date they were granted (2003: 605,554,605 shares and 622,594,025 shares, respectively).

7. Dividend

The Board does not recommend the payment of an interim dividend for the period (2003: Nil).

8. Fixed assets

As at 30th September, 2004 (unaudited):

	Leasehold improvements <i>HK\$'000</i>	Computer equipment <i>HK\$'000</i>	Furniture and fixtures <i>HK\$'000</i>	Office equipment <i>HK\$'000</i>	Motor vehicles <i>HK\$'000</i>	Total <i>HK\$'000</i>
Cost						
1st April, 2004	328	2,537	48	579	1,351	4,843
Additions through acquisition of subsidiaries	–	1,148	176	60	281	1,665
Additions	–	93	–	53	508	654
30th September, 2004	328	3,778	224	692	2,140	7,162
Depreciation						
1st April, 2004	123	1,446	42	396	359	2,366
Additions through acquisition of subsidiaries	–	222	12	10	9	253
Charges for the period	18	284	21	65	121	509
30th September, 2004	141	1,952	75	471	489	3,128
Net book value						
30th September, 2004	187	1,826	149	221	1,651	4,034
31st March, 2004	205	1,091	6	183	992	2,477

9. Goodwill

As at 30th September, 2004 (unaudited)

	<i>HK\$'000</i>
Cost	
1st April, 2004	15,188
Additions	265,800
	<u>280,988</u>
30th September, 2004	<u>280,988</u>
Amortization	
1st April, 2004	1,500
Charges for the period	2,841
	<u>4,341</u>
30th September, 2004	<u>4,341</u>
Net book value	
30th September, 2004	<u><u>276,647</u></u>
31st March, 2004	<u><u>13,688</u></u>

10. Intangible assets

As at 30th September, 2004 (unaudited)

	Internet platform	Trademarks	Computer software	Total
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Cost				
1st April, 2004	3,255	2,371	16,823	22,449
Additions	–	–	–	–
	<u>3,255</u>	<u>2,371</u>	<u>16,823</u>	<u>22,449</u>
30th September, 2004	<u>3,255</u>	<u>2,371</u>	<u>16,823</u>	<u>22,449</u>
Amortization				
1st April, 2004	3,255	481	16,793	20,529
Charges for the period	–	59	8	67
	<u>3,255</u>	<u>540</u>	<u>16,801</u>	<u>20,596</u>
30th September, 2004	<u>3,255</u>	<u>540</u>	<u>16,801</u>	<u>20,596</u>
Net book value				
30th September, 2004	<u><u>–</u></u>	<u><u>1,831</u></u>	<u><u>22</u></u>	<u><u>1,853</u></u>
31st March, 2004	<u><u>–</u></u>	<u><u>1,890</u></u>	<u><u>30</u></u>	<u><u>1,920</u></u>

11. Inventories

	As at 30th September, 2004 HK\$'000 (Unaudited)	As at 31st March, 2004 HK\$'000 (Audited)
Raw materials and low value consumables – at cost	13,631	13,612
Work in progress	328	125
Finished goods – at net realizable value	4,251	253
	<u>18,210</u>	<u>13,990</u>
Less: Provisions	(12,243)	(12,243)
	<u>5,967</u>	<u>1,747</u>

12. Accounts receivable

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

	As at 30th September, 2004 HK\$'000 (Unaudited)	As at 31st March, 2004 HK\$'000 (Audited)
0 – 30 days	30,182	1,806
31 – 60 days	317	297
61 – 90 days	585	215
Over 90 days	4,236	3,207
	<u>35,320</u>	<u>5,525</u>
Less: Provision	(1,326)	(1,326)
	<u>33,994</u>	<u>4,199</u>

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

13. Accounts payable

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

	As at 30th September, 2004 HK\$'000 (Unaudited)	As at 31st March, 2004 HK\$'000 (Audited)
0 – 30 days	333	470
31 – 60 days	43	32
61 – 90 days	12	3
Over 90 days	1,108	810
	<u>1,496</u>	<u>1,315</u>

