

Report of the Directors

The directors have pleasure in submitting their annual report together with the audited financial statements for the year ended 31 December 2002.

PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The principal activities and other particulars of its principal subsidiaries are set out in note 37 on the financial statements.

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

SEGMENTAL INFORMATION

An analysis of the Group's turnover and contributions from operations by business segments for the year ended 31 December 2002 is set out in note 13 on the financial statements. No analysis of the Group's turnover and contributions from operations by geographical segment has been presented as almost all the Group's operating activities are carried out in the PRC.

MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2002, 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 58% and 24% 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 own 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.

FINANCIAL STATEMENTS

The results of the Group for the year ended 31 December 2002 and the state of the Company's and the Group's affairs at that date are set out in the financial statements on pages 33 to 90.

No interim dividend was paid during the year (2001: HK\$Nil). The directors do not recommend the payment of a final dividend for the year ended 31 December 2002 (2001: HK\$Nil).

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TRANSFER TO RESERVES

Profits attributable to shareholders of HK\$36,745,000 (2001: loss of HK\$123,229,000) have been transferred to reserves.

PROPERTY, PLANT AND EQUIPMENT

Movements in property, plant and equipment during the year are set out in note 15 on the financial statements.

BANK LOANS

Particulars of bank loans of the Group and the Company as at 31 December 2002 are set out in note 26 on the financial statements.

DIRECTORS

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

Executive directors

Duan Yongji (*Chairman*)

Shen Guojun

Li Wenjun

Chen Xiaotao

Zhu Xiduo

Independent non-executive directors

Liu Hongru

Andrew Y Yan

In accordance with article 101 of the Company's articles of association, Messrs Shen Guojun and Li Wenjun retire by rotation from the board at the forthcoming annual general meeting. Mr Shen Guojun, being eligible, offers himself for re-election. However, Mr Li Wenjun does not offer himself for re-election.

Messrs Liu Hongru and Andrew Y Yan were appointed as independent non-executive directors of the Company for a term of 3 years commencing on 15 December 2000 and 26 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.

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DIRECTORS' SERVICE CONTRACTS

Messrs Duan Yongji, Shen Guojun and Li Wenjun entered into service contracts with the Company, all of which are for a period of 3 years commencing on 23 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 1 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.

DIRECTORS' INTERESTS IN SHARES

The directors who held office at 31 December 2002 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 | 5,340,000 | — | — | — |

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 42.3% by Stone Jiu Guang New Technology Development (Holdings) Company Limited ("Stone Jiu Guang"), 6.7% by Stone Group Corporation and 51% by the Beijing Stone Investment Company Limited Employees' Shareholding Society ("Employees' Shareholding Society"). In addition, Stone Group Corporation indirectly holds 92,374,413 shares of the Company. Messrs Duan Yongji, Shen Guojun, 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 schemes, none of the directors of the Company had any interests, as at 31 December 2002, 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.

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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 SCHEMES

The share option scheme which was adopted by the Company on 23 July 1993 ("Old Scheme") was originally due to expire on 22 July 2003. Owing to the changes in the Listing Rules in relation to share option schemes with effect from September 2001, the directors proposed and the shareholders approved in a general meeting on 12 April 2002 early termination of the Old Scheme and adoption of a new share option scheme ("New Scheme"). After termination of the Old Scheme, no more options can be granted pursuant to the Old Scheme and in respect of all the outstanding options granted under the Old Scheme, the provisions of the Old Scheme shall remain in force.

The principal terms of the Old Scheme and New Scheme are as follows:—

(a) Old Scheme

The Old Scheme was adopted as an incentive to employees of the Group whereby the directors of the Company are authorized, 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 directors of the Company 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 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 22 July 2003, whichever is earlier.

