1 GENERAL INFORMATION

The Company was incorporated in the British Virgin Islands ("BVI") on 23 November 1999 under the name of Keyword Technology Limited and subsequently changed its name to OICQ.com Limited, Tencent (BVI) Limited and Tencent Holdings Limited on 29 December 1999, 7 June 2001 and 11 February 2004 respectively. On 27 February 2004, the Company's registration was transferred to the Cayman Islands and became an exempt company with limited liability under the Companies Law of the Cayman Islands. The shares of the Company have been listed on the Main Board of the Hong Kong Stock Exchange Limited since 16 June 2004 in an IPO.

The Company is an investment holding company. The Company and its subsidiaries (the "Group") are principally engaged in the provision of mobile and internet value-added services to users and online advertising services in the People's Republic of China (the "PRC").

The operations of the Group were initially conducted through Shenzhen Tencent Computer Systems Company Limited ("Tencent Computer"), a limited liability company established in the PRC by certain shareholders of the Company on 11 November 1998. Tencent Computer is legally owned by the core founders of the Company who are PRC citizens ("the Registered Shareholders").

The PRC laws and regulations limit foreign ownership of companies providing value-added telecommunications services, which included activities and services operated by Tencent Computer. In order to enable certain foreign companies to make investments into the business of the Group, the Company established a subsidiary, Tencent Technology (Shenzhen) Company Limited ("Tencent Technology"), which is a wholly foreign owned enterprise incorporated in the PRC on 24 February 2000. The foreign investors of the Company then subscribed to additional equity interests of the Company.

Certain contractual arrangements have been made among the Company, Tencent Technology, Tencent Computer and the Registered Shareholders so that the decision-making rights and operating and financing activities of Tencent Computer are ultimately controlled by the Company. The Company and Tencent Technology are also entitled to substantially all of the operating profits and residual benefits generated by Tencent Computer under these arrangements. In particular, the Registered Shareholders are required under their contractual arrangements with the Group to transfer these interests in Tencent Computer to the Group or the Group's designee upon the Group's request at a pre-agreed nominal consideration.

Further, pursuant to the contractual arrangements between the Company and Tencent Computer, the Group owns the intellectual property developed by Tencent Computer. It also receives the cash flow derived from the operations of Tencent Computer through the levying of service and consultancy fees and sales of software. The ownership interests in Tencent Computer have also been pledged by the Registered Shareholders to the Group. As a result, Tencent Computer is accounted for as a subsidiary of the Group for accounting purposes.

1 GENERAL INFORMATION (Cont'd)

On formation of the Group in 2000, all of the participating entities were under the control of the same shareholders in similar proportions. This was achieved via direct or indirect ownership as well as, in the case of the control over Tencent Computer, via contractual provisions. As a result, the formation of the Group was accounted for as a business combination between entities under common control under a method similar to the uniting of interests method for recording all assets and liabilities at predecessor carrying amounts. The financial statements are presented as if these three entities had always been combined. This approach was adopted because in management's belief it best reflects the substance of the formation.

During 2004, the Registered Shareholders established another company in the PRC, Shiji Kaixuan, in order to carry out certain business operations of the Group similar to Tencent Computer. The Company also incorporated a new wholly foreign owned enterprise, Shidai Zhaoyang Technology (Shenzhen) Company Ltd. ("Shidai Zhaoyang"). Similar contractual arrangements have been made among the Company, Shidai Zhaoyang, Shiji Kaixuan and the Registered Shareholders. Shiji Kaixuan is also accounted for as a subsidiary of the Group for accounting purposes.

2 ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below:

A Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, modified by the revaluation of financial instruments held for trading.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

During the year, certain changes were introduced to IFRS, which include IFRS3 "Business Combinations", IAS36 "Impairment of Assets" and IAS38 "Intangible Assets". These changes do not have any material impact on the financial statements of the Group in 2004.

2 ACCOUNTING POLICIES (Cont'd)

B Group accounting

Subsidiaries

The consolidated financial statements consist of the financial statements of the Company and its subsidiaries.

Subsidiaries, which are those entities in which the Group has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies, are consolidated.

The existence and effect of potential voting rights that are presently exercisable or presently convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless cost cannot be recovered. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet, interests in subsidiaries are stated at cost less provision for impairment losses. The results of these companies are accounted for by the Company on the basis of dividends received and receivable.

C Foreign currency translation

(1) Measurement currency

Items included in the financial statements of each entity in the Group are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity ("the measurement currency"). The consolidated financial statements are prepared in Renminbi ("RMB"), which is the measurement currency as well as financial statement presentation currency of the Group.

The books and records of the Company and its subsidiaries outside the PRC are maintained in United States Dollars ("USD") while those of the subsidiaries incorporated in the PRC are in RMB.

(2) Transactions and balances

Foreign currency transactions are translated into the measurement currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

2 ACCOUNTING POLICIES (Cont'd)

C Foreign currency translation (Cont'd)

(2) Transactions and balances (Cont'd)

Translation differences on debt securities and other monetary financial assets measured at fair value are included in foreign exchange gains and losses. Translation differences on non-monetary items such as equities held for trading are reported as part of the fair value gain or loss. Translation differences on available-for-sale equities are included in the revaluation reserve in equity.

(3) Consolidation

Non-RMB denominated income statements and cash flows of entities within the Group are translated into RMB at average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences arising from the translation are taken to shareholders' equity. When these entities are sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

D Fixed assets

All fixed assets are stated at historical cost less accumulated depreciation and accumulated impairment charge.

Depreciation is calculated on the straight-line basis to write off the cost to their residual values over their estimated useful lives as follows:

Computer equipment	3 - 5 years
Furniture and office equipment	5 years
Motor vehicles	5 years
Leasehold improvements	the shorter of their useful lives or over the lease terms

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in operating profit.

Repairs and maintenance are charged to the income statement during the financial period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits in excess of the originally assessed standard of performance of the existing asset will flow to the Group. Major renovations are depreciated over the remaining useful life of the related asset.

2 ACCOUNTING POLICIES (Cont'd)

E Impairment of assets

Fixed assets and other non-current assets are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows.

F Investments

The Group classifies its investments in debt and equity securities into the following categories: trading, held-to-maturity and available-for-sale. The classification is dependent on the purpose for which the investments were acquired. Management determines the classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis. Investments that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as trading investments and included in current assets; for the purpose of these financial statements short term is defined as 3 months. Investments with a fixed maturity that management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non-current assets, except for maturities within 12 months from the balance sheet date which are classified as current assets. Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; and are included in non-current assets unless management has the express intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets.

Purchases and sales of investments are recognised on the trade date, which is the date that the Group commits to purchase or sell the asset. Cost of purchase includes transaction costs. Trading and available-for-sale investments are subsequently carried at fair value. Held-to-maturity investments are carried at amortised cost using the effective yield method. Realised and unrealised gains and losses arising from changes in the fair value of trading investments are included in the income statement in the period in which they arise. The fair values of investments are based on quoted bid prices or amounts derived from cash flow models. Fair values for unlisted equity securities are estimated using applicable price/earnings or price/cash flow ratios refined to reflect the specific circumstances of the issuer. Equity securities for which fair values cannot be measured reliably are recognised at cost less impairment. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments are included in the income statement as gains and losses from investment securities.

2 ACCOUNTING POLICIES (Cont'd)

G Leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

H Accounts receivable

Accounts receivable are carried at original invoice amounts less provision made for impairment of these receivables. A provision for impairment of accounts receivable is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest.

I Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with banks, term deposits with banks and other short-term highly liquid investments with original maturities of three months or less.

J Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

K Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Currently enacted tax rates are used in the determination of deferred income tax.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

2 ACCOUNTING POLICIES (Cont'd)

L Employee benefits

(1) Employee leave entitlements

Employee entitlements to annual leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date. Employee entitlements to sick and maternity leave are not recognised until the time of leave.

(2) Pension obligations

The Group contributes on a monthly basis to various defined contribution benefit plans organised by the relevant governmental authorities. The Group's liability in respect of these funds is limited to the contributions payable in each period. Contributions to these plans are expensed as incurred. Assets of the plans are held by government authorities and are separated from those of the Group.

(3) Equity compensation benefits

Share options are granted to employees. Options are granted at exercise price determined by the Board of Directors of the Company. Pre-IPO options are exercisable during the period from the date of commencement of the options' vesting period or the date of the IPO of the Company, whichever is later, to 31 December 2011. Post-IPO options are exercisable during the period of ten years commencing on the adoption date of 24 March 2004. When the options are exercised, the proceeds received, net of any related transaction costs, are credited to share capital (at nominal value) and share premium. The Group does not make any charge to staff costs in connection with the share options grants.

M Government grants/subsidies

Grants/subsidies from government are recognised at their fair value where there is a reasonable assurance that the grants/subsidies will be received and the Group will comply with all attached conditions. Under these circumstances, the grants/subsidies are recognised as income or matched with the associated costs which the grants/subsidies are intended to compensate.

N Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

2 ACCOUNTING POLICIES (Cont'd)

0 Revenue recognition

The Group principally derives revenues from the provision of mobile and telecommunications value-added services, internet value-added services and online advertising. The Group recognises its revenues (see details for each category below) net of applicable business taxes and other related taxes.

(1) Mobile and telecommunications value-added services

Mobile and telecommunications value-added services revenues are derived principally from providing users with mobile instant messaging services, mobile chat services, and other mobile value-added services such as mobile interactive voice response services, ringback tones services, music and image/picture downloads, mobile news and information content services and mobile games services.

These services are substantially billed on a monthly subscription basis with certain portions billed on a per message basis ("Mobile and Telecom Service Fees"). These services are predominantly delivered through the platforms of various subsidiaries of China Mobile Communications Corporation ("China Mobile") and China United Communications Corporation ("China Unicom") and they also collect the Mobile and Telecom Service Fees on behalf of the Group.

Revenue derived from the mobile and telecommunications value-added services are recognised based on the Mobile and Telecom Services Fees, net of any applicable business taxes and other related taxes and amount of uncollectibles.

In order to derive the Mobile and Telecom Service Fees, China Mobile and China Unicom are entitled to a fixed commission, which is calculated based on agreed percentages of the Mobile and Telecom Service Fees received/receivable by these mobile operators, plus, in certain cases, a fixed per-message adjustment for the excess of messages sent over messages received between the platforms of the Group and these two mobile operators (collectively defined as "Mobile and Telecom Charges"). The Mobile and Telecom Charges are withheld and deducted from the gross Mobile and Telecom Service Fees collected by the two operators from the users, with the net amounts remitted to the Group.

The Mobile and Telecom Service Fees and the Mobile and Telecom Charges, or the net amount of the two, are confirmed and advised by subsidiaries of China Mobile and China Unicom to the Group on a monthly basis. For revenue where the amounts are not confirmed/advised by the two mobile operators at the time of reporting the financial results of the Group, management of the Group estimates the amount receivable based on historical data and management estimates, which reflect developing trends in customer payment delinquencies. Historical data used in estimating revenues include the most recent three-month history of the Mobile and Telecom Service Fees actually derived from the operations, the number of subscriptions and the volume of data transmitted between the network gateways of the Group, China Mobile and China Unicom. Adjustments are made in subsequent periods in case the actual revenue amounts are different from the original estimates.

2 ACCOUNTING POLICIES (Cont'd)

O Revenue recognition (Cont'd)

(2) Internet value-added services

Revenue from Internet value-added services ("Internet Service Fees") are derived from subscriptions received/receivable from the provision of a comprehensive customer service platform that utilises instant messaging and online entertainment services to create a virtual community over the internet. Similar to (1) above, these services are substantially delivered to the Group's customers through the platforms of various subsidiaries of China Mobile and China Unicom with monthly subscriptions paid/payable by the users. The two operators also collect the subscriptions on behalf of the Group, and with an agreed portion retained by them as revenue sharing, the net amounts are remitted to the Group. In addition, the Group also appoints agents to sell and collect the fees of prepaid point cards and tokens for the use of the Internet value-added services of the Group.

For services delivered through the mobile operators, the related revenue is recognised on the same basis as mentioned in (1) above. For amounts derived from the sales of prepaid point cards and tokens, they are deferred and recorded as "deferred revenue" in the consolidated balance sheets. The amounts are recognised as revenue of the Group based on the actual utilisation for consumption of the respective services.

(3) Online advertising

Online advertising revenues are derived from fees for selling advertising space on the Group's websites and instant messaging windows in the forms of banners, links and logos, and delivery of advertisements by various means throughout the community created by the Group.

All the advertising contracts are based on the actual time period that the advertisements appear on the Group's web sites or instant messaging windows and the revenues are recognised rateably over the period in which the advertisements are displayed.

(4) Interest income

Interest income is recognised on a time proportion basis, taking account of the principal outstanding and the effective rate over the period to maturity, when it is determined that such income will accrue to the Group.

2 ACCOUNTING POLICIES (Cont'd)

P Dividends

Dividends are recorded in the Group's financial statements in the period in which they are approved by the Group's shareholders.

Q Research and development expenses

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility, and only if the cost can be measured reliably. Other development expenditures are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development that have been capitalised are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit, not exceeding five years.

R Financial instruments

Financial instruments carried on the consolidated balance sheet include cash and cash equivalents, deposits in approved financial institutions, accounts receivable, prepayments, deposits and other receivables, trading investments, held-to-maturity investments, accounts payable, other payables and accruals and deferred revenue. The accounting policies on recognition and measurement of these items are disclosed in the respective accounting policies.

S Segment reporting

Business segments provide products or services that are subject to risks and returns that are different from those of other business segments. Geographical segments provide products or services within a particular economic environment that is subject to risks and returns that are different from those of components operating in other economic environments.

T Comparatives

Where necessary, comparative figures have been reclassified to conform to changes in presentation in the current year.

3 FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group's activities expose it to financial risks including the effects of changes in foreign currency exchange rates, price, interest rates and credit risk. The Group's overall risk management strategy seeks to minimise the potential adverse effects on the financial performance of the Group.

(a) Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions settled in RMB. RMB is not freely convertible into other foreign currencies. The conversion of RMB denominated balances into foreign currencies is subject to the rates and regulations of foreign exchange control promulgated by the PRC government.

The proceeds derived from the IPO are all denominated in Hong Kong Dollars ("HKD"). Certain sums have already been invested into various investments denominated in USD. In addition, the Group is required to pay dividends in HKD in the future when dividends are declared.

The Group had USD and HKD monetary assets as at 31 December 2004 as stated below.