14. Share capital

	30th September, 2004 (Unaudited)		31st March, 2004 (Audited)	
	Number of shares	Nominal value HK\$	Number of shares	Nominal value HK\$
<i>Authorized:</i>				
Ordinary shares of HK\$0.01 each	<u>10,000,000,000</u>	<u>100,000,000</u>	<u>1,000,000,000</u>	<u>10,000,000</u>
<i>Issued and fully paid:</i>				
As at 1st April	693,007,938	6,930,079	588,327,938	5,883,279
Shares issued during the period/year	<u>3,065,463,814</u>	<u>30,654,638</u>	<u>104,680,000</u>	<u>1,046,800</u>
As at 30th September, 2004	<u>3,758,471,752</u>	<u>37,584,717</u>	<u>693,007,938</u>	<u>6,930,079</u>

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

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

- (a) Snow Fair Company Limited ("Snow Fair") entered into share purchases 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 ("Pantosoft Acquisition"). 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 ("Snow Fair Acquisition"). 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 Holdings 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 2,926,103,814 new shares.

For details of the acquisitions, please refer to the announcement and circular of the Company dated 19th May, 2004 and 30th June, 2004 respectively.

The above acquisitions were duly approved by independent shareholders of the Company at an extraordinary general meeting ("EGM") held on 22nd July, 2004. For details of the results of the EGM, please refer to the announcement dated 22nd July, 2004.

15. Related party transaction

	Six months ended 30th September,	
	2004 <i>HK\$'000</i> (Unaudited)	2003 <i>HK\$'000</i> (Unaudited)
Sales of computer software to Beijing Enterprises Teletron Technology Development Co., Ltd.	<u>2,789</u>	<u>—</u>

The directors are of the opinion that the above transaction was conducted in the ordinary course of business of the Group.

MANAGEMENT DISCUSSION AND ANALYSIS

Industry Overview

The current Linux adoption in the PRC market is still in its infancy stage with only 1.4% market share compared with 17% in the US market. The consolidation at the PRC Linux software market has nearly come to the final stage. Software companies with proven business model and profitability are here to stay and gaining foothold in the market. The Government is the largest Linux software buyer in the PRC in the 1st quarter of 2004. While the foreign Linux software providers focus on the less lucrative desktop market and do not have a well-defined strategy in the PRC market, the Group has identified the Government as the target customer thanks to its supportive policy, reliable payment and scalability. With the Government's recognition and support, the Group will combine its proven and reliable Linux technology with various applications to capture the burgeoning potential in the PRC market.

It is the Group's mission to strategically establish the showcase in Beijing City and gradually replicate the successful model to cities and provinces in the rest of the PRC.

Business Review

The Group made significant progress in 2004, successfully completing the acquisition of the Software Businesses of Beijing Development, as well as increasing the stake in Snow Fair and Pantosoft to 100%. The Group was delighted to see the realization of the benefits after the integration of Beijing Development's Software Businesses, which was reflected by the turnaround performance in the interim period ended 30th September 2004.

Upon the completion of the acquisitions, the Group has become one of the few Linux providers to successfully penetrate into the application market in the PRC Government. The Group's Linux platform has been well recognized on its leading-edge technology, low cost of ownership, proven reliability and responsive maintenance services. These laid a solid cornerstone for the Group to provide Linux operating systems and software solutions to government authorities in four key sectors: social security, labour security, e-government and e-education.

During the period under review, the Group has succeeded in gradually migrating Government and educational applications to Linux platforms through various contracts with different provinces and cities.

E-education

In August 2004, the Group signed a contract with the Education Bureau in Guangzhou (廣州市教育局). The Group's software will become the authorized brand for the credit system in all the technical institutions in Guangzhou. In phase one, 50 technical institutions in Guangzhou have already adopted the Group's Linux application platform in the credit system. Later on, the application will further extend to more than 100 technical institutions.

The Group also successfully expanded its presence in Beijing in the provision of e-education software. During the period under review, the Group signed a contract to provide e-education software in Beijing. The contract included the provision of server software, e-education infrastructure and the IC card Yikatong (一卡通) software, etc.. The Group's Linux server had been widely used in more than 1,600 secondary and primary schools out of the 3,000 in Beijing.

Tax System

The Group had also signed the contract to provide Linux embedded system for the tax system in the Shanxi province.

Labour Security

The Group was also awarded the contract of “Labour Management Software and Infrastructure in the Nation” 《一站式服務構架下的勞動就業管理軟件及工程實現》 which had been first employed in the labour security system in Beijing.