The maximum number of shares in respect of which options may be granted under the Old 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 aggregated with the total number of shares already issued and remaining shares issuable to him under the Old Scheme, would exceed 25% of the aggregate number of shares of the Company for the time being issued or issuable under the Old Scheme. The consideration payable on acceptance of an option is HK\$1 payable within 28 days from the offer date. The full amount of subscription price must be paid upon exercise of an option. The Old Scheme was terminated on 12 April 2002.

SHARE OPTION SCHEMES *(Continued)*

(b) New Scheme

The purpose of the New Scheme is to encourage the participants to perform their best in achieving the goals of the Group and at the same time allow the participants to enjoy the results of the Company attained through their effort and contribution. Participants include any employee and director of the Company or any of its subsidiaries or associates as absolutely determined by the directors of the Company.

The directors of the Company may, at their discretion, invite any participant to take up options. An option is deemed to have been accepted by the grantee upon his or her signing the duplicate letter comprising acceptance of the option and paying HK\$1.0 by way of consideration for the grant thereof.

The subscription price for shares in the Company under the New Scheme will be the highest of (i) the closing price of the shares of the Company as stated in the Stock Exchange's daily quotations sheet on the date on which the option is offered, which date must be a business day, (ii) a price being the average of the closing prices of the shares of the Company as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the option is offered, and (iii) the nominal value of a share of the Company.

The total number of shares of the Company which may be issued upon exercise of all options to be granted under the New Scheme and any other share option schemes of the Company must not in aggregate exceed 10% of the total number of shares of the Company in issue as at the date of approval of the New Scheme. The Company may seek approval of the shareholders in general meeting to renew the said 10% limit such that the total number of shares in respect of options that may be granted under the New Scheme or any other share option schemes of the Company shall not exceed 10% of the total number of shares of the Company in issue as at the date of approval to renew the limit. Notwithstanding the above, the maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the New Scheme and any other share options schemes of the Company shall not exceed 30% of the total number of shares of the Company in issue from time to time.

The maximum entitlement for any one participant is that the total number of shares issued and to be issued upon exercise of the options granted to each participant (including exercised or outstanding options) in any 12-month period must not exceed 1 per cent. of the total number of shares of the Company in issue. Any further grant of options in excess of the said 1 per cent. limit shall be subject to shareholders' approval in general meeting with such participant and his or her associates abstaining from voting. An option may be exercised during a period to be determined by the directors in its absolute discretion and in any event such period shall not be longer than 10 years after the date the grant of the option. The New Scheme will remain in force for a period of 10 years from 12 April 2002.

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SHARE OPTION SCHEMES (Continued)

The total number of securities available for issue under the Old scheme and the New Scheme as at 31 December 2002 was 25,651,000 and 239,712,000 shares respectively which represented 2.14% and 20% respectively of the issued share capital of the Company at 31 December 2002.

At 31 December 2002, 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 31 December 2002 was HK\$0.47). 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\$ |
|----------------------------------|---|--|--|-----------------|---|--|---|
| Old Scheme | | | | | | | |
| 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 Duan Yongji | 8,000,000 | — | 8,000,000 | 15-08-2001 | 15-02-2002 to 22-07-2003 | 0.7264 | 0.98 |
| Mr Shen Guojun | 4,000,000 | — | 4,000,000 | 15-08-2001 | 15-02-2002 to 22-07-2003 | 0.7264 | 0.98 |
| Mr Li Wenjun | 2,151,000 | — | 2,151,000 | 15-08-2001 | 15-02-2002 to 22-07-2003 | 0.7264 | 0.98 |
| New Scheme | | | | | | | |
| Mr Duan Yongji (Note a) | — | — | 3,900,000 | 22-05-2002 | 22-08-2002 to 21-05-2012 | 0.792 | 0.78 |
| Mr Shen Guojun (Note a) | — | — | 4,000,000 | 22-05-2002 | 22-08-2002 to 21-05-2012 | 0.792 | 0.78 |
| Mr Li Wenjun (Note a) | — | — | 3,000,000 | 22-05-2002 | 22-08-2002 to 21-05-2012 | 0.792 | 0.78 |
| Mr Zhu Xiduo (Note a) | — | — | 3,000,000 | 22-05-2002 | 22-08-2002 to 21-05-2012 | 0.792 | 0.78 |
| Mr Chen Xiaotao (Note b) | — | — | 8,000,000 | 22-05-2002 | 22-05-2002 to 21-05-2012 | 0.792 | 0.78 |
| Contracted employees (Note c) | — | — | 97,956,000 | 22-05-2002 | 22-05-2002 to 21-05-2012 | 0.792 | 0.78 |
| Contracted employees (Note d) | — | — | 119,856,000 | 31-12-2002 | 31-12-2002 to 30-12-2012 | 0.476 | 0.47 |