		As at 31 December	
Monetary assets	**Currency denomination**	**2004**	2003
		RMB'000	RMB'000
Non-current assets			
Held-to-maturity investments	USD	**167,374**	—
Current assets			
Trading investments	USD	**666,900**	—
Term deposits with original maturities of over three months	USD	**576,227**	3,311
Term deposits with original maturities of over three months	HKD	**122,826**	—
Cash in bank and short-term deposits	USD	**325,593**	128,901
Cash in bank and short-term deposits	HKD	**40,736**	16

The Group may experience a loss as a result of any foreign currency exchange rate fluctuations in connection with our deposits and investments. The Group has not used any means to hedge the exposure to foreign exchange risk.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.1 Financial risk factors (Cont'd)

(b) Price risk

The Group is exposed to price risk because of investments held by the Group which have been classified as trading investments. They are stated at fair value through profit or loss. The Group is not exposed to commodity price risk.

(c) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates and the Group has no interest-bearing borrowings. The Group's exposure to changes in interest rates is mainly attributable to its interest-bearing assets including held-to-maturity investments and term deposits, details of which have been disclosed in notes 16, 20 and 21 to the consolidated financial statements. Interest rates on these deposits have been fixed in the relevant contracts. Other financial assets and liabilities do not have material interest rate risk.

(d) Credit risk

As mentioned in note 2(O), the Mobile and Telecom Fees and revenue from Internet value-added services of the Group are substantially derived from co-operative arrangements with China Mobile and China Unicom (the "mobile telecommunication operators"). If the strategic relationship with either mobile telecommunication operator is terminated or scaled-back; or if the mobile telecommunication operators alter the co-operative arrangements; or if they experience financial difficulties in paying the Group, the Group's Mobile and Telecommunications and Internet value-added services might be adversely affected.

However, in view of the history of cooperation with the mobile telecommunication operators and the sound collection history of the receivables due from them, management believes that no material credit risk is inherent in the Group's outstanding accounts receivable balances.

3 FINANCIAL RISK MANAGEMENT (Cont'd)

3.2 Fair value estimation

The Group's financial assets include cash and cash equivalents, accounts receivable, deposits, prepayments, other receivables and investments; and financial liabilities include accounts payable, other payables and accruals.

The fair value of financial instruments traded in active markets (such as trading securities) is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the Group is the current bid price.

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments.

The nominal value less estimated credit adjustments of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

4 SEGMENT INFORMATION

Primary reporting format – business segments

(in RMB thousands)

Year ended 31 December 2004	Mobile and telecommunications value-added services	Internet value-added services	Online advertising	Others	Total
Revenues	641,190	439,041	54,801	8,501	1,143,533
Gross profit/(loss)	397,263	295,908	37,287	(3,141)	727,317
Other operating income, net					11,039
Selling and marketing expenses					(108,482)
General and administrative expenses					(170,050)
Profit from operations					459,824
Finance income, net					9,412
Profit before tax					469,236
Income tax expenses					(22,534)
Net profit					446,702
Segment assets	132,213	151,084	9,617	5,965	298,879
Unallocated assets					2,564,442
Total assets					2,863,321
Segment liabilities	9,614	76,666	982	3,078	90,340
Unallocated liabilities					120,743
Total liabilities					211,083
Other segment items					
Capital expenditure	13,510	43,968	1,799	2,914	62,191
Unallocated capital expenditure					28,345
Total capital expenditure					90,536
Depreciation	4,540	14,520	605	987	20,652
Unallocated depreciation					7,157
Total depreciation					27,809

4 SEGMENT INFORMATION (Cont'd)

Primary reporting format – business segments (Cont'd)

(in RMB thousands)

Year ended 31 December 2003	Mobile and telecommunications value-added services	Internet value-added services	Online advertising	Others	Total
Revenues	467,369	229,690	32,841	5,057	734,957
Gross profit	325,453	154,201	22,342	3,413	505,409
Other operating expenses, net					(1,226)
Selling and marketing expenses					(55,967)
General and administrative expenses					(112,011)
Profit from operations					336,205
Finance income, net					2,004
Profit before tax					338,209
Income tax expenses					(16,013)
Net profit					322,196
Segment assets	75,250	73,985	3,515	1,148	153,898
Unallocated assets					421,818
Total assets					575,716
Segment liabilities	3,527	3,052	405	447	7,431
Unallocated liabilities					96,328
Total liabilities					103,759
Other segment items					
Capital expenditure	8,769	25,725	676	937	36,107
Unallocated capital expenditure					23,352
Total capital expenditure					59,459
Depreciation	1,512	5,899	306	122	7,839
Unallocated depreciation					9,349
Total depreciation					17,188

4 SEGMENT INFORMATION (Cont'd)

Primary reporting format – business segments (Cont'd)

As at 31 December 2004, the Group principally provides the services of:

- Mobile and telecommunications value-added services
- Internet value-added services
- Online advertising

Other operations of the Group mainly comprise the revenue from trademark licensing and real time exchange services offered to corporations, none of which is of sufficient size to be reported separately.

There are no transactions between the business segments. Unallocated costs represent corporate expenses. Segment assets consist primarily of fixed assets and receivables. Segment liabilities comprise operating liabilities and exclude items such as tax and other current liabilities. Capital expenditures represent additions to fixed assets (note 14). Unallocated assets consist primarily of corporate assets such as held-to-maturity investments, trading investments, prepayments, deposits and other receivables, term deposits with original maturities of over three months and cash and cash equivalents. Unallocated liabilities consist primarily of other payables and accruals and tax liabilities.

Secondary reporting format – geographical segments

The Group mainly operates its businesses in the PRC (excluding Hong Kong) and the respective assets are located in the PRC. The Group also held financial instruments as investments which are traded in other territories.

	Revenue		Total assets		Capital expenditure	
(in RMB thousands)	**2004**	2003	**2004**	2003	**2004**	2003
Operating assets						
- The PRC	**1,143,533**	734,957	**1,036,581**	575,716	**90,536**	59,459
Investments						
- Hong Kong	**—**	—	**589,831**	—	**—**	—
- United States	**—**	—	**542,598**	—	**—**	—
- Europe	**—**	—	**519,874**	—	**—**	—
- Other countries	**—**	—	**174,437**	—	**—**	—
Consolidated	**1,143,533**	734,957	**2,863,321**	575,716	**90,536**	59,459

Revenue is presented based on the countries/geographical regions in which the services are provided. Segment assets are presented according to where the risks and returns of these assets are located. Assets located in the PRC mainly relate to the provision of mobile and internet value-added services and online advertising. Assets outside PRC are mainly held-to-maturity investments, trading investments, term deposits and cash and cash equivalents. Capital expenditures are presented according to where the assets are physical located.

5 COST OF REVENUES

Cost of revenues mainly comprises the Mobile and Telecom Charges (mentioned in note 2(O)(1)) and other direct expenses incurred in deriving the revenues.

6 PROFIT FROM OPERATIONS

The following items have been included in arriving at profit from operations:

	2004	2003
	RMB'000	RMB'000
Depreciation of fixed assets	**27,809**	17,188
(Profit)/loss on sale of fixed assets	**(2)**	983
Research and development expenses (note a)	**55,129**	26,010
Operating lease rentals in respect of office buildings (included in general and administrative expenses)	**15,597**	8,211
Auditors' remuneration	**3,110**	869
Staff costs (note 8)	**151,124**	81,921
Government subsidies (included in other operating income) (note b)	**7,233**	—
Fair value gains on trading investments (included in other operating income)	**3,788**	—
Value-added tax paid upon transfer of software within the Group (included in general and administrative expenses) (note 18)	**12,243**	5,550

Note a: Research and development expenses include staff costs and depreciation of approximately RMB43,330,000 for the year (2003: RMB21,933,000). The Group had not capitalised any of research and development expenses for the year (2003: Nil).

