

REPORT OF THE DIRECTORS

The directors submit herewith their annual report together with the audited accounts for the year ended 31st December, 2001.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The principal activities of its subsidiaries and associates are set out in notes 37 and 38 on the accounts.

The Group's turnover is derived principally from the manufacturing, distribution and sale of electronic and electrical products, office equipment and the provision of technology-enabled value-added services.

The Group operates primarily in the People's Republic of China ("PRC") outside Hong Kong 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 contributions 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 activities outside the PRC mainland are insignificant. Accordingly, no analyses by principal activities and geographical areas are provided.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31st December, 2001, 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 28% and 13% 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, 2001 and the state of the Company's and the Group's affairs at that date are set out in the accounts on pages 26 to 72.

No interim dividend was paid during the year (2000: \$Nil). The directors do not recommend the payment of a final dividend for the year ended 31st December, 2001 (2000: \$Nil).

PROPERTY, PLANT AND EQUIPMENT

Movements in property, plant and equipment during the year are set out in note 13 on the accounts.

SUBSIDIARIES

Particulars regarding the Company's subsidiaries are set out in note 37 on the accounts.

SHARE CAPITAL

Details of movements in the Company's share capital during the year are set out in note 27 on the accounts.

BANK LOANS AND OVERDRAFTS

Particulars of bank loans and overdrafts of the Group and the Company as at 31st December, 2001 are set out in note 24 on the accounts.

REPORT OF THE DIRECTORS

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

Chen Xiaotao (appointed on 30th May, 2001)

Zhu Xiduo (appointed on 30th May, 2001)

Yang Hongru (resigned on 30th May, 2001)

Chu Zhong (resigned on 30th May, 2001)

Independent non-executive directors

Liu Hong Ru

Andrew Y. Yan (appointed on 26th June, 2001)

Kwok Viem, Peter (resigned on 8th October, 2001)

In accordance with the articles 92 and 101 of the Company's articles of association, Messrs. Duan Yongji, Liu Hong Ru, Zhu Xiduo, Chen Xiaotao and Andrew Y. Yan retire from the board at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

Messrs. Liu Hong Ru and Andrew Y. Yan were appointed as independent non-executive directors of the Company for a term of 3 years commencing on 15th December, 2000 and 26th June, 2001 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 and Li Wenjun 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. Mr. Chen Xiaotao also entered into a service contract with the Company for a period of 2 years commencing on 1st June, 2001 and will continue thereafter until terminated by either party to the agreement at no less than 2 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.

REPORT OF THE DIRECTORS

DIRECTORS' INTERESTS IN SHARES

The directors who held office at 31st December, 2001 had the following interests in the issued share capital of the Company at that date as recorded in the register of directors' share interests under Section 29 of the Securities (Disclosure of Interests) Ordinance ("SDI Ordinance"):

	Ordinary Shares of HK\$0.10 each of the Company			
	Personal interests	Family interests	Corporate interests	Other interests
Mr. Duan Yongji	2,790,000	—	—	—

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 indirectly holds 91,374,413 shares of the Company. Messrs. Shen Guojun, Duan Yongji, Li Wenjun, Zhu Xiduo and Chen Xiaotao (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.

Save as disclosed herein and in the share option scheme, none of the directors of the Company had any interests, as at 31st December, 2001, in the equity or debt securities of the Company and its associated corporations (within the meaning of the SDI Ordinance) as recorded in the register required to be kept under section 29 of the SDI Ordinance.

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.

SHARE OPTION SCHEME

The Company has a share option scheme which was adopted on 23rd July, 1993 as incentive to employees of the Group whereby the directors of the Company are authorised, at their discretion, to invite employees of the Group, including directors of any company in the Group, to take up options to subscribe for shares of the Company. The exercise price of options was determined by the board and was the higher of the nominal value of the shares and a price being not less than 80% of the average of the closing prices of the shares on the Stock Exchange of Hong Kong Limited ("Stock Exchange") for the five business days immediately preceding the date of the grant. 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 22nd July 2003 whichever is earlier.

