NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2004

1. REORGANISATION AND BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

The Company was incorporated in the Cayman Islands as an exempted company with limited liability on 23 December 2003 under the Companies Law of the Cayman Islands. Its shares have been listed on the Main Board of The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 22 September 2004.

Pursuant to a group reorganisation (the "Reorganisation") in preparation for the listing of the Company's shares, the Company became the ultimate holding company of the subsidiaries now comprising the Group on 6 January 2004. Details of the Reorganisation are set out in the prospectus issued by the Company on 10 September 2004.

The Group resulting from the Reorganisation is regarded as a continuing entity. Accordingly, the financial statements of the Group have been prepared using the principle of merger accounting in accordance with Statement of Standard Accounting Practice No. 27 "Accounting for Group Reconstructions" issued by Hong Kong Institute of Certified Public Accountants (the "HKICPA").

The Company is an investment holding company. The principal activities of its subsidiaries are set out in note 14.

2. POTENTIAL IMPACT ARISING FROM THE RECENTLY ISSUED ACCOUNTING STANDARDS

In 2004, the HKICPA issued a number of new or revised Hong Kong Accounting Standards and Hong Kong Financial Reporting Standards (herein collectively referred to as "New HKFRSs") which are effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these New HKFRSs in the financial statements for the year ended 31 December 2004.

The Group has commenced considering the potential impact of these New HKFRSs but is not yet in a position to determine whether these New HKFRSs would have a significant impact on how its results of operations and financial position are prepared and presented. These New HKFRSs may result in changes in the future as to how the results and financial position are prepared and presented.

3. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared under the historical cost convention and in accordance with accounting principles generally accepted in Hong Kong. The principal accounting policies adopted are as follows:

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31 December each year.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant inter-company transactions and balances within the Group are eliminated on consolidation.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Investments in subsidiaries

Investments in subsidiaries are stated at cost less any identified impairment loss.

Interests in associates

The consolidated income statement includes the Group's share of the post-acquisition results of its associates for the year. In the consolidated balance sheet, interests in associates are stated at the Group's share of net assets of the associates less any identified impairment loss.

Revenue recognition

Sales of goods are recognised when goods are delivered and title has passed.

Service income is recognised when services are rendered.

Revenue from systems installation contracts, which includes the procurement of hardware on behalf of customers, systems design, planning, consulting, systems integration services, software implementation and maintenance is recognised based on the percentage of completion method by reference to the value of work carried out during the period. When the outcome of the contract cannot be estimated reliably, the costs incurred are recognised as an expense and the revenue is recognised only to the extent of contract costs incurred that it is probable will be recoverable.

Interest income from bank deposits is accrued on a time basis, by reference to the principal outstanding and at the interest rate applicable.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment loss at the balance sheet date.

Depreciation and amortisation are provided to write off the cost of property, plant and equipment over their estimated useful lives and after taking into account their estimated residual value, using the straight-line method, at the following rates per annum:

Land and buildings	Over the term of the lease
Leasehold improvements	Over the unexpired term of the lease
Motor vehicle	20%
Furniture, fixture and equipment	20%

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Research and development expenditure

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

An internally-generated intangible asset arising from development expenditure is recognised only if it is anticipated that the development costs incurred on a clearly-defined project will be recoverable through future commercial activity. The resultant asset is amortised on a straight-line basis over the estimated useful life of the project from the date of commencement of commercial operation subject to a maximum of five years.

Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

Impairment

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Impairment losses are recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised as income immediately.

Leases

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership of the assets concerned to the Group. All other leases are classified as operating leases and annual rentals are charged to the income statement on a straight-line basis over the relevant lease term.

Foreign currencies

Transactions in currencies other than Renminbi ("RMB") are initially recorded at the rates of exchange ruling on the dates of the transactions. Monetary assets and liabilities denominated in currencies other than RMB are translated at the rates ruling on the balance sheet date. Profits and losses arising on exchange are dealt with in the income statement.

