

REPORT OF THE DIRECTORS

The directors submit herewith their annual report together with the audited accounts for the year ended 31st December, 2000.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The principal activities of its subsidiaries and associated companies are set out in notes 33 and 34 on the accounts.

The Group's turnover is derived principally from the manufacture, distribution and sale of electronic and electrical products, office equipment and software development and integration.

The Group operates primarily outside Hong Kong in the People's Republic of China ("PRC") where its existing manufacturing facilities and distribution network are based. The Group's activities in Hong Kong include the sourcing of electronic and electrical products, office equipment and component parts for processing, distribution and sale in the PRC.

The Group's turnover and profit are almost entirely attributable to manufacturing, distribution and sale of electronic and electrical products and office equipment in the PRC. Turnover and contributions to the Group's profit from Hong Kong activities are insignificant. Accordingly, no analyses by principal activities and geographical areas are provided.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31st December, 2000, the five largest customers in aggregate accounted for less than 30% of the Group's turnover. The five largest suppliers in aggregate and the largest supplier of the Group accounted for approximately 48% and 18% respectively by value of the Group's total purchases.

At no time during the year, had the directors, their associates or any shareholder of the Company (which to the knowledge of the directors owns more than 5% of the Company's share capital) any interests (as defined in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules")) in these major suppliers and customers.

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ACCOUNTS

The results of the Group for the year ended 31st December, 2000 and the state of the Company's and the Group's affairs at that date are set out in the accounts on pages 24 to 67.

No interim dividend was paid during the year. The directors do not recommend the payment of a final dividend for the year ended 31st December, 2000 (1999: nil).

PROPERTY, PLANT AND EQUIPMENT

Movements in property, plant and equipment during the year are set out in note 12 on the accounts.

SUBSIDIARIES

Particulars regarding the Company's subsidiaries are set out in note 33 on the accounts.

SHARE CAPITAL

Details of movements in the Company's share capital during the year are set out in note 24 on the accounts.

BANK LOANS AND OVERDRAFTS

Particulars of bank loans and overdrafts of the Group and the Company as at 31st December, 2000 are set out in note 21 on the accounts.

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DIRECTORS

The directors during the financial year and up to the date of this report were:

Executive directors

Shen Guojun (*Chairman*)

Duan Yongji

Li Wenjun

Yang Hongru (appointed on 13th March, 2000)

Chu Zhong

Independent non-executive directors

Liu Hong Ru

Kwok Viem, Peter

In accordance with the article 101 of the Company's articles of association, Messrs. Duan Yongji and Shen Guojun retire by rotation at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

Prof. Liu Hong Ru and Dr. Kwok Viem, Peter were appointed as independent non-executive directors of the Company for a term of 3 years commencing on 15th December, 2000 and 12th May, 1999 respectively. Both the independent non-executive directors are subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the Company's articles of association.

DIRECTORS' SERVICE CONTRACTS

Messrs. Shen Guojun, Duan Yongji, Li Wenjun and Chu Zhong entered into service contracts with the Company, all of which are for a period of 3 years commencing on 23rd July, 1993 and will continue thereafter until terminated by either party to the agreements at 6 months' written notice.

No director proposed for re-election at the forthcoming annual general meeting has an unexpired service contract which is not determinable by the Company or any of its subsidiaries within one year without payment of compensation, other than normal statutory obligations.

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DIRECTORS' INTERESTS IN SHARES

The directors who held office at 31st December, 2000 had the following interests in the issued share capital of the Company (within the meaning of the Securities (Disclosure of Interests) Ordinance (“SDI Ordinance”)) at that date as recorded in the register of directors’ share interests under Section 29 of the SDI Ordinance:

	Ordinary Shares of HK\$0.1 each of the Company			
	Personal interests	Family interests	Corporate interests	Other interests
Mr. Duan Yongji	1,200,000	—	—	—

Note: Beijing Stone Investment Company Limited (“Stone Investment”) together with its associates (as defined in the Listing Rules) holds a total of 407,110,053 shares of the Company. Stone Investment is owned as to 49% by Stone Group Corporation and 51% by the Beijing Stone Investment Company Limited Employees’ Shareholding Society (“Employees’ Shareholding Society”). Stone Group Corporation also directly holds 15,910,146 shares of the Company. Messrs. Shen Guojun, Duan Yongji, Li Wenjun and Chu Zhong (collectively as “the said directors”) are also employees of Stone Group Corporation. So long as the said Directors remain as employees of Stone Group Corporation, each of them together with the other employees collectively own interests in the assets of Stone Group Corporation but none of them has any specific interest in Stone Group Corporation.

DIRECTORS' INTERESTS IN CONTRACTS

No contracts of significance to which the Company, its holding company or any of its subsidiaries or fellow subsidiaries was a party in which a director of the Company had a material interest subsisted at the end of the year or at any time during the year.

ARRANGEMENT TO PURCHASE SHARES

Pursuant to an ordinary resolution passed on 23rd July, 1993, a share option scheme was adopted whereby the directors of the Company, at their discretion, are authorised to invite employees of any member of the Group, including directors of any member of the Group, to take up options to subscribe for shares not exceeding 10% of the issued share capital of the Company. The share option scheme will remain in force for a period of 10 years commencing on 23rd July, 1993. The options are exercisable for a period up to 3 years commencing on the expiry of 6 months after the date on which the option is accepted or to the expiry date of the scheme, whichever is earlier. Details of the options granted are set out in note 25 on the accounts.