SHARE OPTION SCHEMES (Continued)

Notes:

- a. The options granted to these grantees shall be exercisable in the following four batches ("Vesting Period"):
 - (i) Not more than 25% of options granted exercisable from 22-08-2002 to 21-08-2003;
 - (ii) Not more than 50% of options granted exercisable from 22-08-2003 to 21-08-2004;
 - (iii) Not more than 75% of options granted exercisable from 22-08-2004 to 21-08-2005; and
 - (iv) Free to exercise from 22-08-2005 to 21-05-2012.
- b. Free to exercise 4,000,000 options from 22-05-2002 to 21-05-2012 and the remaining 4,000,000 options are subject to the Vesting Period set out in Note (a).
- c. Free to exercise 35,356,000 options from 22-05-2002 to 21-05-2012 and the remaining 62,600,000 options are subject to the Vesting Period set out in Note (a).
- d. Out of total options granted on 31 December 2002, free to exercise 113,856,000 options from 31-12-2002 to 30-12-2012 and the remaining 6,000,000 options shall be exercisable in the following four batches:
 - (i) Not more than 25% of options granted exercisable from 31-03-2003 to 30-03-2004;
 - (ii) Not more than 50% of options granted exercisable from 31-03-2004 to 30-03-2005;
 - (iii) Not more than 75% of options granted exercisable from 31-03-2005 to 30-03-2006; and
 - (iv) Free to exercise from 31-03-2006 to 31-12-2012.

The consideration paid by each of the above directors and employees for the share options granted was HK\$1.0.

The share options granted are not recognised in the financial statements until they are exercised. The weighted average value per option granted in 2001 and 2002 estimated at the date of grant using the Black-Scholes pricing model was HK\$0.562 and HK\$0.424 respectively. The weighted average assumptions used are as follows:

| | 2002 | 2001 |
|-----------------------------|----------------|---------|
| Risk-free interest rate | 4.7% | 5.8% |
| Expected life (in years) | 3 - 5 | 2 |
| Volatility | 0.84 | 0.88 |
| Expected dividend per share | HK\$Nil | HK\$Nil |

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SHARE OPTION SCHEMES (Continued)

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.

Apart from the foregoing, at no time during the year was the Company, or 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.

MANAGEMENT CONTRACTS

Pursuant to an agreement dated 3 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 23 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 31 December 2002, the following corporations were interested in 10% or more of the Company's issued share capital:

| | Note | 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 Jiu Guang | 2 | 407,110,053 | 33.97% |
| Stone Group Corporation | 2 | 499,484,466 | 41.67% |

Notes:

- 1 The holding 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 42.3% by Stone Jiu Guang, 6.7% 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 92,374,413 shares in the Company as at 31 December 2002.

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SUBSTANTIAL INTERESTS IN THE SHARE CAPITAL OF THE COMPANY *(Continued)*

Saved as disclosed above, the Company has not been notified of any other interests representing 10% or more of the issued share capital of the Company and recorded in the register of substantial shareholders maintained under section 16(1) of the SDI Ordinance as at 31 December 2002.