The proven contracts and working experiences in the Government sector have provided the Group with the competitive edge to tap into the enterprise sector. During the period under review, the Group was in talks with different multinational companies to explore the collaboration opportunities in the provision of Linux software and server systems in different applications. This can help further expand the Group's revenue sources in the future.

Prospects

The Group is firmly positioned as the top leader in the e-government application market in the PRC. The Group has already enjoyed exclusive and secured customer base from the Beijing Government as well as a foothold in the e-education market in Shanghai. Given our proven track record and experiences in Beijing and Shanghai, the Group will replicate its successful business model to 22 other major cities in the PRC market for the next 5 years. There is a growing demand of software products in the Government sectors in the PRC market. Many Government-led IT projects, such as the Golden Security Project (金保工程) and the development of numerous application systems in labour security and e-government sectors, are in full swing. The Group's wide recognition and rapport from the Government will be definitely our competitive advantage to win these contracts.

The Group will also sign a collaboration agreement with Union of Network Beijing (“UNB”)(北京網絡行業協會). Under the 4-year agreement, the Group will help UNB to establish the software management and online bar service centres to maintain the IT systems in the online bars. The Group will also help the online bars under UNB to upgrade the IT systems with the Group’s Linux products and solutions. System management services and Linux product training will also be offered to UNB. The collaboration agreement with the UNB has demonstrated the proven capability and recognition of the Group’s Linux solutions and products.

The Group is on course to amalgamate the Beijing headquarters with Beijing Development’s office to expand the Group’s sales and R&D forces in October 2004. The Group expects to strengthen its workforce to cope with the high-growth Linux development in the PRC market.

Viable business model, strong customer base and promising market potential are the pre-requisites for the success of every software companies. The Group has already enjoyed a proven advantage in these areas and is set to sustain its high growth momentum in the coming quarters.

FINANCIAL REVIEW

The Group reported an unaudited, consolidated turnover of approximately HK\$28,808,000 for the three months ended 30th September, 2004, up 357% compared with approximately HK\$6,305,000 in the corresponding period last year. The growth in turnover was mainly due to increase in the contracts in the e-education and e-government sectors after the acquisition of the Software Businesses of Beijing Development. The profit attributable to shareholders for the three months ended 30th September, 2004 was approximately HK\$7,205,000 in comparison with the loss of approximately HK\$3,687,000 in the corresponding period last year.

The Group’s gross profit margin also posted a sharp increase to 55.6% for the three months ended 30th September, 2004, compared with the 14.5% in the corresponding period last year. The increase was attributed to the greater proportion in the sales of software products which enjoyed a relatively higher profit margin than hardware products.

Operating expenses increased to approximately HK\$8,046,000 for the three months ended 30th September, 2004, compared with HK\$4,738,000 in the corresponding period last year. This was due to the increase in sales and marketing activities to keep pace with the growth in turnover and the acquisitions of subsidiaries during the period.

LIQUIDITY, FINANCIAL RESOURCES AND DEBT RATIO

As at 30th September, 2004, the Group has an outstanding short-term bank loans of approximately HK\$7,547,000 (as at 31st March, 2004: Nil). The loan was primarily used to finance short-term cash flows for the Group's operations in China. This loan bears fixed interest rate of 6.048% per annum.

The gearing ratio (defined as total liabilities over equity) of the Group as at 30th September, 2004 was approximately 10.9% (as at 31st March, 2004: approximately 44.4%).

The debt ratio (defined as total liabilities over total assets) of the Group as at 30th September, 2004 was approximately 9.8% (as at 31st March, 2004: approximately 30.8%).

CAPITAL STRUCTURE, EXPOSURE TO EXCHANGE RATES FLUCTUATION

As at 30th September, 2004, the number of issued share capital of the Company was 3,758,471,752 (as at 31st March, 2004: 693,007,938). During the period, a total of 3,065,463,814 new ordinary shares of the Company were issued to for the acquisitions of certain subsidiaries. For details of the acquisitions, please refer to the following section headed "Material Acquisitions And Disposals During The Period And Future Plans For Material Investments".

As at 30th September, 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, are approximately at their fair values because of the short maturity of these instruments.

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

PROSPECTS OF NEW PRODUCTS

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

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

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

- (a) Snow Fair entered into share purchases agreement to acquire 49 shares of Pantosoft from its minority shareholder, 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, representing 68% interest in Astoria, and 100 shares of 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 2,926,103,814 new shares.

