



SinoCom Software Group Limited
中訊軟件集團股份有限公司
(Incorporated in the Cayman Islands with limited liability)

SinoCom



Interim Report 2004

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Chairman's Statement

On behalf of the board of directors (the "Board") of the Company, I am delighted to present the first interim report of the Company and its subsidiaries (collectively the "Group") since the listing of the Company's shares on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 30 April, 2004. Turnover and net profit for the six months ended 30 June, 2004 (the "Period") were approximately HK\$81 million and HK\$25.4 million, surged 63% and 80% respectively over that of same period last year. Basic earnings per share for the Period were HK\$0.11, representing an increase of 57.1% compared with the same period of last year.

The directors ("Directors") do not recommend the payment of an interim dividend for the Period (June, 2003: Nil).

During the Period, the Group continued to implement the strategy of strengthening its relationship with existing customers and broadening its customer base. This strategy has led the Group to success in the past and contributed to the substantial growth in sales. Net profit soared 80% compared with the same period of last year. The macroeconomic control in the PRC, which focused on reforming fiscal structure and the better use of capital, implemented during the Period had no significant impact on our business which has the strong ability to generate foreign income. Instead, outsourcing software development has been identified as a strategic industry by the Central Government of the PRC and measures are expected to be launched to promote the development of the industry and to create a favorable business environment for the industry.

We gained the trust from our customers by maintaining close business partner relationship with them persistently. This helps our Group's outsourcing business to be more focus on the long-term development projects with our stable customers. On the other hand, we have been actively broadening our clientele base in various geographical locations. To this end, we have added two well-known IT firms in the U.S. to our customer list.

On the front of technical support services, the Group recorded a growth rate of 14.6% over the same period in 2003. In order to extend the scope of our services, we planned to establish six additional service centres in the PRC in the first stage, which are expected to be in operation in the second half of the year.

In order to sustain a stable yet rapid growth for our business, our Group will also resort to strategic acquisitions. As such, we are in discussion with a Shanghai based outsourcing software development firm for an acquisition possibility. If realized, it will become our stepping board for developing our business in Shanghai. The Group is also considering to acquire a company in Beijing which has solid experience in provision of outsourcing software service to the U.S. companies in Mainland China. Negotiations are still at a preliminary stage and no legally binding agreements have been entered into. If such acquisitions shall materialize, the Group intends to finance the acquisition from its internal resources.

Chairman's Statement

Human capital is the most important asset and a critical success factor for outsourcing software development business. We value every staff and provide them with professional training as well as opportunities for promotion. We also set up incentive bonus to reward outstanding project teams. Therefore, our senior and middle management staff has been extremely stable and our staff turnover rate has been maintained at a comparatively low level. This stable workforce provides the greatest support to the Group in achieving good performance.

Looking ahead, we expect the PRC government policy will contribute to the vivid growth of the industry. Being a forerunner in the outsourcing software development service industry, we are poised to be benefited. As we will continue to focus on our area of core competence, recruit more IT professionals, exert effective costs control, and strengthen our promotional activities abroad, we are optimistic with the outlook for the second half of the financial year.

I would like to take this opportunity to extend my gratitude to all investors for their support to the listing on the Stock Exchange. To this end, the Board will continue to contribute our best efforts to perform and to reward our shareholders with good return.

Wang Zhiqiang
Chairman and CEO

Hong Kong, 16 August, 2004

Condensed Consolidated Income Statement

For the six months ended 30 June, 2004

| | Notes | Six months ended 30 June | |
|----------------------------------|-------|-----------------------------|-----------------------------|
| | | 2004 HK\$ (Unaudited) | 2003 HK\$ (Unaudited) |
| Turnover | 3 | 81,074,138 | 49,785,173 |
| Cost of sales | | (39,406,342) | (26,028,201) |
| Gross profit | | 41,667,796 | 23,756,972 |
| Other operating income | | 174,829 | 302,854 |
| Selling expenses | | – | (22,375) |
| Administrative expenses | | (12,987,584) | (7,831,757) |
| Profit before taxation | 5 | 28,855,041 | 16,205,694 |
| Taxation | 6 | (3,425,980) | (2,049,597) |
| Profit before minority interests | | 25,429,061 | 14,156,097 |
| Minority interests | | (72,771) | (63,600) |
| Net profit for the period | | 25,356,290 | 14,092,497 |
| Dividend | 7 | 9,970,539 | – |
| Earnings per share | | | |
| – Basic | 8 | 0.11 | 0.07 |

