神州数码
Digital China

神州數碼控股有限公司*
DIGITAL CHINA HOLDINGS LIMITED
(Incorporated in Bermuda with limited liability)

FIRST QUARTERLY REPORT

FOR THE THREE MONTHS ENDED 30 JUNE 2003

(For identification purpose only)*

The board of directors (the “Directors”) of Digital China Holdings Limited (the “Company”) would like to announce the unaudited consolidated quarterly results of the Company and its subsidiaries (collectively the “Group”) for the three months ended 30 June 2003 (collectively referred to herein as “unaudited financials”) together with comparative figures for the corresponding period of last financial year.

CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNT

		Three months ended 30 June	
		2003	2002
		(Unaudited)	(Unaudited)
			(Restated)
	Notes	**HK$’000**	HK$’000
Turnover	2	**3,300,548**	2,849,412
Cost of inventories sold		**(3,076,131)**	(2,610,907)
Selling expenses		**(18,538)**	(20,252)
Promotion and advertising expenses		**(19,521)**	(16,587)
Staff costs		**(80,909)**	(66,019)
Other operating expenses, net		**(233,630)**	(80,991)
Earnings/(Loss) before interest, tax and depreciation		**(128,181)**	54,656
Depreciation		**(12,787)**	(7,555)
Interest income	2	**762**	951
Profit/(Loss) from operating activities	3	**(140,206)**	48,052
Finance costs		**(13,351)**	(9,316)
Share of losses of associates		**(3,027)**	(2,541)
Profit/(Loss) before tax		**(156,584)**	36,195
Tax	4	**6,809**	365
Profit/(Loss) before minority interests		**(149,775)**	36,560
Minority interests		**1,140**	136
Net profit/(loss) from ordinary activities attributable to shareholders		**(148,635)**	36,696
Earnings/(Loss) per share			
- Basic	5	**(17.31) HK cents**	4.27 HK cents
- Diluted	5	**N/A**	4.19 HK cents

CONDENSED CONSOLIDATED BALANCE SHEET

	Notes	**As at 30 June 2003 (Unaudited) HK$'000**	As at 31 March 2003 (Audited) (Restated) HK$'000
Non-current assets			
Fixed assets		**419,598**	323,833
Goodwill		**20,560**	21,113
Intangible assets		**8,664**	6,044
Deferred tax assets		**17,300**	8,606
Interests in associates		**31,752**	25,948
		497,874	385,544
Current assets			
Inventories		**1,291,522**	1,020,503
Trade and bills receivables	6	**1,765,046**	1,512,181
Prepayments, deposits and other receivables		**320,765**	334,335
Cash and bank balances		**413,115**	667,097
		3,790,448	3,534,116
Current liabilities			
Trade and bills payables	7	**1,396,622**	1,424,028
Other payables and accruals		**359,358**	333,103
Tax payable		**1,416**	1,464
Interest-bearing bank borrowings, unsecured		**734,622**	448,986
		2,492,018	2,207,581
Net current assets		**1,298,430**	1,326,535
Total assets less current liabilities		**1,796,304**	1,712,079
Non-current liabilities			
Interest-bearing bank borrowings, unsecured		**546,000**	312,000
Minority interests		**5,951**	7,091
		1,244,353	1,392,988
Capital and reserves			
Issued capital		**85,870**	85,870
Reserves		**1,095,111**	1,243,746
Proposed final dividend		**63,372**	63,372
		1,244,353	1,392,988

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	Three months ended 30 June 2003 (Unaudited) HK$'000	2002 (Unaudited) (Restated) HK$'000
Net cash outflow from operating activities	**(641,611)**	(314,167)
Net cash outflow from investing activities	**(118,656)**	(47,483)
Net cash inflow from financing activities	**506,285**	256,117
Decrease in cash and cash equivalents	**(253,982)**	(105,533)
Effect of foreign exchange rate changes, net	**—**	(2,784)
Cash and cash equivalents at the beginning of the period	**667,097**	472,707
Cash and cash equivalents at the end of the period	**413,115**	364,390

