

The directors have pleasure in submitting their annual report together with the audited financial statements for the year ended 31 December 2003.

## 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 42 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 2003 is set out in note 14 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 2003, 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 55% and 30% respectively by value of the Group's total purchases.

At no time during the year, have 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) had 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 customers and suppliers.

## FINANCIAL STATEMENTS

The results of the Group for the year ended 31 December 2003 and the state of the Company's and the Group's affairs as at that date are set out in the financial statements on pages 25 to 86.

No interim dividend was paid during the year (2002: HK\$Nil). The directors do not recommend the payment of a final dividend for the year ended 31 December 2003 (2002: HK\$Nil). The directors recommend the payment of a special dividend of HK 3 cents per share to the shareholders whose names appear on the Register of Members of the Company on 24 May 2004.

## CHANGE OF COMPANY'S NAME

By a special resolution passed on 27 February 2004, the name of the Company was changed from Stone Electronic Technology Limited (四通電子技術有限公司) to Stone Group Holdings Limited (四通控股有限公司).

## TRANSFER TO RESERVES

Profits attributable to shareholders of HK\$801,186,000 (2002 (restated): HK\$36,646,000) have been transferred to reserves.

## PROPERTY, PLANT AND EQUIPMENT

Movements in property, plant and equipment during the year are set out in note 16 on the financial statements.

## BANK LOANS AND OTHER BORROWINGS

Particulars of bank loans and other borrowings of the Group as at 31 December 2003 are set out in note 27 and 28 on the financial statements.

## CONVERTIBLE NOTES

Particulars of convertible notes of the Group as at 31 December 2003 are set out in note 30 on the financial statements.

## DIRECTORS

The directors during the financial year were:

### *Executive directors*

Duan Yongji (*Chairman*)

Shen Guojun

Li Wenjun (resigned on 22 May 2003)

Chen Xiaotao

Zhang Disheng (appointed on 22 May 2003)

Zhu Xiduo (resigned on 26 March 2004)

### *Independent non-executive directors*

Prof. Liu Hongru

Andrew Y. Yan

The following executive director was appointed after the end of the financial year:

Liu Wei (appointed on 26 March 2004)

In accordance with article 101 of the Company's articles of association, Mr Chen Xiaotao and Prof. Liu Hongru retire by rotation from the board at the forthcoming annual general meeting. Mr Chen Xiaotao being eligible, offers himself for re-election. However, Prof. Liu Hongru does not offer himself for re-election.

In accordance with article 92 of the Company's articles of association, Mr Zhang Disheng and Ms Liu Wei retire from the board at the forthcoming annual general meeting and being eligible, offer themselves for re-election.

Prof. Liu Hongru and Mr Andrew Y. Yan were appointed as independent non-executive directors of the Company for a term of 1 year and 3 years commencing on 15 December 2003 and 26 June 2001 respectively. Both the independent non-executive directors are subject to retirement by rotation and re-election at the forthcoming annual general meeting of the Company in accordance with the Company's articles of association.

## DIRECTORS' SERVICE CONTRACTS

Messrs Duan Yongji and Shen Guojun 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 2003 had the following interests in the shares, underlying shares and debentures of the Company or associated corporations (within the meaning of Part XV of the Securities and Future Ordinance ("SFO")) at that date as recorded in the register of directors' and chief executives' interests and short positions required to be kept under section 352 of the SFO:

	Ordinary shares of HK\$0.10 each of the Company				
	Personal interests	Family interests	Corporate interests	Other interests	% of total Issued shares
Mr Duan Yongji	5,040,000	–	–	–	0.41

*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, Zhang Disheng, 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 and chief executive of the Company had any interests or short positions in the shares, underlying shares or debentures of the Company or associated corporations, as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company pursuant to Model Code for Securities Transactions by Directors of Listed Companies.

## DIRECTORS' INTERESTS IN CONTRACTS

No contracts of significance to which the Company, its holding company or any of its 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 the 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 were 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 were exercisable for a period up to 3 years commencing on the expiry of 6 months after the date on which the option was accepted or 22 July 2003, whichever was earlier.