Condensed Consolidated Balance Sheet

As at 30 June, 2004

| | Notes | 30/06/2004 HK\$ (Unaudited) | 31/12/2003 HK\$ (Audited) |
|--|-------|-----------------------------------|---------------------------------|
| Non-current assets | | | |
| Property, plant and equipment | | 7,830,079 | 7,222,661 |
| Current assets | | | |
| Debtors, deposits and prepayments | 9 | 19,455,057 | 24,331,739 |
| Amounts due from related companies | 10 | 5,405,055 | 8,578,550 |
| Bank balances and cash | | 218,168,114 | 92,517,281 |
| | | 243,028,226 | 125,427,570 |
| Current liabilities | | | |
| Creditors, deposits received and accruals | 11 | 14,540,268 | 13,054,165 |
| Amounts due to related companies | 12 | 50,187 | 6,670 |
| Income tax payable | | 1,507,802 | 92,342 |
| Other tax payable | | 2,622,130 | 3,661,646 |
| | | 18,720,387 | 16,814,823 |
| Net current assets | | 224,307,839 | 108,612,747 |
| Total assets less current liabilities | | 232,137,918 | 115,835,408 |
| Minority interests | | (532,260) | (465,044) |
| | | 231,605,658 | 115,370,364 |
| Capital and reserves | | | |
| Share capital | 13 | 26,589,078 | 19,941,078 |
| Reserves | 14 | 205,016,580 | 95,429,286 |
| | | 231,605,658 | 115,370,364 |

Condensed Consolidated Statement of Changes in Equity

For the six months ended 30 June, 2004

| | Share Capital HK\$ (unaudited) | Share premium HK\$ (unaudited) | Capital reserve HK\$ (unaudited) | Other reserve HK\$ (unaudited) | General reserve fund HK\$ (unaudited) | Enterprise expansion fund HK\$ (unaudited) | Shareholder's contribution HK\$ (unaudited) | Translation reserve HK\$ (unaudited) | Retained profits HK\$ (unaudited) | Total HK\$ (unaudited) |
|--|---|---|---|---|---|--|--|---|--|------------------------------|
| At 1 January, 2003 | 17,645,000 | - | 10,657,000 | - | 3,827,702 | 1,250,161 | 2,725,949 | (509,053) | 21,616,220 | 57,212,979 |
| Issue of shares | 2,296,078 | 21,883,922 | - | - | - | - | - | - | - | 24,180,000 |
| Exchange differences arising on translation of overseas operations not recognised in the income statement | - | - | - | - | - | - | - | 125,691 | - | 125,691 |
| Net profit for the period | - | - | - | - | - | - | - | - | 14,092,497 | 14,092,497 |
| At 30 June, 2003 | 19,941,078 | 21,883,922 | 10,657,000 | - | 3,827,702 | 1,250,161 | 2,725,949 | (383,362) | 35,708,717 | 95,611,167 |
| Capitalisation of reserves to share capital in a subsidiary | - | - | - | 5,077,863 | (3,827,702) | (1,250,161) | - | - | - | - |
| Net profit for the period | - | - | - | - | - | - | - | - | 19,759,197 | 19,759,197 |
| Transfer | - | - | - | - | 3,589,024 | - | - | - | (3,589,024) | - |
| At 31 December, 2003 | 19,941,078 | 21,883,922 | 10,657,000 | 5,077,863 | 3,589,024 | - | 2,725,949 | (383,362) | 51,878,890 | 115,370,364 |
| Issue of shares | 6,648,000 | 107,697,600 | - | - | - | - | - | - | - | 114,345,600 |
| Share issue expenses | - | (13,622,900) | - | - | - | - | - | - | - | (13,622,900) |
| Exchange differences arising on translation of overseas operations not recognised in the income statement | - | - | - | - | - | - | - | 126,843 | - | 126,843 |
| Net profit for the period | - | - | - | - | - | - | - | - | 25,356,290 | 25,356,290 |
| Dividend paid | - | - | - | - | - | - | - | - | (9,970,539) | (9,970,539) |
| At 30 June, 2004 | 26,589,078 | 115,958,622 | 10,657,000 | 5,077,863 | 3,589,024 | - | 2,725,949 | (256,519) | 67,264,641 | 231,605,658 |