REPORT OF THE DIRECTORS

SHARE OPTION SCHEME (Cont'd)

The maximum number of shares in respect of which options may be granted under the share option scheme may not exceed 10% of the issued share capital of the Company from time to time excluding any shares of the Company issued pursuant to the share option scheme.

No option may be granted to any employee which, if exercised in full, would result in such employee becoming entitled to subscribe for such number of shares as, when aggregate with the total number of shares already issued and remaining issuable to him under the share option scheme, would exceed 25% of the aggregate number of shares of the Company for the time being issued or issuable under the share option scheme. The consideration payable on acceptance of an option is HK\$1.00 payable within 28 days from the offer date. Full amount of subscription price must be paid upon exercise of an option.

At 31st December, 2001, the directors and employees of the Company had the following interests in options to subscribe for shares of the Company (market value per share at 31st December, 2001 is HK\$0.83). Each option gives the holder the right to subscribe for one share.

	No. of options outstanding at the beginning of the year	No. of options exercised during the year	No. of options outstanding at the year end	Date granted	Period during which options exercisable	Price per share on exercise of options HK\$	Market value per share at date of grant of options HK\$
Mr. Duan Yongji	7,500,000	—	7,500,000	29-02-2000	29-08-2000 to 22-07-2003	2.796	3.575
Mr. Li Wenjun	4,000,000	—	4,000,000	29-02-2000	29-08-2000 to 22-07-2003	2.796	3.575
Mr. Yang Hongru*	1,590,000	1,590,000	—	21-10-2000	21-04-2001 to 22-07-2003	0.632	0.82
Mr. Duan Yongji	—	—	8,000,000	15-08-2001	15-02-2002 to 22-07-2003	0.7264	0.98
Mr. Shen Guojun	—	—	4,000,000	15-08-2001	15-02-2002 to 22-07-2003	0.7264	0.98
Mr. Li Wenjun	—	—	2,151,000	15-08-2001	15-02-2002 to 22-07-2003	0.7264	0.98

* Mr. Yang Hongru resigned as a director on 30th May, 2001.

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SHARE OPTION SCHEME (Cont'd)

The consideration paid by each of the above directors for the share options granted was HK\$1.00.

The share options granted are not recognised in the financial statements until they are exercised. The weighted average value per option granted in 2000 and 2001 estimated at the date of grant using the Black-Scholes pricing model was HK\$1.832 and HK\$0.562 respectively. The weighted average assumptions used are as follows:

	2001	2000
Risk-free interest rate	5.8%	7.1%
Expected life (<i>in years</i>)	2	2
Volatility	0.88	0.88
Expected dividend per share	HK\$Nil	HK\$Nil

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, such option pricing model requires input of highly subjective assumptions, including the expected stock price volatility. Because the Company's share options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, the Black-Scholes option pricing model does not necessarily provide a reliable measure of the fair value of the share options.

The weighted average closing price of the shares of the Company immediately before the dates on which the options were exercised during the year was HK\$1.35. During the year, no options lapsed or were cancelled.

The Stock Exchange amended the requirements for the share option schemes under the Listing Rules. The new requirements have come into effect from 1st September, 2001 and make some of the provisions of the share option scheme of the Company no longer applicable. Pursuant to an ordinary resolution passed at an extraordinary general meeting of the Company on 12th April, 2002, the share option scheme was terminated and a new share option scheme was adopted. The provisions of the new share option scheme are in line with the new requirements of the Listing Rules.