Note b: During the year, Tencent Computer was granted a financial subsidy (the "Subsidy") by the local ministry of finance in Shenzhen, the PRC. The Subsidy was granted as an incentive offered to that subsidiary for engaging in the Hi-tech software business.

7 FINANCE INCOME, NET

	2004 RMB'000	2003 RMB'000
Interest income	**14,876**	2,572
Exchange losses, net	**(5,043)**	(414)
Bank charges	**(421)**	(154)
	9,412	2,004

8 STAFF COSTS (INCLUDING DIRECTORS' EMOLUMENTS)

	2004 RMB'000	2003 RMB'000
Wages, salaries and bonuses	**135,918**	70,625
Welfare, medical and other expenses	**9,664**	8,674
Contributions to pension plans (note a)	**3,662**	1,439
Training expenses	**1,880**	1,183
	151,124	81,921

Note a: All local employees of the subsidiaries in the PRC participate in employee social security plans enacted in the PRC, including pension, medical and other welfare benefits, which are organised and administered by the governmental authorities. Except for the welfare benefits provided by these social security plans, the Group has no other material commitments to employees. According to the relevant regulations, the portion of premium and welfare benefit contributions that should be borne by the companies within the Group as required by the above social security plans, are calculated based on percentages of the salaries of employees (or on other basis), subject to a certain ceiling, and are paid to the labour and social welfare authorities. Contributions to the plans are expensed as incurred. The applicable percentages used to provide for insurance premium and welfare benefit funds are listed below:

	Percentage
Pension insurance	9%-22.5%
Medical insurance	7%-12%
Unemployment insurance	0.4%-2%

The average number of full-time employees in 2004 was 883 (2003: 422).

9 DIRECTORS' EMOLUMENTS

The aggregate amounts of emoluments payable to directors of the company during the year are as follows:

	2004 RMB'000	2003 RMB'000
Fees – independent non-executive directors	477	—
Basic salaries, bonuses, housing allowances, other allowances and benefits in kind	7,816	1,670
Contributions to pension plans	24	16
	8,317	1,686

	2004	2003
Number of directors		
– with emoluments	5	2
– without emoluments	2	2
Number of directors	7	4

During the year, no share option has been granted to the directors (2003: Nil).

The emoluments of the directors fell within the following bands:

	Number of directors	
Emolument bands	**2004**	2003
Nil - HKD1,000,000	5	4
HKD3,500,001 - HKD4,000,000	2	—

Each of the two executive directors received the same amount of individual emolument during the year of approximately RMB3,920,000 (equivalent to HKD3,678,000) (2003: RMB843,000 (equivalent to HKD791,000)).

No director received any emolument from the Group as an inducement to join or leave the Group or compensation for loss of office. No director waived or has agreed to waive any emoluments during the year (2003: Nil).

10 FIVE HIGHEST PAID INDIVIDUALS

The five individuals whose emoluments were the highest in the Group for the year including two (2003: two) directors of which the details are shown in the analysis presented above (note 9). The emoluments payable to the remaining three (2003: three) individuals during the year are as follows:

	2004	2003
	RMB'000	RMB'000
Basic salaries, bonuses, housing allowances, other allowances and benefits in kind	**10,547**	2,274
Contributions to pension plans	**36**	24
	10,583	2,298

The emoluments fell within the following bands:

	Number of directors	
Emolument bands	**2004**	2003
Nil - HKD1,000,000	**—**	3
HKD2,500,001 - HKD3,000,000	**1**	—
HKD3,000,001 - HKD3,500,000	**1**	—
HKD3,500,001 - HKD4,000,000	**1**	—

11 TAX EXPENSES

(a) Income Tax

(i) Cayman Islands and British Virgin Islands

The Group is not subject to any taxation under these jurisdictions for the year (2003: Nil).

(ii) Hong Kong Profits Tax

No Hong Kong profits tax has been provided as the Group has no assessable profit arising in Hong Kong for the year (2003: Nil).

11 TAX EXPENSES (Cont'd)

(a) Income Tax (Cont'd)

(iii) PRC Enterprise Income Tax

PRC Enterprise Income Tax ("EIT") is provided on the assessable income of the Group for the year, calculated in accordance with the relevant regulations of the PRC after considering the available tax benefits from refunds and allowances.

Tencent Computer, Tencent Technology, Shiji Kaixuan and Shidai Zhaoyang were established in the Shenzhen Special Economic Zone of the PRC where they conduct their operations. Accordingly, they are subject to EIT at a rate of 15%.

According to the provisions stipulated in the tax circular, Shendishuierhan 2002 No. 128, Tencent Computer is exempt from EIT for the one year commencing from the first year of profitable operations after offsetting prior years' tax losses, followed by a 50% reduction for the next two years (the "Tencent Computer Tax Holiday"). The first profit-making year of Tencent Computer was 2002 and the Tencent Computer Tax Holiday commenced in that year. EIT was levied at 7.5% on its assessable profits for the year (2003: 7.5%).

Tencent Technology was approved by the relevant tax authorities as a foreign invested enterprise with productive sales income defined under the provisions stipulated in the tax circular, Shendishuiwaihan 2003 No. 413, Tencent Technology is exempt from EIT for two years commencing from the first year of profitable operations after offsetting prior years' tax losses, followed by a 50% reduction for the next three years if its annual productive sales income exceeds 50% of its reported total sales income (the "Tencent Technology Tax Holiday"). 2003 and 2004 were the first and second profit-making years of Tencent Technology, after offsetting all tax losses brought forward from prior years. Accordingly, no provision for EIT was made in the financial statements for the year (2003: Nil).

Shiji Kaixuan is exempt from EIT for two years starting from the first year of operations according to the provisions stipulated in the tax circular, Shenguoshuifu jianmian 2004 No. 0272, 2004 was the first year of operations of Shiji Kaixuan and accordingly, no provision for EIT had been made in the financial statements for the year.

Shidai Zhaoyang was incorporated in the PRC and it had no assessable profits during the year.

11 TAX EXPENSES (Cont'd)

(a) Income Tax (Cont'd)

(iii) PRC Enterprise Income Tax (Cont'd)

An analysis of the income tax charges for the year is as follows:

	2004 RMB'000	2003 RMB'000
PRC current tax	**23,522**	18,083
Deferred tax (note 25)	**(988)**	(2,070)
	22,534	16,013

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the tax rate of 15%, the tax rate enacted in Shenzhen, the PRC, where the principal activities of the Group are conducted. The difference is analysed as follows:

	2004 RMB'000	2003 RMB'000
Profit before tax	**469,236**	338,209
Tax calculated at a tax rate of 15% (2003: 15%)	**70,386**	50,731
Effects of different tax rates applicable to companies within the Group	**(1,799)**	(15,111)
Effects of tax holiday on assessable profit of subsidiaries	**(111,556)**	(56,003)
Income not subject to tax	**—**	(129)
Expenses not deductible for tax purposes	**1,573**	34
Deferred tax assets not recognised (note 25)	**61,596**	36,491
Losses reported by companies within the Group not subject to tax	**2,334**	—
Tax charge	**22,534**	16,013

11 TAX EXPENSES (Cont'd)

(b) Value-added tax, business tax and related taxes

The operations of the Group are also subject to the following taxes in the PRC:

Category	Tax rate	Basis of levy
Value-added tax ("VAT")	17%	Sales value of goods sold, offsetting by VAT on purchases
Business tax ("BT") (note)	3 - 5%	Services fee income
City construction tax (note)	1%	Net VAT and BT payable amount
Educational surcharge (note)	3%	Net VAT and BT payable amount

Note: These three charges are recorded as a reduction against gross revenue.