For details of the acquisitions, please refer to the announcement and circular of the Company dated 19th May, 2004 and 30th June, 2004 respectively.

The above acquisitions were duly approved by independent shareholders of the Company at an EGM held on 22nd July, 2004. For details of the results of the EGM, please refer to the announcement dated 22nd July, 2004.

The above acquisitions were completed on 16th August, 2004. For details, please refer to the announcement dated 16th August, 2004

SEGMENTAL INFORMATION

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

STAFF

As at 30th September, 2004, the Group employed 343 employees, including directors of the Company, (2003: 109) at market remuneration and benefits such as defined retirement/pension contributions, employee share options and medical insurance, etc. Total staff costs for the reported period were approximately HK\$4.60 million (2003: approximately HK\$4.17 million). The increase was mainly due to the acquisition of a subsidiary in 2004.

CHARGE OF ASSETS

As at 30th September, 2004, the Group did not have any charge on its assets (2003: Nil).

CONTINGENT LIABILITIES

As at 30th September, 2004 the Group did not have any material contingent liabilities (2003: Nil).

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

As at 30th September, 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

Name of director	Personal interests	Number of shares of the Company			% of issued share capital
		Family interests	Corporate interests	Total	
Mr. Ma Gary Ming Fai	1,000,000	–	116,681,821 (note 1)	117,681,821	3.13%

Note:

- These shares are held by Upwise Investments Ltd. and Princeton Venture Partners Limited. 74,821,349 shares are held by Upwise Investments Ltd. and the entire issued share capital of Upwise Investments Ltd. is beneficially owned by Mr. Ma Gary Ming Fai. 41,860,472 shares are held by Princeton Venture Partners Limited. Princeton Venture Partners Limited is wholly owned by PVP Limited. PVP Limited is in turn owned as to 43.56% by Innovative Group Ltd. Innovative Group Ltd. is in turn wholly owned by Mr. Ma Gary Ming Fai. Mr. Ma Gary Ming Fai is taken to be interested in 74,821,349 shares and 41,860,472 shares by virtue of his corporate interests in Upwise Investments Ltd. and Innovative Group Ltd. respectively.

(2) Interests in underlying shares*(a) Pre-IPO share options*

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

Details of the pre-IPO share options granted to certain Director and employee is as follows:

Name of Director	Date granted	Exercise period	No. of shares eligible for subscription under the pre-IPO share option	Exercise price per share
Mr. Ma Gary Ming Fai	14th November, 2001	11th June, 2002 to 13th November, 2011	50,000,000	HK\$0.266

Up to 30th September, 2004, no options under the Pre-IPO Share Option Scheme have been exercised.

(b) *Post-IPO share options*

On 21st November, 2001, the shareholders of the Company adopted a share option scheme (“Share Option Scheme”), the principal terms of which were set out on pages 199 to 208 of the Prospectus. Under the terms of the Share Option Scheme, the Board may, at their discretion, invite any full-time employees of the Group, including any executive and non-executive directors, and any advisers, consultants of or to any member of the Group to take up options to subscribe for shares in the Company.

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

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 post-IPO share option	Exercise price per share
Mr. Cheng Shu Wing	19th December, 2003	19th December, 2003 to 18th December, 2013	1,000,000	HK\$0.14
Mr. Wang Shi Yu	19th December, 2003	19th December, 2003 to 18th December, 2013	1,000,000	HK\$0.14
			<u>2,000,000</u>	

Up to 30th September, 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 30th September, 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 Reorganization prior to the listing of the Company's shares on GEM, as at the date hereof, neither the Company nor any of its subsidiaries was a party to any arrangements to enable the Directors and/or the chief executives of the Company to acquire benefits by means of the acquisition of shares in, or debt securities, including debentures, of the Company or any other body corporate, and none of the Directors, chief executives or their respective spouses or children under the age of 18 had any right to subscribe for the securities of the Company, or had exercised any such right.