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital (Unaudited) HK$'000	Share premium account (Unaudited) HK$'000	Capital reserve (Unaudited) HK$'000	Reserve funds (Unaudited) HK$'000	Exchange fluctuation reserve (Unaudited) HK$'000	Retained profits (Unaudited) HK$'000	Proposed final dividend (Unaudited) HK$'000	Total (Unaudited) HK$'000
At 1 April 2003								
- as previously reported	85,870	289,895	623,689	27,874	1,003	292,679	63,372	1,384,382
- adjustment on adoption of SSAP12 (Revised)	—	—	—	—	—	8,606	—	8,606
- as restated	85,870	289,895	623,689	27,874	1,003	301,285	63,372	1,392,988
Net loss for the period	—	—	—	—	—	(148,635)	—	(148,635)
At 30 June 2003	**85,870**	**289,895**	**623,689**	**27,874**	**1,003**	**152,650**	**63,372**	**1,244,353**
At 1 April 2002								
- as previously reported	85,868	289,850	623,689	14,259	(669)	188,504	59,936	1,261,437
- adjustment on adoption of SSAP12 (Revised)	—	—	—	—	—	10,725	—	10,725
- as restated	85,868	289,850	623,689	14,259	(669)	199,229	59,936	1,272,162
Exchange realignment	—	—	—	—	1,790	—	—	1,790
Net profit for the period (Restated)	—	—	—	—	—	36,696	—	36,696
At 30 June 2002 (Restated)	85,868	289,850	623,689	14,259	1,121	235,925	59,936	1,310,648

Notes:

1. **Basis of presentation and principal accounting policies**

The unaudited financials are prepared in accordance with Hong Kong Statement of Standard Accounting Practice ("SSAP") No. 25 "Interim financial reporting" issued by the Hong Kong Society of Accountants. In preparing the unaudited financials, the same basis of presentation, accounting policies and methods of computation as set out in the Group's annual accounts for the year ended 31 March 2003 had been consistently applied except for the adoption of the following new/revised SSAPs and the change of the accounting estimate:

Adoption of the new/revised SSAPs

- SSAP 12 (Revised) : "Income taxes"
- SSAP 35 : "Accounting for government grants and disclosure of government assistance"

SSAP 12 (Revised) principally prescribes the accounting treatment and disclosures for deferred tax. In prior years, deferred tax is provided using the income statement liability method on all significant timing differences to the extent it is probable that the liability will crystalise in the foreseeable future, a deferred tax asset is not recognised until its realisation is assured beyond reasonable doubt. SSAP 12 (Revised) requires the adoption of the balance sheet liability method, whereby deferred tax is recognised in respect of all temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, with limited exceptions. In the absence of any specific transitional requirements in SSAP 12 (Revised), the new accounting policy has been applied retrospectively. The principal impacts of the revision of this SSAP are that opening retained profits at 1 April 2002 and 1 April 2003 have been increased by HK$10.7 million and HK$8.6 million respectively and the tax benefit for the current period and prior period increased by HK$8.7 million and HK$0.5 million respectively.

SSAP 35 prescribes the accounting treatment and disclosures for government grants and disclosures for other forms of government assistance. This SSAP has had no major impact on the unaudited financials.

Change of the accounting estimate

During the period, the rates used to determine the general provision of the inventories of a business segment were revised. In the opinion of the Directors, the revised general provision rates would be more appropriate for the Group to determine the inventory value. The effect of change of accounting estimate was not material to the current and prior period results.

2. Turnover, revenue and segment information

The Group is principally engaged in the distribution of information technology ("IT") products, provision of systems integration services and development and distribution of networking products. Turnover represents invoiced value of goods sold and services rendered to customers, net of business tax, value-added tax and government surcharges, and after allowances for goods returned and trade discounts.

Primary reporting format - business segments

	Three months ended 30 June	
	2003	2002
	(Unaudited)	(Unaudited)
		(Restated)
	HK$'000	HK$'000
Segment turnover		
Distribution of IT products	**2,728,707**	2,276,938
Provision of systems integration services (including hardware and software sale and services revenue)	**527,328**	516,101
Distribution of networking products	**44,513**	56,373
	3,300,548	2,849,412
Other revenue		
Interest income	**762**	951
	3,301,310	2,850,363
Segment results		
Distribution of IT products	**150,460**	169,363
Provision of systems integration services (including hardware and software sale and services revenue)	**63,648**	70,461
Distribution of networking products	**10,309**	(1,319)
	224,417	238,505
Unallocated items	**(364,623)**	(190,453)
Profit/(Loss) from operating activities	**(140,206)**	48,052
Finance costs	**(13,351)**	(9,316)
Share of losses of associates	**(3,027)**	(2,541)
Profit/(Loss) before tax	**(156,584)**	36,195
Tax	**6,809**	365
Profit/(Loss) before minority interests	**(149,775)**	36,560
Minority interests	**1,140**	136
Net profit/(loss) from ordinary activities attributable to shareholders	**(148,635)**	36,696

Secondary reporting format - geographical segments

Over 90% of the Group's operations are located in The People's Republic of China ("PRC"), which is considered as one geographical location in an economic environment with similar risks and returns. Consequently, no geographical segment analysis is presented.