On consolidation, the assets and liabilities of the Group's overseas operations are translated at exchange rates prevailing on the balance sheet date. Income and expenses items are translated at the average exchange rates for the period. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the years. Taxable profit differs from net profit as reported in the income statement because it excludes items of income and expense that are taxable or deductible in other years, and it further excludes income statement items that are never taxable or deductible.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill (or negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable differences arising on investments in subsidiaries and associates, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is revised at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Government grants

Government grants are recognised as income when there is reasonable assurance that the conditions attaching to such grants are complied and with the rights to receive payment have been established.

Inventories

Inventories, represents computer hardware and spare parts, are stated at the lower of cost and net realisable value. Cost is calculated using first in, first out method.

Retirement benefits costs

Payments made to state-managed retirement benefits schemes are charged as an expense as they fall due.

4. BUSINESS AND GEOGRAPHICAL SEGMENTS

Business segments

For management purposes, the Group's operation is currently categorised into four operating divisions – system integration, customised software products, sale of hardware and software products and maintenance and other services. These divisions are the basis on which the Group reports its primary segment information.

Business segments for the year are as follows:

	2004		2003	
	Turnover	Results	Turnover	Results
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*
System integration	58,891	24,479	77,375	34,860
Customised software products	12,734	11,868	18,141	14,477
Sale of hardware and software products	27,047	4,675	12,632	4,100
Maintenance and other services	16,284	9,982	1,247	1,006
	114,956	51,004	109,395	54,443
Unallocated other operating income		7,784		10,100
Unallocated corporate expenses		(22,811)		(10,224)
Profit from operations		35,977		54,319
Share of results of associates		(52)		(598)
Gain on disposal of an associate		37		–
Interest expense on convertible notes		(1,143)		–
Profit before taxation		34,819		53,721
Income tax expense		–		(7,550)
Profit after taxation and before minority interests		34,819		46,171
Minority interests		82		(34)
Net profit for the year		34,901		46,137

No business segment information for the assets, liabilities, capital expenditure, depreciation and other non-cash expenses of the Group is shown as all the assets and liabilities are shared by the business segments and cannot be separately allocated.

Geographical segments

No geographical segment information of the Group is shown as the Group's operations, sales by geographical market and assets are substantially located in the People's Republic of China ("PRC").

5. OTHER OPERATING INCOME

	2004 RMB'000	2003 RMB'000
Refund of value added tax *(Note a)*	3,038	8,619
Government subsidy *(Note b)*	3,940	1,000
Interest income on bank deposits	542	481
Others	264	–
	7,784	10,100

Notes:

(a) Value added tax is paid at 17%. Pursuant to an approval by the Shinan Sub-Bureau of the Qingdao Local Tax Bureau in February 2003 and January 2004, Qingdao Zhongtian Information Technology Co., Ltd. 青島中天信息技術有限公司("Qingdao Zhongtian"), a subsidiary of the Company, is entitled to refund of value added tax on sales of qualified software products for the period from 1 March 2002 to 31 December 2003 and for the year ended 31 December 2004 as Qingdao Zhongtian is ranked as a software enterprise.

(b) The amount represents subsidy from the Qingdao Municipal Science and Technology Commission Shinan Sub Bureau 青島市市南區科技局, Qingdao Municipal Science and Technology Commission 青島市科技局 and Qingdao Shinan Software Park 青島市市南區軟件園 for the purpose of giving immediate financial support to the Group's development activity.

6. PROFIT FROM OPERATIONS

	2004 RMB'000	2003 RMB'000
Profit from operations has been arrived at after charging:		
Auditors' remuneration	769	17
Amortisation of development costs	633	253
Depreciation and amortisation of property, plant and equipment	1,668	1,007
Loss on disposal of property, plant and equipment	308	–
Operating lease rentals on rented premises	383	390
Staff costs:		
Directors' emoluments *(Note 7)*	1,719	612
Other staff costs	5,735	5,954
Retirement benefits scheme contribution (excluding directors)	480	399
	7,934	6,965
Allowances for doubtful debts	144	124
Research and development expenditure	2,620	1,970
Less: Amount capitalised	(1,968)	(1,550)
	652	420
Cost of inventories recognised as expense	53,748	50,191
and after crediting:		
Bad debts recovered	624	–