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 18 January 2002 to acquire 12.5% of the equity interests of Beijing Stone Electronic Technology Co., Ltd. ("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 became 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 18 January 2002.

- 2 Stone Advance Technology Limited ("Stone Advance"), a wholly-owned subsidiary of the Company, entered into sales arrangements from time to time in respect of the sales of GSM module and GPS board by Stone Advance to Beijing Yizhou Qicheng Information Technology Co Ltd ("Beijing Yizhou"), a subsidiary of Beijing Centek Data Communication Technology Co Ltd ("Beijing Centek"), one of the joint venture partners of Shanghai Centek Communication Industry Service Co Ltd ("Shanghai Centek"), of which the Company is the major investor. In addition, Beijing Yizhou sold GSM products to Shanghai Centek and sold GPS products to Beijing Centek for resale to Shanghai Centek.

The arrangements constitute connected transactions of the Company and the details were announced by the directors of the Company on 1 August 2002. In December 2002, the Company sold its entire equity investment in Shanghai Centek to a third party and the sales arrangements ceased to constitute connected transactions of the Company thereafter.

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CONNECTED TRANSACTIONS *(Continued)*

- 3 Beijing Stone New Technology Industrial Company Limited ("Beijing New Technology"), a wholly owned subsidiary of the Group, entered into an agreement on 1 January 2001 with Stone Group Corporation to acquire 30% beneficial interest in Shanghai Stone Hu Guang Technology Shareholding Company ("Shanghai Hu Guang") from Stone Group Corporation at a consideration of Rmb1,760,000 (equivalent to approximately HK\$1,659,000). On 18 October 2002, Beijing Stone Computer Company Limited ("Beijing Computer"), a subsidiary of the Group, entered into an agreement with Beijing New Technology to acquire the 30% beneficial interest in Shanghai Hu Guang from Beijing New Technology at a consideration of Rmb1,760,000. In addition, Beijing Computer acquired another 21% beneficial interest in Shanghai Hu Guang from Stone Group Corporation at a consideration of Rmb1,240,000 (equivalent to approximately HK\$1,169,000) on 18 October 2002. Upon completion, Shanghai Hu Guang became a non-wholly owned subsidiary of the Group.

The acquisitions constitute connected transactions of the Company and the details were announced by the directors of the Company on 23 December 2002.

- 4 On 12 April 2002, Beijing New Technology entered into a loan agreement for the advance of Rmb200,000 (equivalent to approximately HK\$189,000) to Stone Investment, the controlling shareholder of the Company, for a term of three months from 21 March 2002 to 21 June 2002. On 23 April 2002, Beijing New Technology entered into a further loan agreement for the advance of Rmb2,000,000 (equivalent to approximately HK\$1,885,000) to Stone Investment for a term of one year from 23 April 2002 to 23 April 2003.

The loan advances constitute connected transactions of the Company and the details were announced by the directors of the Company on 23 December 2002.

Subsequent to the year end and up to the date of the report, the Group entered into and completed the following transaction:

Beijing Computer entered into an agreement to acquire from Beijing New Technology a cashier machine business at a cash consideration of Rmb5,000,000 (equivalent to approximately HK\$4,713,000) plus the lower of (i) Rmb5,000,000 and (ii) 50% of the audited after-tax profits (if any) generated from the cashier machine business for the years ending 2003 and 2004 in aggregate.

The acquisition constitutes a connected transaction of the Company and the details were announced by the directors of the Company on 11 March 2003.

Further details of the above and other related party transactions during the year are set out in note 34 on the financial statements.

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FIVE YEAR SUMMARY

A summary of the consolidated results and assets and liabilities of the Group for the five years ended 31 December 2002 is set out on page 91 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 page 92 of the annual report.

RETIREMENT SCHEMES

Particulars of the retirement schemes of the Group are set out in note 11 on the financial statements.

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 meets 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

Duan Yongji

Chairman

Hong Kong, 25 April 2003