3. Profit/(Loss) from operating activities

The Group's profit/(loss) from operating activities is arrived at after charging/(crediting):

	Three months ended 30 June 2003 (Unaudited) HK$'000	2002 (Unaudited) HK$'000
Exchange losses, net	**168**	573
Operating lease rentals in respect of land and buildings	**6,271**	9,815
Pension scheme contributions	**4,089**	3,467
Loss on disposal of fixed assets	**152**	628
Amortisation of goodwill*	**553**	—
Provisions and write-off of obsolete inventories*	**101,728**	14,127
Provisions and write-off of doubtful trade receivables*	**87,000**	12,594

* *The amortisation of goodwill, the provisions and write-off of obsolete inventories and the provisions and write-off of doubtful trade receivables for the three months ended 30 June 2002 and 2003 are included in "Other operating expenses, net" of the unaudited condensed consolidated profit and loss account.*

4. Tax

	Three months ended 30 June 2003 (Unaudited) HK$'000	2002 (Unaudited) (Restated) HK$'000
Group		
Current tax:		
PRC corporate income tax	**(1,885)**	(98)
Deferred tax:		
Origination and reversal of temporary difference	**8,207**	1,783
Benefits of previously unrecognised tax losses now recognised	**487**	(1,320)
	8,694	463
Total	**6,809**	365

(a) PRC corporate income tax represents tax charges on the estimated assessable profits of the PRC subsidiaries of the Group. In general, the PRC subsidiaries of the Group are subject to the PRC corporate income tax rate of 33% except for certain subsidiaries which are entitled to tax holiday and preferential tax rates.

(b) No provision for Hong Kong profits tax has been made as the Group has no estimated assessable profits arising in Hong Kong for the three months ended 30 June 2002 and 2003.

(c) No provision for Hong Kong profits tax and PRC corporate income tax have been made for the associates as the associates have no estimated assessable profits for the three months ended 30 June 2002 and 2003.

5. Earnings/(Loss) per share

The calculation of basic loss per share is based on the net loss attributable to shareholders for the three months ended 30 June 2003 of approximately HK$148,635,000 (30 June 2002: restated profit of HK$36,696,000), and the weighted average of 858,704,331 (30 June 2002: 858,680,331) ordinary shares in issue during the three months ended 30 June 2003.

Diluted loss per share for the three months ended 30 June 2003 has not been calculated as the impact of the outstanding share options was anti-dilutive.

The calculation of diluted earnings per share for the three months ended 30 June 2002 was based on the net profit attributable to shareholders for the three months ended 30 June 2002 of approximately HK$36,696,000 (restated) and 875,288,465 ordinary shares, which was the weighted average of 858,680,331 ordinary shares in issue during the three months ended 30 June 2002 and the weighted average of 16,608,134 ordinary shares deemed to have been issued at no consideration on the deemed exercise of all share options during the three months ended 30 June 2002.

6. Trade and bills receivables

An ageing analysis of the trade and bills receivables as at balance sheet dates, net of provisions, is as follows:

	30 June 2003 (Unaudited) HK$'000	31 March 2003 (Audited) HK$'000
Within 30 days	**977,548**	800,880
31 to 60 days	**294,783**	225,131
61 to 90 days	**150,192**	134,537
91 to 180 days	**190,156**	161,376
Over 180 days	**152,367**	190,257
	1,765,046	1,512,181

The Group's trading terms with its customers are mainly on credit, except for new customers, where payment in advance is normally required. The credit period is generally for a period of 30 days, extending up to 60 days, 90 days and 180 days for distribution business, networking products business and systems integration business respectively for major customers.

7. Trade and bills payables

An ageing analysis of the trade and bills payables as at balance sheet dates is as follows:

	30 June 2003 (Unaudited) HK$'000	31 March 2003 (Audited) HK$'000
Within 30 days	**753,895**	711,060
31 to 60 days	**499,718**	446,339
61 to 90 days	**38,008**	140,647
Over 90 days	**105,001**	125,982
	1,396,622	1,424,028

8. Contingent liabilities

At 30 June 2003, the Group had discounted bills with recourse to banks amounting to approximately HK$351,196,000 (31 March 2003: HK$372,332,000).

DIVIDEND

The Directors do not recommend the payment of any dividend in respect of the three months ended 30 June 2003.