Condensed Consolidated Cash Flow Statement

For the six months ended 30 June, 2004

| | Six months ended 30 June | |
|--|--------------------------|-------------|
| | 2004 | 2003 |
| | HK\$ | HK\$ |
| | (Unaudited) | (Unaudited) |
| Net cash from operating activities | 36,604,608 | 8,990,419 |
| Net cash used in investing activities | (1,567,468) | (665,718) |
| Net cash from financing activities | 90,613,693 | 18,343,836 |
| Net increase in cash and cash equivalents | 125,650,833 | 26,668,537 |
| Cash and cash equivalents at 1 January | 92,517,281 | 48,148,813 |
| Cash and cash equivalents at 30 June | 218,168,114 | 74,817,350 |
| Analysis of the balances of cash and cash equivalents | | |
| Bank balances and cash | 218,168,114 | 74,817,350 |

Notes to the Condensed Financial Statements

For the six months ended 30 June, 2004

1. BASIS OF PREPARATION

The condensed financial statements have been prepared in accordance with the applicable disclosure requirements of Appendix 16 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the "Stock Exchange") and with Statement of Standard Accounting Practice No. 25 "Interim Financial Reporting".

2. PRINCIPAL ACCOUNTING POLICIES

The condensed financial statements have been prepared under the historical cost convention and the accounting policies adopted are consistent with those followed in the preparation of the Group's financial statements for the year ended 31 December, 2003.

3. TURNOVER

| | Six months ended 30 June | |
|--|--------------------------|-------------|
| | 2004 | 2003 |
| | HK\$ | HK\$ |
| Revenue from outsourcing software development services | 79,814,585 | 47,401,168 |
| Revenue from technical support services | 4,879,996 | 4,257,091 |
| | 84,694,581 | 51,658,259 |
| Business tax and other government charges | (3,620,443) | (1,873,086) |
| | 81,074,138 | 49,785,173 |

4. SEGMENT INFORMATION

(a) Business segment

The Group is principally engaged in the provision of outsourcing software development services and accordingly, no business segment analysis is presented.

Notes to the Condensed Financial Statements

For the six months ended 30 June, 2004

(b) Geographical segment

The following table provides an analysis of the Group's sales by location of markets, irrespective of the origin of the services:

Income statement for the six months ended 30 June, 2003

| | People's Republic of China ("PRC") HK\$ | Japan HK\$ | Consolidated HK\$ |
|----------------------------------|---|---------------|----------------------|
| Turnover | 4,044,236 | 45,740,937 | 49,785,173 |
| Cost of sales | (3,506,272) | (22,521,929) | (26,028,201) |
| Segment results | 537,964 | 23,219,008 | 23,756,972 |
| Other operating income | | | 302,854 |
| Unallocated corporate expenses | | | (7,854,132) |
| Profit before taxation | | | 16,205,694 |
| Taxation | | | (2,049,597) |
| Profit before minority interests | | | 14,156,097 |
| Minority interests | | | (63,600) |
| Net profit for the period | | | 14,092,497 |

Income statement for the six months ended 30 June, 2004

| | PRC HK\$ | Japan HK\$ | Consolidated HK\$ |
|----------------------------------|-------------|---------------|----------------------|
| Turnover | 4,635,903 | 76,438,235 | 81,074,138 |
| Cost of sales | (3,432,112) | (35,974,230) | (39,406,342) |
| Segment results | 1,203,791 | 40,464,005 | 41,667,796 |
| Other operating income | | | 174,829 |
| Unallocated corporate expenses | | | (12,987,584) |
| Profit before taxation | | | 28,855,041 |
| Taxation | | | (3,425,980) |
| Profit before minority interests | | | 25,429,061 |
| Minority interests | | | (72,771) |
| Net profit for the period | | | 25,356,290 |