7. DIRECTORS' EMOLUMENTS

	2004 RMB'000	2003 RMB'000
Fees for		
– independent non-executive directors	62	–
Other emoluments for executive directors		
– salaries and other benefits	1,625	540
– retirement benefits scheme contributions	32	31
– performance-related incentive payments	–	41
	1,657	612
	1,719	612

The emoluments of directors during the year are analysed as follows:

	2004 RMB'000	2003 RMB'000
Director A	509	206
Director B	341	161
Director C	318	131
Director D	298	114
Director E	191	–
Director F	32	–
Director G	15	–
Director H	15	–
	1,719	612

No emoluments were paid by the Group to the directors as a discretionary bonus or an inducement to join or upon joining the Group or as a compensation for loss of office for the year.

No directors waived emoluments during the year.

8. EMPLOYEES' EMOLUMENTS

The aggregate emoluments of the five highest paid individuals included five (2003: one) executive directors of the Company, whose emoluments are included in note 7 above. The aggregate emoluments of the remaining four highest paid individuals for the year ended 31 December 2003 are as follows:

	2003
	RMB'000
Salaries and other benefits	699
Retirement benefits schemes contributions	41
Performance-related incentive payments	154
	894

The emoluments of each of the four individuals were within HK$1,000,000 (equivalent to RMB1,060,000) for the year ended 31 December 2003.

9. INCOME TAX EXPENSE

No provision for Hong Kong Profits Tax has been made as the Group's income neither arises in, nor is derived from Hong Kong.

The applicable income tax rate for the Company's subsidiaries in the PRC is 33%. In accordance with the relevant PRC income tax laws and regulations, Qingdao Zhongtian is recognised as a software enterprise and is entitled to 50% tax relief in 2003. The charge for 2003 represents PRC income tax for that year.

On 2 January 2004, Qingdao Zhongtian was transformed to a wholly foreign-owned enterprise. In accordance with the tax legislations applicable to foreign investment enterprises, Qingdao Zhongtian is entitled to exemptions from PRC income tax for the two years commencing from its first profit-making year of operations and thereafter, entitled to a 50% relief from PRC income tax of 33% for the next three years. Qingdao Zhongtian is exempted from PRC income tax for the current year.

9. INCOME TAX EXPENSE *(continued)*

The charge for the year can be reconciled to the profit per the income statement as follows:

	2004		2003	
	RMB'000	%	RMB'000	%
Profit before taxation	34,819		53,721	
Tax at domestic income tax rate	11,490	33.0	17,728	33.0
Tax effect of expenses that are not deductible in determining taxable profit	2,021	5.8	325	0.6
Tax effect of income that are not taxable in determining taxable profit	(3,730)	(10.7)	(3,358)	(6.3)
Tax effect of income that are not taxable under tax holidays	(10,051)	(28.9)	–	–
Income tax on concessionary rate	–	–	(7,342)	(13.6)
Others	270	0.8	197	0.4
Tax expense and effective tax rate for the year	–	–	7,550	14.1

There was no significant unprovided deferred taxation for both years or at the balance sheet dates.

10. DIVIDENDS

		2004	2003
	Notes	RMB'000	RMB'000
Proposed dividend – HK$0.025 (approximately RMB0.0266) per share	(a)	10,637	–
Paid	(b)	31,869	23,375
		42,506	23,375

Notes:

(a) A final dividend in respect of 2004 at HK$0.025 per share has been proposed by the Directors and is subject to approval by the shareholders in the forthcoming annual general meeting.

(b) The Company has declared special dividend of RMB31,869,000 (equivalent to HK$30,000,000) to its shareholders on 21 June 2004.

The dividend for the year ended 31 December 2003 was paid by a subsidiary to its then shareholders prior to the Reorganisation.

11. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the net profit for the year of RMB34,901,000 (2003: RMB46,137,000) and the weighted average number of 311,421,503 shares (2003: 275,308,633) in issue and issuable on the assumption that the capitalisation issue of 275,308,633 shares had been effective on 1 January 2003.