INTERESTS DISCLOSEABLE UNDER THE SFO AND SUBSTANTIAL SHAREHOLDERS

As at 30th September, 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	Nature of interests	Number of shares	Percentage of issued share capital
Beijing Development	Interests of controlled corporation	2,115,513,445	56.29%
Beijing Enterprises Holdings Limited	Interests of controlled corporation	2,115,513,445 (<i>note 1</i>)	56.29%
Beijing Enterprises Investments Limited	Interests of controlled corporation	2,115,513,445 (<i>note 2</i>)	56.29%
Beijing Holdings Limited	Interests of controlled corporation	2,115,513,445 (<i>note 3</i>)	56.29%
Chung Kwok Ho	Interests of controlled corporation	382,864,129 (<i>note 4</i>)	10.18%
Lee Man Yee	Interests of spouse	382,864,129 (<i>note 5</i>)	10.18%
Cosmos Vantage Limited	Beneficial interests	382,864,129 (<i>note 6</i>)	10.18%
Amberwood Group Ltd.	Beneficial interests	204,712,000 (<i>note 7</i>)	5.45%
Chong Sok Un	Interests of controlled corporation	204,712,000 (<i>note 8</i>)	5.45%

Notes:

1. Beijing Enterprises Holdings Limited was deemed to be interested in the 2,115,513,445 shares by virtue of its controlling interests in Beijing Development.
2. Beijing Enterprises Investments Limited was deemed to be interested in the 2,115,513,445 shares by virtue of its controlling interests in Beijing Enterprises Holdings Limited.
3. Beijing Holdings Limited was deemed to be interested in the 2,115,513,445 shares by virtue of its controlling interests in Beijing Enterprises Investments Limited.
4. Chung Kwok Ho held these shares through Cosmos Vantage Limited in which he is the sole beneficial owner.
5. These shares were held by Cosmos Vantage Limited, which is wholly owned by Chung Kwok Ho. Lee Man Yee is the spouse of Chung Kwok Ho and accordingly she was deemed to be interested in these shares.
6. Cosmos Vantage Limited is wholly owned by Chung Kwok Ho.
7. Amberwood Group Ltd. is wholly owned by Chong Sok Un
8. Chong Sok Un held these shares through Amberwood Group Ltd. in which she is the sole beneficial owner.

Save as disclosed above, as at 30th September, 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”. Details of outstanding pre-IPO share options granted to other executives and full time employees as at 30th September, 2004 are as follows:

Type of grantee	Date granted	Exercise period	No. of shares eligible for subscription under the pre-IPO share option	Exercise price per share
Employee	14th November, 2001	11th June, 2002 to 13th November, 2011	30,000,000	HK\$0.266

Up to 30th September, 2004, no options under the Pre-IPO Share Option Scheme have been exercised.

(b) Post-IPO Share Option Scheme

On 21st November, 2001, the shareholders of the Company adopted a share option scheme (“Share Option Scheme”), the principal terms of which were set out on pages 199 to 208 of the Prospectus. Under the terms of the Share Option Scheme, the Board may, at their discretion, invite any full-time employees of the Group, including any executive and non-executive directors, and any advisers, consultants of or to any member of the Group to take up options to subscribe for shares in the Company.

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

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

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

Up to 30th September, 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

During the six months ended 30th September, 2004, neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities.

COMPETING INTERESTS

During the period under review, none of the Directors or the management shareholders (as defined in the GEM Listing Rules) of the Company had any interest in a business that competed or might compete with the business of the Group.

AUDIT COMMITTEE

As required by Rule 5.23 of the GEM Listing Rules, the Company has established an audit committee on 21st November, 2001 with written terms of reference which deal clearly with its authority and duties. The audit committee's principal duties are the review and supervision of the Company's financial reporting process and internal control systems. The audit committee comprises two independent non-executive Directors, namely Mr. Cheng Shu Wing and Mr. Wang Shi Yu. The Group's unaudited results have been reviewed by the two independent non-executive Directors of the Company.

BOARD PRACTICES AND PROCEDURES

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

At the date of this announcement, The board of directors of Company comprises Mr. Zhang Honghai, Mr. Li Kang Ying, Mr. Ma Gary Ming Fai, Mr. Cao Wei, Mr. Ng Kong Fat, Brian, Mr. E Meng and Ms. Chen Zhi (who are executive directors of the Company), and Mr. Cheng Shu Wing and Mr. Wang Shi Yu (who are independent non-executive directors of the Company).

By order of the Board
Xteam Software International Limited
Zhang Honghai
Chairman

Hong Kong, 19th October, 2004