Notes to the Condensed Financial Statements

For the six months ended 30 June, 2004

5. PROFIT BEFORE TAXATION

Profit before taxation is arrived at after charging (crediting):

| | Six months ended 30 June | |
|---|--------------------------|-----------|
| | 2004 | 2003 |
| | HK\$ | HK\$ |
| Depreciation | 1,037,242 | 819,913 |
| Loss on disposal of property, plant and equipment | – | 6,115 |
| Operating lease rentals in respect of rented premises | 4,631,382 | 3,219,791 |
| Allowance for (write-back of) bad and doubtful debts | 132,370 | (1,687) |
| Interest income | (93,192) | (36,254) |

6. TAXATION

| | Six months ended 30 June | |
|------------------|--------------------------|-----------|
| | 2004 | 2003 |
| | HK\$ | HK\$ |
| PRC income tax | 2,709,799 | 1,570,693 |
| Japan income tax | 716,181 | 478,904 |

Zhongxun Computer System (Beijing) Company Limited (“SinoCom Beijing”), a subsidiary of the Company, has been recognised as a technologically advanced enterprise by the relevant PRC government authorities since 26 September, 1995. Pursuant to the Income Tax Laws, on 18 November, 1996, the External Branch of State Tax Authority in Beijing granted approval to SinoCom Beijing to entitle the reduced state enterprise income tax rate of 15%. In addition, SinoCom Beijing is subject to a more favourable income tax rate of 10% as the annual export revenue of its software development business is more than 70% of SinoCom Beijing’s total annual income pursuant to the relevant PRC regulations.

Taxation arising in Japan is calculated at a progressive statutory rate of 22% on the portion of taxable income not exceeding Yen8,000,000 (equivalent to approximately HK\$588,000) and 30% on the portion of taxable income in excess of Yen8,000,000.

There are no significant temporary differences during the six months ended 30 June, 2004 or at the balance sheet dates.

7. DIVIDEND

On 30 April, 2004, a dividend of HK5 cents per share (2002: Nil) was paid to shareholders as final dividend for the year ended 31 December, 2003.

The directors do not recommend the payment of an interim dividend.

Notes to the Condensed Financial Statements

For the six months ended 30 June, 2004

8. EARNINGS PER SHARE

The calculation of the basic earnings per share is based on the profit for the six months ended 30 June, 2004 of HK\$25,356,290 (2003: profit of HK\$14,092,497) and the weighted average number of 221,692,540 shares (2003: 191,926,328 shares) in issue during the period.

No diluted earnings per share has been presented because the Company has no outstanding potential ordinary shares during the period or as at the balance sheet date.

9. TRADE AND OTHER RECEIVABLE

The Group normally allows credit period of 30 to 45 days to trade customers.

The following is an aged analysis of trade debtors at the balance sheet date:

| | 30/06/2004 HK\$ | 31/12/2003 HK\$ |
|---|--------------------|--------------------|
| 0-30 days | 11,612,982 | 9,426,981 |
| 31-60 days | 1,134,944 | 5,397,279 |
| 61-90 days | 22,670 | 65,708 |
| Over 90 days | 79,293 | 43,774 |
| Trade debtors | 12,849,889 | 14,933,742 |
| Other debtors, other receivable and prepayments | 6,605,168 | 9,397,997 |
| | 19,455,057 | 24,331,739 |

10. AMOUNTS DUE FROM RELATED COMPANIES

The amounts are unsecured, non-interest bearing and have no fixed terms of repayment.

11. CREDITORS, DEPOSITS RECEIVED AND ACCRUALS

The following is an aged analysis of trade creditors at the balance sheet date:

| | 30/06/2004 HK\$ | 31/12/2003 HK\$ |
|---|--------------------|--------------------|
| 0-30 days | 196,914 | 457,792 |
| 31-60 days | 222,574 | 12,852 |
| 61-90 days | 68,395 | 3,804 |
| Over 90 days | 476,671 | 18,743 |
| Trade creditors | 964,554 | 493,191 |
| Other creditors, deposits received and accruals | 13,575,714 | 12,560,974 |
| | 14,540,268 | 13,054,165 |

Notes to the Condensed Financial Statements

For the six months ended 30 June, 2004

12. AMOUNTS DUE TO RELATED COMPANIES

The amounts are unsecured, non-interest bearing and have no fixed terms of repayment.