The maximum number of shares in respect of which options might be granted under the Old Scheme might 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 might 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 was HK\$1 payable within 28 days from the offer date. The full amount of subscription price should 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 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% of the total number of shares of the Company in issue. Any further grant of options in excess of the said 1% 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.

## SHARE OPTION SCHEMES (Continued)

The total number of shares available for issue under the Old Scheme and New Scheme as at 31 December 2003 was nil and 209,262,000 shares respectively, which represented 0% and 17.2% respectively of the issued share capital of the Company at 31 December 2003.

At 31 December 2003, 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 2003 is HK\$0.80). 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 lapsed during 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\$	Market value per share on exercise of options HK\$	% of the total issued shares
<b>Old Scheme</b>										
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	-	-

## SHARE OPTION SCHEMES (Continued)

	No. of options outstanding at the beginning of the year	No. of options lapsed during 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\$	Market value per share on exercise of options HK\$	% of the total issued shares
<b>New Scheme</b>										
Mr Duan Yongji (Note a)	3,900,000	-	-	3,900,000	22-05-2002	22-08-2002 to 21-05-2012	0.792	0.78	-	0.320
Mr Shen Guojun (Note a)	4,000,000	-	-	4,000,000	22-05-2002	22-08-2002 to 21-05-2012	0.792	0.78	-	0.328
Mr Li Wenjun (Note a & f)	3,000,000	-	-	3,000,000	22-05-2002	22-08-2002 to 21-05-2012	0.792	0.78	-	0.246
Mr Zhu Xiduo (Note a)	3,000,000	-	-	3,000,000	22-05-2002	22-08-2002 to 21-05-2012	0.792	0.78	-	0.246
Mr Chen Xiaotao (Note b)	8,000,000	-	-	8,000,000	22-05-2002	22-05-2002 to 21-05-2012	0.792	0.78	-	0.657
Mr Zhang Disheng (Note c & f)	10,400,000	-	-	10,400,000	22-05-2002	22-05-2002 to 21-05-2012	0.792	0.78	-	0.854
Contracted employees (Note d)	87,556,000	24,200,000	250,000	63,106,000	22-05-2002	22-05-2002 to 21-05-2012	0.792	0.78	0.85	5.181
Contracted employees (Note e)	119,856,000	6,000,000	-	113,856,000	31-12-2002	31-12-2002 to 30-12-2012	0.476	0.47	-	9.347

## 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 5,000,000 options from 22-05-2002 to 21-05-2012 and the remaining 5,400,000 options are subjects to Vesting Period set out in Note (a).
- (d) Free to exercise 8,356,000 options from 22-05-2002 to 21-05-2012 and the remaining 54,750,000 options are subject to the Vesting Period set out in Note (a).
- (e) Free to exercise 113,856,000 options from 31-12-2002 to 30-12-2012.
- (f) Mr Li Wenjun resigned and Mr Zhang Disheng was appointed as the director of the Company on 22 May 2003. The interests disclosed for Mr Zhang Disheng represent the options granted to him prior to his appointment.

The consideration paid by each of the above directors and employees for the share options granted was HK\$1.

Except for options lapsed and exercised as mentioned above, no options were granted, exercised or cancelled during the year.

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 24 September 2003 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 2003 at reimbursement costs which shall not exceed HK\$3,500,000 per annum.

## SUBSTANTIAL INTERESTS IN THE SHARE CAPITAL OF THE COMPANY

As at 31 December 2003, to the best knowledge of the directors, the following parties were recorded in the register kept by the Company under section 336 of the SFO as being directly or indirectly interested in 5% or more of the issued share capital of the Company:

	Note	Shares held	Underlying shares in respect of derivative interests*	Aggregate total	% of total issued shares
Stone Investment	1	407,110,053	–	407,110,053	33.42
Employees' Shareholding Society	2	407,110,053	–	407,110,053	33.42
Stone Jiu Guang	2	407,110,053	–	407,110,053	33.42
Stone Group Corporation	2	499,484,466	–	499,484,466	41.01
First Shanghai Investments Limited ("First Shanghai")	3	3,382,769	105,769,231	109,152,000	*
Chen Donghai	4	–	76,923,076	76,923,076	*

\* physically settled unlisted derivatives

Notes:

- (1) The shareholding of 407,110,053 shares comprised 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. In addition, Stone Group Corporation also indirectly held 92,374,413 shares of the Company as at 31 December 2003.
- (3) The aggregate interest of First Shanghai comprised the combined shareholdings of First Shanghai and its wholly-owned subsidiaries.
- (4) The interest of Chen Donghai was held by him as beneficial owner.