12 DIVIDENDS

Pursuant to a resolution passed by the board of directors dated 17 March 2005, a final dividend for 2004 of HKD0.07 per share was proposed, subject to the approval of the shareholders in the annual general meeting to be held on 27 April, 2005. Such proposed dividend has not been shown as an appropriation in these financial statements. These financial statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 December 2005.

The dividends declared in respect of 2003 (approved in 2004) and 2002 (approved in 2003) were USD 3,500,000 (equivalent to approximately RMB28,935,000) and USD1,250,000 (equivalent to approximately RMB10,334,000), respectively.

13 EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net profit by the weighted average number of ordinary shares in issue during the year.

	2004 **RMB'000**	2003 RMB'000
Net profit	**446,702**	322,196
Weighted average number of ordinary shares in issue (thousands) (note)	**1,523,376**	1,321,151
Basic earnings per share (RMB per share) (note)	**0.293**	0.244

13 EARNINGS PER SHARE (Cont'd)

The diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding by the assumption of the conversion of all potential dilutive ordinary shares. Share options granted are the potential dilutive ordinary shares of the Company. A calculation is done to determine the number of shares that could have been acquired at fair value (determined as to be the average market price of the Company's shares during the year) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares so calculated is compared against the number of shares that would have been issued assuming the exercise of the share options. The difference is added to the denominator as an issue of ordinary shares for no consideration. No adjustment is made to earnings (numerator).

There were no potential dilutive instruments for 2003 as the Pre-IPO share options as stated in note 31 had not met the pre-condition for their exercisability before the IPO. Accordingly, the diluted earnings per share for 2003 is equal to the basic earnings per share.

	2004 **RMB'000**	2003 RMB'000
Net profit	**446,702**	322,196
Weighted average number of ordinary shares in issue (thousands) (note)	**1,523,376**	1,321,151
Adjustments for – share options (thousands)	**30,652**	—
Weighted average number of ordinary shares for diluted earnings per share (thousands) (note)	**1,554,028**	1,321,151
Diluted earnings per share (RMB per share) (note)	**0.287**	0.244

Note: All per share information has been adjusted retroactively as if the aggregate effect of the two share splits (mentioned in note 26) had taken place at the beginning of 2003.

14 FIXED ASSETS

(in RMB thousands)

	Computer equipment	Furniture and office equipment	Motor vehicles	Leasehold improvements	Total
Year ended 31 December 2003					
Opening net book amount	34,728	1,191	534	2,398	38,851
Additions	50,842	4,052	1,184	3,381	59,459
Disposals	(970)	—	(13)	—	(983)
Depreciation charge	(10,622)	(646)	(141)	(5,779)	(17,188)
Closing net book amount	73,978	4,597	1,564	—	80,139
At 31 December 2003					
Cost	91,354	5,434	1,801	6,728	105,317
Accumulated depreciation	(17,376)	(837)	(237)	(6,728)	(25,178)
Net book amount	73,978	4,597	1,564	—	80,139
Year ended 31 December 2004					
Opening net book amount	73,978	4,597	1,564	—	80,139
Additions	69,653	4,983	791	15,109	90,536
Disposals	(181)	(605)	—	—	(786)
Depreciation charge	(23,786)	(1,356)	(327)	(2,340)	(27,809)
Closing net book amount	119,664	7,619	2,028	12,769	142,080
At 31 December 2004					
Cost	160,565	9,703	2,591	16,118	188,977
Accumulated depreciation	(40,901)	(2,084)	(563)	(3,349)	(46,897)
Net book amount	119,664	7,619	2,028	12,769	142,080

15 INTERESTS IN SUBSIDIARIES

(a) Interests in subsidiaries

The amount represents the investment in the equity interests of subsidiaries of the Company. Details are as follows:

	2004 RMB'000	2003 RMB'000
Investment in equity interests of subsidiaries, unlisted and at cost (note i)	**4**	16,534

As at 31 December 2004, the Company had interests in the following companies:

Name	Place and date of establishment and nature of legal entity	Particulars of issued/registered share capital	Percentage of equity/interest attributable to the Company: **2004 Direct**	**2004 Indirect**	2003 Direct	2003 Indirect	Principal activities
Tencent Computer	Established on 11 November 1998 in the PRC, private limited liability company	RMB20,000,000	**—**	**100%**	—	100% (note ii)	Provision of internet instant messaging and value-added services and of internet advertisement service
Tencent Technology (note i)	Established on 24 February 2000 in the PRC, wholly foreign owned enterprise	US$2,000,000	**—**	**100%**	100%	—	Development of computer software and provision of internet information service
Tencent Limited	Established on 14 March 1997 in the BVI, private limited liability company	US$1	**100%**	**—**	100%	—	Investment holding
Realtime Century Technology Limited	Established on 14 March 1997 in the BVI, private limited liability company	US$1	**100%**	**—**	100%	—	Investment holding
Shiji Kaixuan	Established on 13 January 2004 in the PRC, private limited liability company	RMB11,000,000	**—**	**100% (note ii)**	—	—	Provision of internet instant messaging and value-added services and of internet advertisement service
Shidai Zhaoyang	Established on 8 February 2004 in the PRC, wholly foreign owned enterprise	US$500,000	**—**	**100%**	—	—	Provision of technical and management consultancy services
Tencent Asset Management Limited ("Tencent Asset Management")	Established on 7 July 2004 in the BVI, private limited liability company	US$100	**100%**	**—**	—	—	Assets management

15 INTERESTS IN SUBSIDIARIES (Cont'd)

(a) Interests in subsidiaries (Cont'd)

Name	Place and date of establishment and nature of legal entity	Particulars of issued/registered share capital	Percentage of equity/interest attributable to the Company				Principal activities
			2004		2003		
			Direct	Indirect	Direct	Indirect	
Best Logistic Developments Limited	Established on 5 May 2004 in the BVI, private limited liability company	US$100	100%	—	—	—	Investment holding
TCH Alpha Limited	Established on 15 October 2004 in the BVI, private limited liability company	US$100	100%	—	—	—	Dormant
TCH Beta Limited	Established on 15 October 2004 in the BVI, private limited liability company	US$100	100%	—	—	—	Dormant
TCH Sigma Limited	Established on 15 October 2004 in the BVI, private limited liability company	US$100	100%	—	—	—	Dormant

Note i: In 2004, the Company transferred all its equity investment (the "Transfer") in its wholly owned subsidiary, Tencent Technology, to a newly acquired wholly owned subsidiary at a consideration of USD1 (equivalent to approximately RMB8). Since it is a reorganization under common control of the same shareholder, the difference between the original cost of investment in Tencent Technology and the consideration received by the Company for the Transfer in the amount of RMB16,534,000 was recorded as a debit to the capital reserve of the Company and no gain or loss had been recognised by the Company in the transaction.

Note ii: As explained in note 1, the Company lacks equity ownership in these two subsidiaries. Nevertheless, under ceratin contractual agreements enacted among the Registered Shareholders, the Company and its other subsidiaries, the Company controls these companies by way of controlling more than one half of the voting rights of them, governing their financial and operating policies and appointing or removing the majority of the members of their controlling authorities, and casting the majority of votes at meetings of such authorities. In addition, such contractual agreements also transfer the risks and rewards of the two companies to the Company.