13. SHARE CAPITAL

| | <i>Notes</i> | Number of shares | HK\$ |
|---|--------------|-----------------------------|-------------------|
| Ordinary shares of HK\$0.10 each | | | |
| <i>Authorised:</i> | | | |
| At 1 January, 2003, 31 December, 2003 and 30 June, 2004 | | 1,000,000,000 | 100,000,000 |
| <i>Issued and fully paid:</i> | | | |
| At 1 January, 2003 | | 176,450,000 | 17,645,000 |
| Issue of shares | 1 | 22,960,782 | 2,296,078 |
| At 31 December, 2003 | | 199,410,782 | 19,941,078 |
| Issue of shares | 2 | 66,480,000 | 6,648,000 |
| At 30 June, 2004 | | 265,890,782 | 26,589,078 |

Notes:

- The Group allotted and issued 22,960,782 ordinary shares of HK\$0.10 each to Legend New-Tech Investment Limited at a consideration of HK\$24,180,000 on 28 February, 2003.
- The Group issued 66,480,000 ordinary shares of HK\$0.10 each by way of placing and public offer for listing of shares on the Stock Exchange on 30 April, 2004.

14. OPERATING LEASE COMMITMENTS

At the balance sheet date, the Group had commitments for future minimum lease payments in respect of rented premises which fall due as follows:

| | 30/06/2004 HK\$ | 31/12/2003 HK\$ |
|---------------------------------------|----------------------------|----------------------------|
| Within one year | 3,394,578 | 6,136,870 |
| In the second to fifth year inclusive | 2,679,691 | 4,882,648 |
| | 6,074,269 | 11,019,518 |

Operating lease payments represent rentals payable by the Group for its office premises. Leases are negotiated for an average term of three years.

BUSINESS REVIEW

Operating results for the Period

Turnover

Turnover of the Group for the Period amounted to approximately HK\$81 million, representing an increase of approximately HK\$31.3 million, or 63%, over the same period in 2003. Revenue was derived from outsourcing software development services and from technical support services, which accounted for approximately 94% and 6% of the total revenue respectively. Market segments remained unchanged. Outsourcing software development services and technical support services were provided solely to customers located in Japan and Mainland China respectively during the Period. Increase in turnover was mainly derived from sales in Japan. Revenue from customers located in Mainland China recorded a steadily growth at approximately 15% over the same period in 2003.

Turnover grew from expanded business volume with existing customers. The largest five customers for the year ended 31 December, 2003 are still the largest five customers for the Period and accounted for approximately 90% of the total revenue. It is the Group's strategy to increase the cooperation with existing customers in order to work with them for long term stable projects which offer higher return and project team stability. To this end, the Group focused on these projects and selectively declined small project orders. During the Period, the two largest customers increased their business volume with the Group by approximately 95% and 158% respectively over the same period in 2003.

Gross profit and cost of sales

Gross profit of the Group for the Period amounted to approximately HK\$41.7 million, representing an increase of approximately HK\$17.9 million or 75%, over that for the same period in 2003. Gross profit margin during the Period was approximately 51.4%, representing an increase of approximately 3.7 percentage point over the 47.7% recorded for the same period last year.

Corresponding cost of sales increased to approximately HK\$39.4 million, representing an increase of approximately HK\$13.4 million or 51% compared to the same period in 2003. Percentage increase in cost of sales is lower than that of turnover contributed to the increase in gross profit margin. Employee costs consisted of basic salary, welfare and project bonus were the largest components of the cost of sales, which accounted for approximately 36.4% of the total turnover or approximately 74.8% of the total cost of sales. The number of employees of the Group increased by approximately 55% from 587 as at 30 June, 2003 to 909 as at 30 June, 2004, representing an addition of 322 headcount. Associated employee costs increased by approximately HK\$10.2 million or 52.6% as compared to the same period in 2003. Basic salaries to engineers increased by approximately 24.9% due to addition of both headcounts and salaries. However, the average engineer salary was lower than that in the same period of last year due to the recruitment of more new engineers and fresh graduates at lower salary range that has weighted down the average salary. Provision of project bonus as an incentive to the engineers accounted mainly for the rest of the increase in employee costs.