MANAGEMENT DISCUSSION AND ANALYSIS

In the new financial year, the Group has realigned its corporate structure with the setting up of a software group, which, headed by President Guo Wei, highlights a strategic move of huge significance for the Group's long-term development. The software group comprises the Group's existing division providing industry-specific application solutions and related services, the newly acquired and renamed company Beijing Digital China SicTech Co., Ltd., and the joint venture company Digital China Management Systems Limited which focuses on the Enterprise Resources Planning market. Through consolidating the Group's resources and increasing the guidance from the top management, the realignment aims to swiftly enhance the Group's competitiveness in the PRC's industry application software market and accelerate the Group's transformation into an application software and services provider.

BUSINESS REVIEW

The sudden outbreak of severe acute respiratory syndrome ("SARS") during the beginning of the year has adversely affected the Group's operations, causing the Group to record a net loss of HK$149 million for the first quarter of the new financial year. The Group's mobile telephone business took the brunt of SARS and posted an operating loss of approximately HK$17 million. During the first quarter, mobile telephone orders made in the beginning of the financial year gradually made delivery, causing the inventory at the end of first quarter to be higher than that at the end of last financial year. In view of the Group's mobile telephone inventory at the end of the first quarter and the price deterioration taking place in the PRC's mobile telephone market, the management considers that it is necessary for the Group to make an additional special provision of approximately HK$95 million for its mobile telephone business in its accounts for the first financial quarter. Moreover, since last July, the Group has become concerned with the payment behaviour of a number of large customers. After careful review, the Group has decided to make an additional provision of around HK$60 million in respect of the accounts receivable from some of these independent customers. Despite such provision, the Group will continue to explore all available avenues to recover such outstanding amount. Nevertheless, during the period from April to June 2003 when SARS was most devastating and taking a toll on the Group's businesses, the Group still managed to increase its turnover by 15.8% to HK$3,300 million compared with HK$2,850 million for the same period last year, albeit the Group's gross profit margin has retreated to 6.8% from the 8.0% recorded a year ago mainly as a result of the loss incurred in the distribution of mobile telephones. Besides its damage to the Group's distribution business, the SARS epidemic has also brought a negative impact on the gross profit margin of almost each of the Group's other businesses.

Distribution Business

The Group's distribution business generated a turnover of HK$2,730 million during the first financial quarter, a growth of 19.8% compared with the same period last year. However, its gross profit margin dropped to 5.51%, compared to 6.95% and 7.44% respectively for the last financial year and the corresponding period last year. The significant decline in gross profit margin was due to a loss incurred in the distribution of mobile telephones, which suffered most from the impact of SARS. With its operations almost ground to a halt before SARS subsided, the mobile telephone business has accumulated a large inventory that exerted tremendous pressure on the Group's profitability. Given that mobile telephones have the characteristics of being short in life cycle and highly susceptible to price pressure, the inventory problem topped the management's agenda, who took swift and decisive measures to clear the backlog. Nonetheless, huge stockpile was a common issue haunting the PRC's mobile telephone operators in the aftermath of SARS. It was therefore inevitable that in the course of disposing the mobile telephone inventory the Group incurred a significant loss, which severely affected the Group's overall gross profit and bottom line earnings for the first financial quarter.

Other products distributed by the Group were relatively less affected by SARS, which recorded an aggregate turnover growth of close to 20%. Particularly strong sales growth was seen in enterprise solution products including UNIX servers and storage products, and software items. This proved that the Group's core distribution business was unhampered by the setback in the mobile telephone front. It managed to maintain a remarkable performance despite the highly difficult operating environment, and enabled the Group to further strengthen its market position and competitiveness in the distribution sector. On 1 July 2003, the Group entered into a strategic alliance agreement with China Great Wall Computer Shenzhen Co., Ltd. ("Great Wall"), pursuant to which the Group was appointed as the exclusive distributor of Great Wall's personal computer products in the PRC and will be responsible for the development and management of sales channels concerning Great Wall's personal computer business and the provision of after sales services for the products in the PRC. Given that personal computer products still account for the largest share in the PRC's overall IT market, it is believed that the alliance with Great Wall will provide room for the Group in this huge marketplace.