(b) Amounts due from/(to) subsidiaries

The amounts due from subsidiaries mainly represent advances made to Tencent Asset Management for making investments in financial instruments of RMB1.8 billion. The remaining balances represent current account balances maintained with the companies within the Group. All of them are unsecured, interest free and have no fixed repayment terms.

16 HELD-TO-MATURITY INVESTMENTS

The amount as at 31 December 2004 represents two 3-Year notes issued by two financial institutions (the "Notes") at variable annual coupon rates over the issuance period of the Notes with maturity in August and October 2007, respectively. Embedded in the Notes are call options (the "Option") which entitle the issuers to repurchase the Notes at par from the Group after specified periods are lapsed until maturity of the Notes. Upon the exercise of the Option, the issuers are required to pay to the Group the principals together with the accrued interest.

There were no disposals of or impairment provisions made against held-to-maturity investments during the year ended 31 December 2004.

17 ACCOUNTS RECEIVABLE

	2004	2003
	RMB'000	RMB'000
0 - 30 days	130,297	45,694
31 days - 60 days	25,340	31,573
61 days - 90 days	15,711	17,635
Over 90 days but less than a year	21,377	4,824
	192,725	99,726

The Group has no formal credit periods communicated to its customers but the customers usually settle the amounts due to it within a period of 30 to 90 days. A substantial balance of the receivable balances as at the end of the year were due from China Mobile, China Unicom and China Telecommunications Corporation and their branches, subsidiaries and affiliates.

18 PREPAYMENTS, DEPOSITS AND OTHER RECEIVABLES

The amount includes VAT refund receivable from the local tax authorities, which arose from certain intragroup sales of software, in the amount of RMB17,922,000 (2003: RMB25,900,000). According to a notice of the relevant government authorities in the PRC, Caishui 2000 No. 25, the portion of VAT paid in excess of 3% on software products developed and sold by an ordinary VAT payer would be immediately refunded by the tax bureau (the "Tax Rebate").

In addition, the respective VAT paid/payable in these intragroup transactions, net of the amounts of the Tax Rebate received/receivable, in the amount of approximately RMB12,243,000 (2003: RMB5,550,000), had been recorded as part of the general and administrative expenses of the Group during the year.

19 TRADING INVESTMENTS

Trading investments represent an investment portfolio held by the Group. The fair values of the respective underlying financial instruments are determined with reference to published price quotations in an active market.

In the consolidated cash flow statement, acquisitions of trading investments have been taken into account in the determination of the cash flows from operating activities (note 28).

In the consolidated income statement, changes in fair values of trading investments are recorded in other operating income.

20 TERM DEPOSITS WITH ORIGINAL MATURITIES OF OVER THREE MONTHS

The effective interest rates for the year of the term deposits with original maturities of over three months of the Group and the Company are 1.70% (2003: 1.61%) and 1.23% (2003: Nil) respectively.

As at 31 December 2004, the Group has term deposits with original maturities of over three months denominated in the USD and HKD are presented in note 3.1(a). They were deposited in banks outside the PRC.

Approximately RMB85,001,000 (2003: RMB20,000,000) of the Group deposits were denominated in RMB and were deposited with banks in the PRC. Within the balance, approximately RMB40,001,000 (2003: Nil) are deposits placed with a bank with PRC bonds provided by the bank as collaterals for the deposits ("Deposits with Collaterals").

All these term deposits of the Company were denominated in USD.

21 CASH AND CASH EQUIVALENTS

	Group		Company	
	2004	2003	**2004**	2003
	RMB'000	RMB'000	**RMB'000**	RMB'000
Cash at bank and in hand	**382,282**	208,454	**41,915**	128,761
Short-term deposits	**477,559**	117,132	**4,144**	—
	859,841	325,586	**46,059**	128,761

The effective interest rates for the year of the short-term bank deposits of the Group and the Company are 1.59% (2003: 1.14%) and 0.84% (2003: Nil) respectively, and these deposits have original maturities of three months or less.

21 CASH AND CASH EQUIVALENTS (Cont'd)

As at 31 December 2004, details of the balances maintained by the Group which were denominated in USD and HKD are presented in note 3.1 (a). The Company's balances denominated in USD and HKD are RMB5,887,000 (2003: RMB128,493,000) and RMB40,106,000 (2003: RMB247,000), respectively.

As at 31 December 2004, approximately RMB493,512,000 (2003: RMB196,669,000) of the balance of the Group are denominated in RMB and deposited with banks in the PRC. Within the amount, approximately RMB223,005,000 (2003: Nil) were Deposits with Collaterals as mentioned in note 20.

The Company had no material balances denominated in RMB.

22 ACCOUNTS PAYABLE

Accounts payable and their ageing analysis are as follows:

	2004	2003
	RMB'000	RMB'000
0 - 30 days	**694**	—
31 days - 60 days	**297**	—
61 days - 90 days	**23**	—
Over 90 days but less than a year	**1,492**	—
	2,506	—

23 OTHER PAYABLES AND ACCRUALS

	2004	2003
	RMB'000	RMB'000
Staff costs and welfare accruals	**42,944**	21,661
Prepayments received from customers	**4,007**	18,836
Marketing and administrative expenses accruals	**13,452**	1,124
Professional fees accruals	**6,360**	6,625
Others	**13,149**	11,055
	79,912	59,301

24 DEFERRED REVENUE

Deferred revenue mainly represents prepaid service fees received from customers for certain Internet value-added services where the related services have not been rendered.

25 DEFERRED INCOME TAXES

Deferred income taxes are calculated in full on temporary differences under the liability method using the tax rates which are expected to apply at the time of reversal of the temporary differences.

The deferred tax liabilities were provided in respect of tax applicable to the transfer of profits derived from Tencent Computer to the Company. The movements of deferred tax liabilities are as follows:

	2004	2003
	RMB'000	RMB'000
At beginning of year	**988**	3,058
Credit to income statement	**(988)**	(2,070)
At end of year	**—**	988

As mentioned in note 18 to the financial statements, certain intragroup software sales have been transacted. The costs of the software purchased can be amortised as expenses over their contracted useful lives (the "Amortisation") for income tax deduction claims in ascertaining the assessable profits of Tencent Computer. These have given rise to a temporary difference between the accounting base and the tax base of the amounts of software sold in these transactions. As at 31 December 2004, the net book value of software recorded by Tencent Computer was RMB653,911,000 (2003: RMB271,118,000).

The related deferred tax assets, estimated to be in the amount RMB98,087,000 based on the enacted tax rate of enterprises based in Shenzhen at 15%, had not been recognised in the consolidated financial statements as at 31 December 2004 (2003: RMB36,491,000) because there was no reasonable certainty that Tencent Computer would obtain the approval from the local tax bureau.

26 SHARE CAPITAL AND SHARE PREMIUM

The authorised share capital of the Company as at 1 January 2003 was 5,000,000 shares at USD0.01 (equivalent to RMB0.083) each. Pursuant to a resolution passed on 26 September 2003, the Company undertook a share split whereby each then issued ordinary share was split into 10.788 shares. The authorised share capital was then increased from 5,000,000 shares to 53,941,626 shares and the par value of each share was also altered from USD0.01 (equivalent to RMB0.083) each to no par value.