Administrative expenses

Administrative expenses during the Period increased to approximately HK\$13 million, representing an increase of approximately 65.8% over the same period in 2003. The increase was slightly higher than the increase in turnover. Provision has been made to the bonus payable to the Company's Directors in accordance with the terms of Directors' service agreements. Payment of such bonus will be subject to the Group's whole year audited results and approval by the Board.

Management Discussion and Analysis

Profit before taxation, taxation, and net profit

Profit before taxation for the Period amounted to approximately HK\$28.9 million, representing an increase of HK\$12.6 million or 78% over the same period in 2003.

Effective tax rate for the Period was 11.9%, slightly lower than the 12.6% in the corresponding period last year.

Net profit for the Period amounted to approximately HK\$25.4 million, representing an increase of approximately HK\$11.3 million or 80% over the same period in 2003. Net profit margin was 31.3%, increased by approximately 3 percentage point over that in the same period in 2003 as a result of economy of scale in long term stable large projects.

Outlook

In the first half of 2004, the trend of software outsourcing from Japan to Mainland China continued to grow. Directors believe that this trend is at its start up stage since it was the common consensus reached by Japanese software developers that Mainland China is the best place for software development for Japanese software in 2002. More Japanese customers are exploring to outsource software development work in Mainland China. The Group signed up fundamental contracts with two renowned Japanese customers at the end of 2003, however, it does not expect large business volume from them in 2004 for two reasons. Firstly, the Group's human resources are being nearly fully utilized and are reserved for its existing customers. Secondly, it is the Japanese customers' business practice to outsource small scale projects to new contractors in order to test their service level and work quality. Large scale projects will be outsourced when they have obtained satisfactory results from these new contractors. The Group is currently working for their small scale projects and the Directors are confident that that the Group will gain customers' confidence and large scale projects orders in the near future.

Given the strong demand and the Group's operating scale, the Directors believe that it is a seller's market in which the Group is able to select long term large scale projects which offer higher return and project team stability. The only constraint to growth is the Group's human resources capacity. Notwithstanding the supply of fresh graduates is abundant in Mainland China, organic growth in human resources will be around 30% to 50% depending on the Group's ability to recruit experienced engineers, in particular, those with working experience in Japan to lead newly recruited junior engineers. Other than to grow organically, the Group is actively seeking opportunities to acquire companies engaged in Japan outsourcing software development in both Mainland China and Japan. Recently, the Group is considering to acquire a software development company in Mainland China, which has operations in both Shanghai and Japan and has about 100 employees. Negotiations are still at a preliminary stage and no legally binding agreements have been entered into. If such acquisition shall materialize, the Group intends to finance the acquisition from its internal resources.

Technical support services to Sun Microsystems continue to grow. Directors expect the growth will continue and service points in additional six cities in Mainland China were set up to expand the Group's existing service network in July 2004.

The Group also developed business relations with U.S. companies in Mainland China. During the Period, the Group has signed up supplier agreements with two multinational I.T. companies for outsourcing software development. However, considering that profit contributions generated by the Group's engineers working for Japanese customers are more than that for the U.S. customers, the Group will, therefore, continue to concentrate its resources on the Japanese market. In order to

cater for the business demand from the new U.S. customers in Mainland China, the Group is currently considering to acquire a company in Beijing which has solid experience in provision of outsourcing software service to U.S. companies in Mainland China. Negotiations are still at a preliminary stage and no legally binding agreements have been entered into. If such acquisition shall materialize, the Group intends to finance the acquisition from its internal resources.

Liquidity and financial resources

Net assets

As at 30 June, 2004, the Group recorded total assets of approximately HK\$250.9 million which were financed by liabilities of HK\$18.7 million, minority interests of HK\$0.5 million and equity of HK\$231.6 million. The Group's net assets value as at 30 June, 2004 increased by 100.7% to approximately HK\$231.6 million as compared to approximately HK\$115.4 million as at 31 December, 2003.

Liquidity

The Group had a total cash and bank balances of approximately HK\$218.2 million as at 30 June, 2004 (as at 31 December, 2003: approximately HK\$92.5 million). There was neither bank borrowing nor non-current liability and hence the Group is at a nil gearing position. As at 30 June, 2004, the current ratio was increased to 13 from 7.5 as at 31 December, 2003.