Systems Integration

The Group's systems integration business recorded a turnover of HK$530 million during the first financial quarter, a gain of 2.2% and 28.1% respectively from the same period last year and the preceding financial quarter. Its gross profit margin declined to 12.07% compared to the 13.65% recorded in the corresponding period last year, which was attributable mainly to the increase in development costs incurred by certain projects and the additional discounts made to customers amidst the SARS outbreak. Nevertheless, the period under review represented the second consecutive financial quarter since the end of 2002 that the Group's systems integration business reported a turnover growth on a year-to-year comparison. This was achieved despite business opportunities from the telecommunications sector, a major source of revenue for the Group's systems integration business, has remained muted. While major telecommunications operators are not expected to substantially reduce their IT spending this year as in the case of last year, neither is there a significant growth in sight. Indeed, SARS has affected the Group's systems integration business mainly in two ways: it has abruptly interrupted some projects in progress so the Group could not collect its accounts receivable as scheduled, and it has delayed the negotiation and contract signing of certain projects. Given the above, the management is satisfied that the systems integration business still managed to record a growth despite the unfavourable impact brought by SARS. This can be attributed to the Group's devoted efforts in providing application software solutions for the financial sector, the telecommunications sector and the PRC government bodies, as well as the Group's extensive customer base and long-term relationships established in these sectors. During the first quarter, the Group entered into systems integration contracts with Netcom and China Mobile at an amount of HK$93 million and HK$40 million, respectively. In early August 2003, the Group secured a contract to develop a core banking system for the State Development Bank of the PRC at an amount of HK$31 million, which represented a milestone achievement of the Group in further developing the financial sector. The management believes that the Group through continuously enhancing its application software solutions will be able to further strengthen its core competitiveness and leading position in these sectors, and that software solutions will continue to gain proportion in the total turnover of the systems integration business.

Networking Products

Having experienced an extended decline in turnover during the past year, the Group's networking products business made a turnaround in the first financial quarter. It is the first time in about two years that the turnover of this business achieves a growth on a quarterly basis. Its turnover for the three months ended 30 June 2003 amounted to HK$44.5 million, which albeit was still lower than the HK$56.4 million recorded in the same period last year, represented an increase of 15.6% from the preceding quarter's HK$38.5 million. It also marked the first sign of a full recovery that capitalises on the Group's launch of networking products of its own brand. The management firmly believes that these brand products will capture a stronger position in the market with higher endorsement from more users. It is expected that the networking products business with its reshuffle completed and its management strengthened will continue to grow in the rest of the financial year 2003/04.

As SARS was widespread in several major PRC cities, it affected the Group in another major area, namely the control of operational risks. Due to the disruptions brought by SARS, the Group's accounts receivable and inventory increased significantly during the first financial quarter. Accounts receivable rose from HK$1,512 million at the beginning of the period to HK$1,765 million at the end of the period, whereas inventory increased from HK$1,021 million to HK$1,292 million. Inventory turnover also rose from an average of 29.75 days in the last financial year to 33.82 days during the first financial quarter, while accounts receivable turnover rose from 40.2 days to 44.68 days albeit the latter was similar to the 45.87 days recorded in the same period last year. The significant increase in accounts receivable was mainly due to delay in payments made by some customers and down-stream distributors / retailers who were affected by SARS. As for the increase in inventory, the main reason was the over-optimistic forecasts made on the sales of consumer products in particular mobile telephones. With these two major risk benchmarks brought to higher levels, a significant amount of the Group's operating capital was locked up, hence the Group recorded a net operating capital outflow of HK$642 million for the period. To alleviate the pressure on cash flow, the Group increased short-term and long-term bank borrowings by HK$286 million and HK$234 million respectively, and ended the period with short-term and long-term bank borrowings at an aggregate amount of HK$735 million and HK$546 million respectively. The management is fully aware that the operating capital outflow and the increase in bank borrowings could have negative effects on the Group's operations and business development, and has made it a top priority to restore the Group's cash flow position and reduce its bank borrowings through measures that include reducing the Group's accounts receivable and inventory. As at the date of this report, these measures have already achieved significant results. The management is confident that the Group's operating capital outflow predicament during the first financial quarter - which resulted from the loss incurred by the mobile telephone business and the increase in inventory and accounts receivable - has been brought fully under control, and that the Group will be able to report improvement in its cash flow position in the second financial quarter.

PROSPECTS

While SARS has been subdued in late June and gradually subsiding, its impact on the Group's business is not expected to confine to the first financial quarter. Nonetheless, the management is confident that the disposal of mobile telephone inventory should be completed in the second financial quarter and as such it should lay good grounds for the Group to regain healthy development in the second half of the financial year. In the face of intensifying competition in the PRC's mobile telephone market, the Group will closely monitor and evaluate the circumstances and adopt appropriate realignment measures to ensure that its mobile telephone distribution business can cope with the changes in market conditions and operate in a manner that is in the best interest of the Group's long-term development.

LIQUIDITY AND FINANCIAL RESOURCES

At 30 June 2003, the Group had total assets of HK$4,288 million which were financed by total liabilities of HK$3,038 million, minority interests of HK$6 million and shareholders' funds of HK$1,244 million.