Apart from the foregoing, at no time during the year was the Company, any of its holding company, subsidiaries or fellow subsidiaries a party to any arrangement to enable the directors or chief executive of the Company or any of their spouses or children under eighteen years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

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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, 2001, according to the register of substantial shareholders maintained under Section 16(1) of the SDI Ordinance and so far as known to the directors, the following companies were interested in 10% or more of the Company's issued share capital of the company:

	<i>Note</i>	Shares held	Percentage of total issued shares
Stone Investment	1	407,110,053	33.97%
Employees' Shareholding Society	2	407,110,053	33.97%
Stone Group Corporation	2	498,484,466	41.59%

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 indirectly holds 91,374,413 shares in the Company as at 31st December, 2001.

CONNECTED TRANSACTIONS

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

1. The Company entered into a conditional agreement with Stone Group Corporation on 18th September, 2000 to acquire 25% equity interest in Mitsubishi Stone Semiconductor Company Limited. The consideration was satisfied by way of the issue and allotment of 76,464,267 new shares of HK\$0.10 each in the Company at a price of HK\$1.13 per share to Stone Group Corporation upon the completion of this transaction on 18th April, 2001.

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

2. The Company 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 of the entire 35% equity interest in Beijing Stone Matsushita Electric Works, Ltd at a consideration of US\$17,350,000 (HK\$135,330,000) to Matsushita. This transaction was completed on 26th April, 2001.

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

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CONNECTED TRANSACTIONS (Cont'd)

3. The Company entered into a conditional agreement with Stone Group Corporation on 23rd July, 2001 to inject US\$10,000,000 (equivalent to HK\$78,000,000) in cash into Beijing Stone Electronic Technology Co., Ltd. ("Beijing Stone Electronic") such that the investment capital of Beijing Stone Electronic would be increased from US\$10,000,000 to US\$20,000,000 and the Company would increase its equity interests in Beijing Stone Electronic from 75% to 87.5%. The transaction was completed on 18th October, 2001.

As Stone Group Corporation is a substantial shareholder of Beijing Stone Electronic and holds a 49% interest in Stone Investment which is the controlling shareholder of the Company, the capital injection constitutes a connected transaction of the Company and the details were announced by the directors of the Company on 23rd July, 2001.

4. Beta-One Enterprise Limited ("Beta-One"), a subsidiary of the Company, entered into a conditional agreement on 8th November, 2001 with Stone Group Corporation to sell its accounts receivable of HK\$12,176,000 in aggregate due by various debtors. The consideration was satisfied by way of Stone Group Corporation procuring Springbend Holdings Limited, a subsidiary of Stone Group Corporation, to transfer 628,301 ordinary shares of Sina.com and 25 ordinary shares of Soaring High Investments Limited to Beta-One or such other party as may be directed by Beta-One.

The arrangement constitutes a connected transaction of the Company and the details were announced by the directors of the Company on 9th November, 2001.

Further details of the above and other related party transactions during the year are set out in note 32 on the accounts.

Subsequent to the year end and up to the date of the report, the Company entered into a conditional agreement with Stone Group Corporation on 18th January, 2002 to acquire 12.5% of the equity interests of Beijing Stone Electronic from Stone Group Corporation for a consideration of RMB18,000,000 (equivalent to approximately HK\$16,965,000). Upon completion, Beijing Stone Electronic will become a wholly-owned subsidiary of the Company.

The acquisition constitutes a connected transaction of the Company and the details were announced by the directors of the Company on 18th January, 2002.

FIVE YEAR SUMMARY

A summary of the consolidated results and assets and liabilities of the Group for the five years ended 31st December, 2001 is set out on page 73 of the annual report.

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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 page 74 of the annual report.

RETIREMENT SCHEME

Particulars of the retirement scheme of the Group are set out in note 11 on the accounts.

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 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.

AUDIT COMMITTEE

The audit committee comprises two independent non-executive directors and reports to the board of directors. The audit committee meet with the Group's senior management and external auditors regularly to review the effectiveness of the internal control systems and the interim and annual reports of the Group.

By Order of the Board

Shen Guojun

Chairman

Hong Kong, 24th April, 2002