Saved as disclosed above, the Company has not been notified of any other interests representing 5% or more of the issued share capital of the Company and recorded in the register of substantial shareholders maintained under section 336 of the SFO as at 31 December 2003.

## CONNECTED TRANSACTIONS

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

- (1) Beijing Stone Computer Company Limited ("Beijing Stone Computer"), a 51% owned subsidiary of the Group, entered into an agreement to acquire from Beijing Stone New Technology Industrial Company Limited, a wholly owned subsidiary of the Group, 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 cashier machine business for the years ended/ending 31 December 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.

## CONNECTED TRANSACTIONS *(Continued)*

- (2) Beijing Stone Computer entered into agreements on 15 August 2003 with three of the shareholders (“the Shareholders”) of Shanghai Stone Hu Guang Technology Shareholding Company Limited (“Shanghai Hu Guang”) to acquire a 45% equity interest in Shanghai Hu Guang from the Shareholders at an aggregate consideration of Rmb5,688,600 by means of a trust arrangement, whereby Mr. Zhang Disheng, Mr. Alan Aiping Luo and Mr. Yang Lang Tao acted as the trustees and agreed to hold their respective shares on trust for Beijing Stone Computer. Among the trustees, Mr Zhang Disheng is an executive director of the Company and Beijing Stone Computer while Mr Alan Aiping Luo is an executive director of Beijing Stone Computer, and Mr Yang Lang Tao is the general manager of Shanghai Hu Guang and his capacity falls within the definition of chief executive under the Listing Rules.

The acquisition by means of a trust arrangement constitutes a connected transaction of the Company and the details were announced by the directors of the Company on 15 August 2003.

- (3) Stone Group Corporation and Beijing Stone Electronic Technology Co., Ltd. (“Beijing Stone Electronic”) entered into two loan agreements (“Loan Agreements”) on 22 September 2003 and 23 September 2003 respectively with Guangdong Development Bank (“GDB”). Pursuant to the Loan Agreements, GDB advanced two loans (“the Loans”) in the total sum of Rmb12,000,000 to Stone Group Corporation for a term of six months from 22 September 2003 and 23 September 2003 respectively. In addition, Beijing Stone Electronic entered into two pledge agreements (“Pledge Agreements”) on 22 September 2003 and 23 September 2003 respectively with GDB. Pursuant to the Pledge Agreements, Beijing Stone Electronic placed a total amount of Rmb12,600,000 in cash as a pledge for granting the Loans to Stone Group Corporation by GDB. The Loans have been repaid in December 2003 and the pledged deposits were released accordingly.

The financial arrangement constitutes connected transactions of the Company and the details were announced by the directors of the Company on 10 December 2003.

- (4) On 24 September 2003, the Company entered into a service agreement (the “Service Agreement”) with Stone Group Corporation, pursuant to which Stone Group Corporation shall provide the Group with the services as may be directed by the board from time to time and the Company shall pay cash to Stone Group Corporation on a reimbursement basis which shall not exceed HK\$3,500,000 per annum for a term of 5 years commencing from 23 July 2003.

The arrangement constitutes a connected transaction of the Company and the details were announced by the directors of the Company on 10 December 2003.

Further details of the above and other related party transactions during the year are set out in note 38 on the financial statements.

## **FIVE YEAR SUMMARY**

A summary of the consolidated results and assets and liabilities of the Group for the five years ended 31 December 2003 is set out on page 87 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 88 of the annual report.

## **RETIREMENT SCHEMES**

Particulars of the retirement schemes of the Group are set out in note 13 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, 26 April 2004