Treasury policies

The Group has a strong cash generating capacity and generally finances its operations with internally generated cash without bank borrowings. Surplus cash, which is, mainly in Hong Kong dollars, Japanese Yen, and Renminbi ("RMB") is deposited with licensed banks in Hong Kong, Japan and Mainland China.

Foreign exchange exposure

The Group mainly earns revenue in Japanese Yen and incurs costs in RMB. Any depreciation of Japanese Yen against RMB will result in decrease in the income of the Group, which will have an adverse impact on the Group's profitability. To minimize exposure on foreign exchange fluctuations, the Group will from time to time review its foreign exchange position and adopt appropriate measures. The Group is working with international banks for appropriate hedging tools suitable for the Group's foreign exchange cash flow pattern.

Employee and remuneration policies

As at 30 June, 2004, the Group employed approximately 909 full time employees in Mainland China and Japan. Employees are remunerated based on their performance, work experience and the prevailing market rates. Performance related bonuses are granted on a discretionary basis. Other employee benefits include pension fund, insurance and medical coverage, training programs and participation in the Group's share option scheme.

Management Discussion and Analysis

Director's interest in securities

As at 30 June, 2004, the interests and short positions of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) (the "SFO") as recorded in the register maintained by the Company under section 352 of the SFO or otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies were as follows:

(a) Interests in the Company

| Name of Director | Capacity/Nature of interest | No. of shares of the Company | Note | Approximate percentage of shareholding |
|--------------------|--------------------------------------|------------------------------|------|--|
| Mr. Wang Xubing | Interest of a controlled corporation | 149,750,000(L) | 1 | 56.32% |
| Mr. Wang Zhiqiang | Interest of a controlled corporation | 149,750,000(L) | 2 | 56.32% |
| Mr. Jun Otaka | Beneficial owner | 500,000(L) | | 0.19% |
| Dr. Shi Chongming | Beneficial owner | 1,010,800(L) | 3 | 0.38% |
| Mr. Siu Kwok Leung | Beneficial owner | 1,070,000(L) | 4 | 0.40% |

Notes:

- These shares are beneficially owned by China Way International Limited ("China Way"). By virtue of his 51% shareholding interest in China Way, Mr. Wang Xubing is deemed or taken to be interested in the 149,750,000 shares of the Company owned by China Way for the purpose of the SFO.
- These shares are beneficially owned by China Way. By virtue of his 49% shareholding interest in China Way, Mr. Wang Zhiqiang is deemed or taken to be interested in the 149,750,000 shares of the Company owned by China Way for the purpose of the SFO.
- These shares are held by Pure Finance Limited as trustee for Dr. Shi Chongming and are beneficially owned by Dr. Shi Chongming.
- These shares are held by Pure Finance Limited as trustee for Mr. Siu Kwok Leung and are beneficially owned by Mr. Siu Kwok Leung.
- The letter "L" denotes a long position in shares.

(b) Interests in shares of associated corporations of the Company

| Name of associated corporation | Name of Director | Capacity/Nature of Interest | Number of ordinary shares of US\$1.00 each | Approximate percentage of shareholding |
|--------------------------------|-------------------|--------------------------------------|--|--|
| China Way | Mr. Wang Xubing | Interest of a controlled corporation | 51(L) | 51% |
| China Way | Mr. Wang Zhiqiang | Interest of a controlled corporation | 49(L) | 49% |

Note: The letter "L" denotes a long position in shares.

Management Discussion and Analysis

Save as disclosed above, as at 30 June, 2004, there was no other Director or chief executive of the Company who had any interest or short position in shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of the SFO) which were recorded in the register maintained by the Company under section 352 of the SFO or otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

Directors' rights to acquire shares

As at 30 June, 2004, no option was granted to Directors to acquire shares in the Company. At no time during the Period were rights to acquire benefits by means of the acquisition of shares in the Company granted to any Director or their respective spouse or children under 18 years of age, or were any such rights exercised by them; or was the Company or any of its subsidiaries a party to any arrangement that enabled any Directors to acquire such rights in any other body corporate.