On 24 March 2004, the Company undertook another share split whereby each then issued ordinary share was split into 70 shares. The Board also resolved to increase the authorised share capital to 10,000,000,000 ordinary shares and a par value of HKD0.0001 was re-assigned to each share.

The shares and per share information presented in these financial statements have taken into account the effects of the two share splits as if they had taken place on 1 January 2003.

Movements in the issued share capital for the year ended 31 December 2003 and 2004 are as follows:

	Number of shares	**Ordinary shares**	**Share premium**	**Total**
		RMB'000	RMB'000	RMB'000
At 1 January 2003	1,800,688	149	53,105	53,254
Shares cancelled during the year (note (a))	(131,580)	(10)	(37,844)	(37,854)
Increase in number of shares upon share split (note (b))	16,337,772	—	—	—
Shares cancelled after share split (note (c))	(12)	(1)	—	(1)
At 31 December 2003/1 January 2004	18,006,868	138	15,261	15,399
Increase in number of shares upon share split (note (d))	1,242,473,892	—	—	—
Shares issued during the year (note (e))	420,160,500	45	1,516,425	1,516,470
Additional shares issued during the year (note (f))	63,024,000	7	237,264	237,271
Shares issued in relation to employees share option scheme (note (g))	21,239,150	2	8,771	8,773
At 31 December 2004	1,764,904,410	192	1,777,721	1,777,913

26 SHARE CAPITAL AND SHARE PREMIUM (Cont'd)

Note:

(a) On 11 August 2003, the Company undertook a redemption of 131,580 ordinary shares in issue from certain of the then shareholders at a consideration of USD34.80 (equivalent to RMB287.69) each. All these redeemed shares were then cancelled.

(b) On 26 September 2003, the Company undertook a share split (the "First Share Split") whereby 1 then issued ordinary share was split into 10.788 shares. Accordingly, the number of issued shares was increased from 1,669,108 to 18,006,880 with the relative percentage of shareholding among the shareholders remained unchanged. The nominal value of the ordinary shares was also decreased from USD0.01 to no par value.

(c) On 30 September 2003, the Company undertook to redeem a total of 12 ordinary shares from the then existing shareholders at a consideration of USD3.23 (equivalent to RMB26.66) each. All these redeemed shares were then cancelled.

(d) On 24 March 2004, the Company undertook another share split (the "Second Share Split") whereby 1 then issued ordinary share was split into 70 shares, while the relative rights of each shareholder remained unchanged.

(e) On 16 June 2004, a total of 420,160,500 shares of HKD0.0001 per share were issued at HKD3.70 each and were fully paid up in form of cash. This issuance consisted of (1) a public offering of 210,080,000 shares in Hong Kong and (2) a placement of 210,080,500 shares to institutional investors outside Hong Kong and the United States in reliance on Regulation S under the Securities Act and those in the United States in reliance on Rule 144A or another exemption under the Securities Act.

(f) On 8 July 2004, a total of 63,024,000 additional shares of HKD0.0001 per share were issued at HKD3.70 each after the exercise of an over-allotment option in full by the sponsor of the IPO on behalf of certain international purchasers.

(g) During the year of 2004, 21,239,150 Pre-IPO options of the Company granted in 2001 and 2002 at an exercise price of USD0.0497 each were exercised.

As at 31 December 2004, all issued shares were fully paid.

27 OTHER RESERVES

(a) Group

		PRC statutory reserves				
	Capital reserve	Statutory surplus reserve fund	Statutory public welfare fund	Reserve fund	Retained earnings	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Balance at 1 January 2003	1,000	—	—	—	143,696	144,696
Dividend relating to 2002	—	—	—	—	(10,334)	(10,334)
Net profit	—	—	—	—	322,196	322,196
Profit appropriations to statutory reserves	—	500	3,122	31	(3,653)	—
Transfer from retained earnings to capital reserve	19,000	—	—	—	(19,000)	—
Balance at 31 December 2003/ 1 January 2004	20,000	500	3,122	31	432,905	456,558
Dividend relating to 2003	—	—	—	—	(28,935)	(28,935)
Net profit	—	—	—	—	446,702	446,702
Profit appropriations to statutory reserves	—	9,500	11,053	8,236	(28,789)	—
Balance at 31 December 2004	20,000	10,000	14,175	8,267	821,883	874,325

27 OTHER RESERVES (Cont'd)

(a) Group (Cont'd)

In accordance with the Companies Laws of the PRC and the articles of association of two subsidiaries of the Group in the PRC, Tencent Computer and Shiji Kaixuan, appropriations of net profit (after offsetting accumulated losses from prior years) should be made by Tencent Computer and Shiji Kaixuan to their respective Statutory Surplus Reserve Funds, the Statutory Public Welfare Funds and the Discretionary Reserve Funds before distributions are made to the investors. The percentages of appropriation to Statutory Surplus Reserve Fund and Statutory Public Welfare Fund are 10% and 5 - 10%, respectively. The amount to be transferred to the Discretionary Reserve Fund is determined by the shareholders' meetings of Tencent Computer and Shiji Kaixuan. When the balance of the Statutory Surplus Reserve Fund reaches 50% of the paid up/registered capital, such transfer needs not be made. Both of the Statutory Surplus Reserve Fund and Discretionary Reserves Fund can be capitalised as capital of an enterprise, provided that the remaining Statutory Surplus Reserve Fund shall not be less than 25% of the registered capital. However, the Statutory Public Welfare Fund is only available to provide collective staff welfare benefits.

In addition, in accordance with the Law of the PRC on Enterprises with Foreign Investments and the articles of association of other two subsidiaries of the Group in the PRC, Tencent Technology and Shidai Zhaoyang, appropriations from net profit (after offsetting accumulated losses brought forward from prior years) should be made by the Tencent Technology and Shidai Zhaoyang to their respective Reserve Funds and the Staff Bonus and Welfare Funds before distributions are made to the owners. The percentage of net profit to be appropriated to the Reserve Fund is not less than 10% of the net profit. The percentage to be appropriated to the Staff Bonus and Welfare Fund is determined by their respective boards of directors. When the balance of the Reserve Fund reaches 50% of the paid up capital, such transfer needs not be made.

For Tencent Technology and Shidai Zhaoyang, the Staff Bonus and Welfare Fund is available to fund payments of special bonuses to staff and for collective staff welfare benefits. Upon approval from their respective boards of directors, the Reserve Fund can be used to offset an accumulated deficit or to increase capital.

In 2004, the shareholders meetings of Tencent Computer and board of directors of Tencent Technology proposed and approved the percentages of the 2003 profit appropriations and they were recognised in their 2004 financial statements, respectively. For the year ended 31 December 2004, no profit appropriations has been made by Shidai Zhaoyang since it reported losses. In addition, despite the fact that Shiji Kaixuan commenced its commercial operations and reported profits in 2004, the directors have not proposed the appropriations and therefore no appropriations have been accrued in its 2004 financial statements.

27 OTHER RESERVES (Cont'd)

(b) Company

	Capital reserve RMB'000	Retained earnings RMB'000	Total RMB'000
As at 1 January 2003	—	56,794	56,794
Dividend relating to 2002	—	(10,334)	(10,334)
Net profit	—	100,743	100,743
As at 31 December 2003/1 January 2004	—	147,203	147,203
Dividend relating to 2003	—	(28,935)	(28,935)
Capital reserve arising from Group reorganisation (note i)	(16,534)	—	(16,534)
Loss for the year	—	(12,056)	(12,056)
As at 31 December 2004	(16,534)	106,212	89,678

Note i: As described in note 15(a), the debit balance of the capital reserve of the Company arose as a result of the intragroup transfer of equity interests in a subsidiary which is under the common control of the same shareholder.