The Group had a current ratio of approximately 1.52 compared to that of approximately 1.6 as at 31 March 2003.

At 30 June 2003, the Group had cash and bank balances and unsecured short-term bank borrowings of HK$413 million and HK$735 million respectively.

The aggregate interest-bearing debts as a ratio of shareholders' funds increased from 0.55 as at 31 March 2003 to 1.03 as at 30 June 2003 due to the increase in the utilisation of bank borrowings of HK$520 million to finance the increase of inventories and trade receivables. The computation of this ratio is based on the total interest-bearing borrowings of HK$1,281 million (31 March 2003: HK$761 million) and shareholders' funds of HK$1,244 million (31 March 2003: HK$1,393 million as restated).

At 30 June 2003, the Group had borrowings denominated in Renminbi and United States Dollar amounting to HK$47 million and HK$1,234 million respectively.

The whole Renminbi borrowings and part of the United States Dollar borrowings amounting to HK$735 million were short-term bank borrowings repayable within one year and guaranteed by the Company.

The rest of United States Dollar borrowings amounting to HK$546 million represents the syndicated loan ("Loan") repayable within four years counting from the date of the first drawdown and guaranteed by Digital China Limited, a wholly owned subsidiary of the Company. The Loan is subject to a condition that Legend Holdings Limited, the controlling shareholder of the Company, is to beneficially hold not less that 40% of the issued share capital of the Company throughout the term of the relevant agreement dated 24 March 2003 ("Agreement") for governing the Loan.

As the unexpected loss incurred by the Group in the first financial quarter has adversely affected certain debt related ratios as the Company is otherwise required to maintain under the Agreement, the Company has already written to obtain the confirmation from the syndicate of banks failing which the Company may have to make an early repayment of the Loan. At 31 July 2003, the Group has short-term banking facilities at an aggregate amount of HK$931 million, of which only HK$203 million has been utilised. As such, while the Company is negotiating with the syndicate of banks on the acceptable arrangement for the Loan, the Company believes that it has sufficient financial resources,unutilised credit facilities and reserves to meet the repayment request should it occur and the repayment of Loan is not expected to have any significant impact on the funding requirements for the Group's daily operations.

At 30 June 2003, the Group's total available credit facilities amounted to HK$4,155 million of which HK$2,740 million was in trade lines, HK$869 million was in short-term and revolving money market facilities and HK$546 million was in transferable loan facility. At 30 June 2003, the facility drawn down was HK$1,769 million in trade lines, HK$244 million in short-term and revolving money market facilities and HK$546 million in transferable loan facility.

Under the normal course of business, the Group had issued performance bonds to some customers for potential claims of non-performance in order to satisfy the specific requirements of these customers. As no material claims had been made by the customers under such performance bonds in the past, the management considers that the possibility of realisation of any actual material liabilities arising from such performance bonds is remote.

During the period ended 30 June 2003, capital expenditure of HK$16 million was incurred in the construction of integrated and centralised research and development and management centre in Beijing and an automated warehouse in Shanghai and HK$81 million was paid to acquire an office building in Beijing to accommodate the Group's future growth. Apart from the above, capital expenditure spent on the regular acquisition of fixed assets was HK$13 million. In view of the comparatively high debt ratio, the management has taken relevant counter-measures and adopted prudent financial management controls over inventories, trade receivables and cash flow positions.

The management considers that the Group's financial position, together with its availability of sufficient unutilised credit facilities, will enable the Group to meet its anticipated future cash flow requirements.

HUMAN RESOURCES

At 30 June 2003, the Group had approximately 4,000 full-time employees. The majority of these employees work in the PRC. The Group offers remuneration packages in line with industry practice. Remuneration of the Group's employees includes basic salaries and bonuses. The Group incurred total staff costs of approximately HK$81 million for the three months ended 30 June 2003 (30 June 2002: HK$66 million). In order to attract and retain a high caliber of capable and motivated workforce, the Company offers share options to staff based on the individual performance and the achievements of Company's targets. The Group is committed to providing its staff with various in-house and external training and development programs.