There were no diluted earnings per share for the year ended 31 December 2003 as there were no potential shares.

The calculation of diluted earnings per share is based on the adjusted net profit for the year of RMB36,044,000, representing the net profit for the year of RMB34,901,000 added with interest expense of convertible notes of RMB1,143,000, and the adjusted weighted average number of 337,958,388 shares in issue and issuable after the respective issue date of convertible notes taking into account the weighted average of 26,536,885 shares assumed to be issued prior to the conversion of convertible notes on 17 September 2004.

12. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings	Leasehold improvements	Motor vehicle	Furniture, fixture and equipment	Total
	RMB'000	*RMB'000*	*RMB'000*	*RMB'000*	*RMB'000*
THE GROUP					
COST					
At 1 January 2004	9,776	1,868	1,882	1,909	15,435
Additions	–	72	477	1,255	1,804
Disposals	–	(500)	–	–	(500)
At 31 December 2004	**9,776**	**1,440**	**2,359**	**3,164**	**16,739**
DEPRECIATION AND AMORTISATION					
At 1 January 2004	672	167	29	449	1,317
Provided for the year	440	427	387	414	1,668
Eliminated on disposals	–	(192)	–	–	(192)
At 31 December 2004	**1,112**	**402**	**416**	**863**	**2,793**
NET BOOK VALUES					
At 31 December 2004	8,664	1,038	1,943	2,301	13,946
At 31 December 2003	9,104	1,701	1,853	1,460	14,118

Land and buildings are situated in the PRC and are held under long leases.

13. DEVELOPMENT COSTS

	THE GROUP RMB'000
COST	
At 1 January 2004	2,050
Additions	1,968
At 31 December 2004	4,018
AMORTISATION	
At 1 January 2004	378
Provided for the year	633
At 31 December 2004	1,011
CARRYING VALUES	
At 31 December 2004	3,007
At 31 December 2003	1,672

Development costs are amortised using the straight-line method over their estimated useful life of five years.

14. INVESTMENTS IN SUBSIDIARIES/AMOUNT DUE FROM (TO) A SUBSIDIARY

	THE COMPANY	
	2004	2003
	RMB'000	*RMB'000*
Unlisted equity investments, at cost	**64,401**	–
Amount due from a subsidiary	**94,088**	–
Amount due to a subsidiary	**8,601**	–

The balances with the subsidiary are unsecured, interest free and have no fixed terms of repayment. In the opinion of the directors, the amounts will not be receivable/repayable within one year from the balance sheet date and, accordingly, the amounts are classified as non-current.

14. INVESTMENTS IN SUBSIDIARIES/AMOUNT DUE FROM (TO) A SUBSIDIARY *(continued)*

Details of the Company's subsidiaries as at 31 December 2004 are as follows:

Name	Form of business structure	Place of incorporation/ establishment	Issued and fully paid share capital/ registered capital	Proportion of equity held by the Company	Principal activities
Success Advantage Limited ("Success Advantage")	Limited company	British Virgin Islands	US$100	100%	Investment holding
Qingdao Zhongtian	Wholly foreign owned enterprise	PRC	HK$90,000,000	100%	Provision of system integration, applications and maintenance services
Qingdao Software Park Overseas Services Centre Co., Ltd. 青島軟件園海外服務中心有限公司	Equity joint venture	PRC	RMB1,000,000	90%	Provision of service related to software consultants
Qingdao Embedded Software Engineering Technology Research Centre Co., Ltd. 青島市嵌入式軟件工程技術研究中心有限公司	Equity joint venture	PRC	RMB1,000,000	90%	Provision of development for the implant application software and system

Except Success Advantage, all subsidiaries are held indirectly by the Company.

None of the subsidiaries had issued any debt securities outstanding at the end of the year or at any time during the year.