28 CONSOLIDATED CASH FLOW STATEMENTS

(a) Reconciliation of net profit to net cash inflow from operating activities:

	2004 RMB'000	2003 RMB'000
Net profit	**446,702**	322,196
Adjustments for:		
Taxation	**22,534**	16,013
Depreciation	**27,809**	17,188
(Profit)/loss on disposals of fixed assets	**(2)**	983
Fair value gains on trading investments	**(3,788)**	—
Interest income	**(14,876)**	(2,572)
Changes in working capital:		
Accounts receivable	**(92,999)**	(40,632)
Prepayments, deposits and other receivables	**(11,307)**	(32,797)
Trading investments	**(663,112)**	—
Accounts payable	**2,506**	—
Other payables and accruals, and other taxes payable	**44,400**	81,344
Increase in amounts due to related parties	—	(1,499)
Deferred revenue	**59,546**	3,153
Cash (used in)/generated from operations	**(182,587)**	363,377

In the consolidated cash flow statement, proceeds from disposals of fixed assets comprise:

	2004 RMB'000	2003 RMB'000
Net book amount	**786**	983
Profit/(loss) on disposals of fixed assets	**2**	(983)
Proceeds from disposals of fixed assets	**788**	—

28 CONSOLIDATED CASH FLOW STATEMENTS (Cont'd)

(b) Analysis of changes in financing

	Dividends payable RMB'000	Share capital including premium RMB'000	Total RMB'000
At 1 January 2003	—	53,172	53,172
Redemption of shares	—	(37,855)	(37,855)
Proposed dividends	10,334	—	10,334
Payment of dividends	(10,334)	—	(10,334)
At 31 December 2003/1 January 2004	—	15,317	15,317
Proceeds from issue of shares and share options	—	1,914,020	1,914,020
Payment for share issuance expenses	—	(148,325)	(148,325)
Received from shareholders	—	82	82
Proposed dividends	28,935	—	28,935
Payment of dividends	(28,790)	—	(28,790)
Balance at 31 December 2004	145	1,781,094	1,781,239

(c) Major non-cash transactions

The major non-cash transaction in 2004 was the Second Share Split mentioned in note 26 (2003: First Share Spilt mentioned in note 26).

29 COMMITMENTS

(a) Capital commitments

Capital expenditure contracted for at the balance sheet date but not recognised in the financial statements is as follows:

	2004	2003
	RMB'000	RMB'000
Purchase of fixed assets	**12,150**	7,043

(b) Operating lease commitments

The future aggregate minimum lease payments under non-cancellable operating leases in respect of buildings are as follows:

	2004	2003
	RMB'000	RMB'000
Not later than one year	**17,328**	13,533
Later than one year and not later than five years	**15,713**	28,740
	33,041	42,273

(c) Bandwidth leasing commitments

The future aggregate minimum lease payments under non-cancellable bandwidth leases are as follows:

	2004	2003
	RMB'000	RMB'000
Not later than one year	**62,651**	63,919
Later than one year and not later than five years	**3,250**	2,192
	65,901	66,111

30 RELATED PARTIES TRANSACTIONS

Except as disclosed in note 9 (Directors' emoluments) and note 31 (Share option plans) to the Financial Statements, the Group also undertook the following major transactions with related parties. In the opinion of the Directors, these transactions were conducted in the ordinary and usual course of business and the pricing of these transactions was determined based on mutual negotiation and agreement between the Company and the related parties.

(a) Intellectual property and know-how licensing agreement and supplementary agreements with a shareholder and its affiliate

On 27 June 2002, the Company granted a sole and exclusive license to a shareholder ("the Shareholder") and its affiliates (collectively the "Operators"), to use certain proprietary intellectual property and know-how of the Company for a license fee computed at 40% of gross revenue derived by the Operators by using these proprietary information in certain countries. The agreement is for a term of 15 years expiring in 2017.

Pursuant to two supplementary agreements dated 18 January and 18 June 2003 respectively, an affiliate of the Shareholder is granted the right to use any licensed mobile downloaded images developed by the Group and both the Shareholder and the Operators are granted a sole and exclusive license to use certain trademarks and other intellectual property belonging to the Company.

During the year, no license fees were received/receivable by the Company as the Shareholder had not generated any revenue from the provision of the services (2003: Nil).

(b) Cooperation agreement between Tencent Technology and a subsidiary of a shareholder

On 1 January 2003, Tencent Technology entered into a cooperation agreement with a subsidiary of the Shareholder in Shanghai, the PRC, to develop a co-branded SMS channel. Tencent Technology is entitled to 40% of the revenue so generated while the counter contract party is entitled to the remaining 60%. This contract has expired on 31 December 2004. Sharing of revenues of approximately RMB275,000 was paid/payable by the Group under such arrangements (2003: RMB587,000).

(c) Deposit in connection with the formation of Shiji Kaixuan

Pursuant to an agreement entered into among the Registered Shareholders and Tencent Technology on 16 December 2003, a sum of RMB11,000,000 was advanced by Tencent Technology to the Registered Shareholders for making capital contribution into Shiji Kaixuan, a subsidiary of the Group. The Registered Shareholders granted an irrevocable and exclusive right to Tencent Technology, and through another person, to purchase all or part of the equity interests and assets of Shiji Kaixuan at a nominal consideration. Shiji Kaixuan was formally approved to be established on 13 January 2004 by the relevant PRC authorities and therefore the deposit had been transferred to investment in subsidiaries in the financial statements of the Company.

31 SHARE OPTION PLANS

Share options are granted to employees. Movements in the number of share options outstanding are as follows:

	2004			2003
	Pre-IPO	**Post-IPO**	**Total**	Pre-IPO
At 1 January	**62,088,600**	**—**	**62,088,600**	62,561,100
Granted	**10,464,230**	**6,311,520**	**16,775,750**	—
Exercised	**(21,239,150)**	**—**	**(21,239,150)**	—
Lapsed	**(906,763)**	**(10,559)**	**(917,322)**	(472,500)
At 31 December	**50,406,917**	**6,300,961**	**56,707,878**	62,088,600

Pre-IPO share options were granted in 2004 at the price of USD0.1967 and USD0.4396 per share (2003: USD0.0497 per share) and will expire on 31 December 2011. Post-IPO share options were granted on 14 September 2004 at an exercise price of HKD3.665 per share and will expire after 10 years commencing on the adoption date of 24 March 2004.

Options exercised in 2004 resulted in 21,239,150 shares (2003 : Nil) being issued at USD0.0497 each.

	2004	2003
	RMB'000	RMB'000
Ordinary share capital – at par	**2**	—
Share premium	**8,771**	—
Proceeds	**8,773**	—
Fair value, at exercise date, of shares issued	**101,601**	—

Share options outstanding as at 31 December 2004 have the following terms:

Expiry Date	**Exercise price**	**2004**	2003
31 December 2011	USD0.0497	**40,371,450**	62,088,600
31 December 2011	USD0.1967/ USD0.4396	**10,035,467**	—
10 years commencing on the adoption date of 24 March 2004	HKD3.665	**6,300,961**	—
		56,707,878	62,088,600

On 26 January 2005 and 3 February 2005, 16,006,530 shares and 4,513,600 shares of Post-IPO share options were granted at the exercise price of HKD4.485 and HKD4.8 per share, respectively.