DIRECTORS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

At 30 June 2003, the interests and short positions of the directors of the Company and their associates in the shares and underlying shares of the Company which were required to be notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to Divisions 7 and 8 of Part XV of the Securities and Futures Ordinance ("SFO") (including interests and short positions which they were taken or deemed to have under such provisions of the SFO), or which were required to be recorded in the register kept by the Company pursuant to Section 352 of the SFO, or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code") contained in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules"), were as follows:

Shares of HK$0.10 each of the Company

Name of director	**Capacity**	**Interests in shares** (Note 1)	**Interests in underlying shares** (Note 1)	**Aggregate percentage of holding (%)** (Note 3)
LI Qin	Beneficial owner	1,016,000	—	0.12
GUO Wei	Beneficial owner	904,000	5,600,000	0.76
ZENG Maochao	Beneficial owner	808,000	—	0.09
	Interest of spouse	60,000 (Note 2)	—	0.01
LIN Yang	Beneficial owner	220,000	3,000,000	0.37
YU Lishan (Note 4)	Beneficial owner	48,000	2,200,000	0.26
HUA Zhinian	Beneficial owner	80,000	2,200,000	0.27

Notes:

1. All the above interests in the shares and underlying shares of the Company were long positions. None of the directors of the Company or their associates held any short positions in the shares or underlying shares of the Company at 30 June 2003. Interests in the underlying shares of the Company represent share options granted to such directors, further details of which are set out in the section headed "Share Options" below.
2. 60,000 shares were owned by the wife of Mr. ZENG Maochao.
3. The aggregate percentages of holding are calculated on the basis of 858,704,331 shares of the Company in issue at 30 June 2003.
4. Mr. YU Lishan has retired as a director of the Company at the last annual general meeting of the Company held on 8 August 2003.

DIRECTORS' INTERESTS AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES (continued)

Save as disclosed above, at 30 June 2003, none of the directors and chief executives of the Company or their associates had any interests or short positions in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of the SFO) which were required to be recorded in the register kept by the Company pursuant to Section 352 of the SFO or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code.

SHARE OPTIONS

The old share option scheme of the Company was adopted on 14 May 2001 ("2001 Share Option Scheme") and terminated on 18 July 2002. Upon termination, no further options shall be granted under the 2001 Share Option Scheme but the provisions of the 2001 Share Option Scheme shall remain in full force and effect in all other respects to govern all outstanding options granted thereunder prior to termination. The new share option scheme of the Company was adopted on 18 July 2002 ("2002 Share Option Scheme").

(i) **2001 Share Option Scheme**

The following table shows the movements in the Company's share options under the 2001 Share Option Scheme during the three months ended 30 June 2003 and options outstanding at the beginning and end of the period:

Grantee	**Outstanding as at 01/04/03**	**Granted during the period**	**Exercised during the period**	**Lapsed during the period**	**Outstanding as at 30/06/03**	**Subscrip-tion price** (HK$) (Note 2)	**Date of grant**	**Exercisable period** (Note 1)
Directors								
GUO Wei	2,800,000	—	—	—	2,800,000	3.180	12/07/01	12/07/02-11/07/09
	2,800,000	—	—	—	2,800,000	1.976	31/08/01	31/08/02-30/08/09
LIN Yang	1,500,000	—	—	—	1,500,000	3.180	12/07/01	12/07/02-11/07/09
	1,500,000	—	—	—	1,500,000	1.976	31/08/01	31/08/02-30/08/09
YU Lishan (Note 3)	1,100,000	—	—	—	1,100,000	3.180	12/07/01	12/07/02-11/07/09
	1,100,000	—	—	—	1,100,000	1.976	31/08/01	31/08/02-30/08/09
HUA Zhinian	1,100,000	—	—	—	1,100,000	3.180	12/07/01	12/07/02-11/07/09
	1,100,000	—	—	—	1,100,000	1.976	31/08/01	31/08/02-30/08/09
Other Employees	34,784,000	—	—	222,000	34,562,000	3.604	08/06/01	08/06/02-19/06/09
	19,974,000	—	—	55,000	19,919,000	1.976	31/08/01	31/08/02-30/08/09

Note:

1. All options granted are subject to a vesting period of 4 years with 25% becoming exercisable on the first anniversary, 25% on the second anniversary, 25% on the third anniversary and 25% on the fourth anniversary of the respective date of grant.

2. The subscription price of the options is subject to adjustment in the case of rights or bonus issues, or other similar changes in the Company's share capital.

3. Mr. Yu Lishan has retired as a director of the Company at the last annual general meeting of the Company held on 8 August 2003.

(ii) **2002 Share Option Scheme**

No share options have ever been granted under the 2002 Share Option Scheme since its adoption on 18 July 2002.