Substantial shareholders

As at 30 June, 2004, the following parties (other than the Directors or the chief executive of the Company) were recorded in the register kept by the Company under section 336 of the SFO as being directly or indirectly interested, or had short positions, in the shares and underlying shares of the Company.

| Name of shareholder | Capacity/Nature of interest | No. of shares of the Company | <i>Note</i> | Approximate percentage of shareholding |
|---|--------------------------------------|-------------------------------------|-------------|---|
| China Way | Beneficial owner | 149,750,000(L) | | 56.32% |
| Legend New-Tech Investment Limited | Beneficial owner | 22,960,782(L) | | 8.64% |
| Right Lane Limited | Interest of a controlled corporation | 22,960,782(L) | 1 | 8.64% |
| Legend Holdings Limited | Interest of a controlled corporation | 22,960,782(L) | 2 | 8.64% |
| Chinese Academy of Sciences Holdings Co., Ltd. | Interest of a controlled corporation | 22,960,782(L) | 3 | 8.64% |
| Employee's Stock Society of Legend Holdings Limited | Interest of a controlled corporation | 22,960,782(L) | 4 | 8.64% |
| Madam Zhang Yue | Interest of spouse | 149,750,000(L) | 5 | 56.32% |
| Madam Yuan Yue Ling | Interest of spouse | 149,750,000(L) | 6 | 56.32% |

Notes:

1. Right Lane Limited is beneficially interested in the entire issued share capital of Legend New-Tech Investment Limited ("Legend New-Tech"). By virtue of its 100% interest in Legend New-Tech, Right Lane Limited is deemed or taken to be interested in the 22,960,782 shares beneficially owned by Legend New-Tech.
2. Legend Holdings Limited is beneficially interested in the entire issued share capital of Right Lane Limited. By virtue of its 100% interest in Right Lane Limited, Legend Holdings Limited is deemed or taken to be interested in the 22,960,782 shares beneficially owned by Legend New-Tech.

Management Discussion and Analysis

3. Chinese Academy of Sciences Holdings Co., Ltd. is beneficially interested in a 65% equity interest in Legend Holdings Limited. By virtue of its interest in Legend Holdings Limited, Chinese Academy of Sciences Holdings Co., Ltd. is deemed or taken to be interested in the 22,960,782 shares beneficially owned by Legend New-Tech.
4. Employee's Stock Society of Legend Holdings Limited is beneficially interested in 35% equity interest in Legend Holdings Limited. By virtue of its interest in Legend Holdings Limited, Employee's Stock Society of Legend Holdings Limited is deemed or taken to be interested in the 22,960,782 shares beneficially owned by Legend New-Tech.
5. Madam Zhang Yue is the wife of Mr. Wang Xubing and is deemed to be interested in the 149,750,000 shares in which Mr. Wang Xubing is deemed or taken to be interested for the purposes of the SFO.
6. Madam Yuan Yue Ling is the wife of Mr. Wang Zhiqiang and is deemed to be interested in the 149,750,000 shares in which Mr. Wang Zhiqiang is deemed or taken to be interested for the purposes of the SFO.
7. The letter "L" denotes a long position in shares.

Save as disclosed above, as at 30 June, 2004, there was no other person (not being a Director or a chief executive of the Company) who had any interest or short position in shares or underlying shares of the Company which were recorded in the register required to be kept under section 336 of the SFO.

Purchase, sale or redemption of the Company's securities

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

Review by audit committee

The audit committee has reviewed with the management the accounting principles and practices adopted by the Group. The audit committee has also discussed auditing, internal control and financial reporting matters with the management and reviewed the unaudited interim financial statements of the Group set out in this interim report.

The 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 accounting period covered by this interim report, in compliance with the Code of Best Practice as set out in Appendix 14 to the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules").

Adoption of the model code

The Company has adopted the Model Code (the "Model Code") for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 to the Listing Rules (as may be amended from time to time by the Stock Exchange pursuant to the Listing Rules) as the Company's code of conduct and rules governing dealings by all Directors in the securities of the Company.

All Directors had complied with the required standard regarding Directors' securities dealings set out in the Model Code during the six months' period ended 30 June, 2004.