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ARRANGEMENT TO PURCHASE SHARES (Cont'd)

The share options granted to the directors of the Company during the year and outstanding at 31st December, 2000 are as follows:—

	Date of grant	Subscription price per share (HK\$)	Number of shares to be issued upon the exercise of share options
Mr. Duan Yongji	29-02-2000	2.796	7,500,000
Mr. Li Wenjun	29-02-2000	2.796	4,000,000
Mr. Yang Hongru	21-10-2000	0.632	1,590,000

The above options were granted at the aggregate consideration of HK\$3.00. No options have been exercised by any of the director during the year ended 31st December, 2000.

MANAGEMENT CONTRACTS

Pursuant to an agreement dated 3rd August, 1998 between the Company and Stone Group Corporation, the latter agreed to provide, inter alia, secretarial and other related services and the use of office equipment to the Group for a term of five years commencing from 23rd July, 1998 at reimbursement costs which shall not exceed HK\$2,750,000 per annum.

SUBSTANTIAL INTERESTS IN THE SHARE CAPITAL OF THE COMPANY

As at 31st December, 2000, the register of substantial shareholders maintained under Section 16(1) of the SDI Ordinance shows that the Company has been notified of the following interests, being 10% or more of the Company's issued share capital:

	Note	Shares held
Stone Investment	1	407,110,053
Employees' Shareholding Society	2	407,110,053
Stone Group Corporation	2	423,020,199

Notes:

1. The shareholding of 407,110,053 shares comprises the combined shareholdings of Stone Investment and its associates (as defined in the Listing Rules).
2. Stone Investment is owned as to 49% by Stone Group Corporation and 51% by Employees' Shareholding Society which are accordingly deemed to be interested in the said 407,110,053 shares. Stone Group Corporation also directly holds 15,910,146 shares in the Company as at 31st December, 2000.

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CONNECTED TRANSACTIONS

During the year, the Group entered into the following transactions:

1. The Company has entered into a conditional agreement with Stone Group Corporation on 5th July, 2000 (the “Acquisition Agreement”) to acquire 71% of the equity interest in Shanghai Stone-MTI Computer System Engineering Co. Ltd (“SMTI”) at a consideration of HK\$68,288,240. The consideration was satisfied as to HK\$40,000,000 in cash and the balance of HK\$28,288,240 by way of the issue and allotment of 15,910,146 new shares of HK\$0.1 each in the Company at a price of HK\$1.778 per share to Stone Group Corporation.

Stone Group Corporation is a substantial shareholder of Beijing Stone Electronic Technology Limited, a subsidiary of the Company. It also holds 49% interest in Stone Investment which is the controlling shareholder of the Company. The agreement constituted a connected transaction to the Company and the details were announced by the directors of the Company on 5th July, 2000.

Pursuant to the Acquisition Agreement, the audited profit after taxation of SMTI for the year ended 31st December, 2000 was guaranteed by Stone Group Corporation to be not less than RMB12,780,000 (equivalent to \$12,034,000) (the “Guaranteed Profit”). In the event that the Guaranteed Profit is less than RMB12,780,000, an amount which is equivalent to 71% of 8 times of the shortfall shall be paid by Stone Group Corporation to the Company in cash.

The independent board of directors of the Company has confirmed that the audited profit after taxation of SMTI for the year ended 31st December, 2000 amounted to RMB7,269,000 (equivalent to \$6,845,000). Pursuant to the Acquisition Agreement, the compensation is due for payment within one month after announcement of the audited result of the Company for the year ended 31st December, 2000, that is on or before 20th May, 2001. As at the date when the accounts are approved by the directors, Stone Group Corporation has not fulfilled its obligation under the guarantee.

2. The Company has entered into a conditional agreement with Stone Group Corporation on 18th September, 2000 to acquire 25% equity interest in Mitsubishi Stone Semiconductor Co Ltd. (“MSSC”) at a consideration of HK\$103,892,000. The consideration will be satisfied by way of the issue and allotment of 76,464,267 new shares of HK\$0.1 each in the Company at a price of HK\$1.3587 per share to Stone Group Corporation. This transaction was completed on 18th April, 2001.

The agreement constituted a connected transaction of the Company and the details were announced by the directors of the Company on 18th September, 2000.

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CONNECTED TRANSACTIONS *(Cont'd)*

3. The Company has entered into a conditional agreement with Matsushita Electric Works, Ltd (“Matsushita”), Matsushita Electric Works (China) Ltd, Mitsui & Company Ltd and Stone Group Corporation on 7th December, 2000 to dispose the entire 35% interest in Beijing Stone Matsushita Electric Works, Ltd at a consideration of US\$17,350,000 (HK\$135,330,000) to Matsushita. As at 31st December, 2000, the Company was still awaiting the approvals from the relevant PRC government authority approving the transaction contemplated under the agreement.

The disposal constituted a connected transaction of the Company and the details were announced by the directors of the Company on 7th December, 2000.

4. Further details of the above and other connected transactions during the year are set out in note 30 on the accounts.

FINANCIAL SUMMARY

A summary of the consolidated results and assets and liabilities of the Group for the five years ended 31st December, 2000 is set out on page 68 of the annual report.

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

During the year, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

PROPERTIES

Particulars of the major properties and property interests of the Group are shown on pages 69 to 70 of the annual report.

RETIREMENT SCHEME

Particulars of the retirement scheme of the Group are set out in note 10 on the accounts.

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COMPLIANCE WITH THE CODE OF BEST PRACTICE

The Company has complied throughout the year with the Code of Best Practice as set out by The Stock Exchange of Hong Kong Limited in Appendix 14 to the Listing Rules.

AUDITORS

KPMG retire and, being eligible, offer themselves for reappointment. A resolution for the reappointment of KPMG as auditors of the Company is to be proposed at the forthcoming annual general meeting.

By Order of the Board

Shen Guojun

Chairman

Hong Kong, 20th April, 2001