SUBSTANTIAL SHAREHOLDERS' INTERESTS

At 30 June 2003, the following persons, not being a director or chief executive of the Company, had the following interests and short positions in the shares and underlying shares of the Company as recorded in the register required to be kept by the Company under Section 336 of the SFO:

Name	**Note**	**Long position held in shares**	**Short position held in shares**	**Percentage of holding of long / short position in shares (%)** (Note 9)
Legend Holdings Limited	1, 2	426,785,314	11,920,200	49.70/1.39
Employees' Shareholding Society of Legend Holdings Limited	1, 3	426,785,314	11,920,200	49.70/1.39
GAP Coinvestment Partners II, L.P.	4	111,774,000	—	13.02/—
GAP (Bermuda) Limited	4	111,774,000	—	13.02/—
General Atlantic Partners (Bermuda), L.P.	4	111,774,000	—	13.02/—
General Atlantic Parnters, LLC	4	111,774,000	—	13.02/—
GapStar, LLC	4	111,774,000	—	13.02/—
JF Asset Management Limited	5	54,080,200	—	6.30/—
J.P. Morgan Fleming Asset Management (Asia) Inc.	6	54,080,200	—	6.30/—
J.P. Morgan Fleming Asset Management Holdings Inc.	7	54,080,200	—	6.30/—
J.P. Morgan Chase & Co.	8	59,983,100	—	6.99/—

Notes:

1. The English names "Legend Holdings Limited" and "Employees' Shareholding Society of Legend Holdings Limited" are direct transliterations of their Chinese registered names "聯想控股有限公司" and "聯想控股有限公司職工持股會" respectively.

2. 140,232,042 shares were held by Right Lane Limited, a wholly owned subsidiary of Legend Holdings Limited, and Legend Holdings Limited was deemed to be interested in such shares by virtue of the SFO. Therefore, the 426,785,314 shares in which Legend Holdings Limited was interested as disclosed above also included the 140,232,042 shares held by Right Lane Limited.

3. Employees' Shareholding Society of Legend Holdings Limited was the controlling shareholder of Legend Holdings Limited and therefore, by virtue of the SFO, was deemed to be interested in the 426,785,314 shares in which Legend Holdings Limited was interested.

4. GAP Coinvestment Partners II, L.P., GAP (Bermuda) Limited, General Atlantic Partners (Bermuda), L.P., General Atlantic Partners, LLC and GapStar, LLC have entered into an agreement pursuant to which each of the aforesaid parties was deemed to be interested in the aggregate of 111,774,000 shares.

5. JF Asset Management Limited held 54,080,200 shares in the capacity as Investment Manager.

6. J.P. Morgan Fleming Asset Management (Asia) Inc. was the controlling shareholder of JF Asset Management Limited and, by virtue of the SFO, was deemed to be interested in the 54,080,200 shares held by JF Asset Management Limited.

7. J.P. Morgan Fleming Asset Management Holdings Inc. was the controlling shareholder of J.P. Morgan Fleming Asset Management (Asia) Inc. and, by virtue of the SFO, was deemed to be interested in the 54,080,200 shares in which J.P. Morgan Fleming Asset Management (Asia) Inc. was deemed to be interested.

8. J.P. Morgan Chase & Co. was deemed to be interested in an aggregate of 59,983,100 shares by virtue of the SFO. 5,838,900 shares were held by JPMorgan Chase Bank which was a controlled corporation of J.P. Morgan Chase & Co.. Another 54,080,200 shares were held by JF Asset Management Limited in which J.P. Morgan Chase & Co. was deemed to be interested through its controlling shareholding in J.P. Morgan Fleming Asset Management Holdings Inc. (please refer to notes 5, 6 and 7 above for further details). The remaining 64,000 shares were held by J.P. Morgan Whitefriars Inc., which was a company controlled in turn by J.P. Morgan Overseas Capital Corporation, J.P. Morgan International Finance Limited, J.P. Morgan International Inc. and JPMorgan Chase Bank, all of which were wholly owned subsidiaries of J.P. Morgan Chase & Co. and hence its controlled corporations.

9. The percentages of holding of long/short positions are calculated on the basis of 858,704,331 shares of the Company in issue at 30 June 2003.

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

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

AUDIT COMMITTEE

The Audit Committee has reviewed with the management the accounting principles and practices adopted by the Group and discussed auditing, internal control and financial reporting matters including the review of the unaudited financials and this quarterly report.

CODE OF BEST PRACTICE

None of the directors of the Company is aware of any information that would reasonably indicate that the Company is not, or was not for any part of the accounting period under review, in compliance with Appendix 14 of the Listing Rules, except that the non-executive director and independent non-executive directors of the Company are not appointed for a specific term but are subject to retirement by rotation and re-election in accordance with the Bye-Laws of the Company.

By Order of the Board
LI Qin
Chairman

Hong Kong, 19 August 2003

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