15. INTERESTS IN AN ASSOCIATE

	THE GROUP	
	2004	2003
	RMB'000	*RMB'000*
Share of net assets	**248**	1,287

Details of the Company's associate, which is established and operating in the PRC, at 31 December 2004 are as follows:

Name of associate	Form of business structure	Place of establishment	Proportion of nominal value of registered capital held indirectly by the Company	Principal activities
Beijing TongMing Pairui Company Limited 北京通銘派瑞有限公司	Domestic owned enterprise	PRC	25%	Provision of service related software consultants

16. TRADE RECEIVABLES

The Group has a policy of allowing a credit period ranged from 90 to 180 days. The aged analysis of trade receivables is stated as follows:

	THE GROUP	
	2004	2003
	RMB'000	*RMB'000*
0 to 90 days	**31,802**	4,953
91 to 180 days	**1,716**	25
181 to 365 days	**3,830**	258
Over 365 days	**–**	1,279
	37,348	6,515

17. TRADE AND OTHER PAYABLES

The aged analysis of trade and other payables is stated as follows:

	THE GROUP	
	2004	2003
	RMB'000	*RMB'000*
0 to 90 days	**14,666**	38,787
91 to 180 days	**3,105**	225
181 to 365 days	**700**	–
Over 365 days	**–**	130
	18,471	39,142

18. AMOUNT DUE TO A RELATED COMPANY

THE GROUP

The amount represents balance due to Qingdao Zhongtian Technology Development Co., Ltd. 青島中天科技發展有限公司 ("Zhongtian Technology"). Certain directors of the Company are also directors of Zhongtian Technology. The balance was unsecured, interest free and was fully repaid in 2004.

19. SHARE CAPITAL

	Number of shares		Share capital	
	2004	2003	**2004**	2003
			HK$'000	*HK$'000*
Ordinary shares of HK$0.10 each				
Authorised:				
At 1 January	**3,900,000**	3,900,000	**390**	390
Increase on 27 July 2004	**996,100,000**	–	**99,610**	–
At 31 December	**1,000,000,000**	3,900,000	**100,000**	390
Issued and fully paid:				
At 1 January	**1**	–	**–**	–
Allotted and issued on 30 December 2003	**–**	1	**–**	–
Further allotment *(Note i)*	**99**	–	**–**	–
Issue of shares by way of placing and public offer *(Note ii)*	**85,000,000**	–	**8,500**	–
Issue of shares pursuant to conversion of convertible notes *(Note 22)*	**39,691,267**	–	**3,969**	–
Capitalisation issue of shares *(Note iii)*	**275,308,633**	–	**27,531**	–
At 31 December	**400,000,000**	1	**40,000**	–
Equivalent to RMB'000			**42,428**	–

The Company was incorporated in the Cayman Islands on 23 December 2003 with an initial authorised share capital of HK$390,000 divided into 3,900,000 shares of HK$0.10 each. On 30 December 2003, one ordinary share was allotted and issued at par.

Notes:

(i) Pursuant to the agreement dated 6 January 2004 entered into between the Company and shareholders of Success Advantage, as part of the Reorganisation, the shareholders of Success Advantage transferred their entire interests in Success Advantage in consideration of the allotment and issue by the Company of 99 ordinary shares of HK$0.10 each at par on the same date.

(ii) The Company issued 85,000,000 ordinary shares of HK$0.10 each by way of placing and public offer for listing of its shares on the Stock Exchange on 17 September 2004 at a price of HK$0.80 per share.

(iii) Pursuant to an ordinary resolution dated 27 July 2004, 275,308,633 new shares of HK$0.10 each were issued by way of capitalisation of share premium of RMB29,202,000.

The new shares rank pari passu with the existing shares in all respects.

The balance at 31 December 2003 represented the aggregate capital amount of Success Advantage and Qingdao Zhongtian.

20. SHARE OPTION SCHEME

Pursuant to a share option scheme approved by a resolution of the shareholders of the Company dated 27 July 2004 (the "Scheme"), the Company may grant options to the directors or employees of the Company or its subsidiaries, for the recognition of their contributions to the Group, to subscribe for shares in the Company with a payment of HK$1.00 upon each grant of options offered and the options granted must be taken up within 28 days from the date of grant. The exercise price of the share option will be determined at the higher of the average of closing prices of shares on the Stock Exchange on the five trading days immediately preceding the date of grant of the option; the closing price of the Company's shares on the Stock Exchange on the date of grant; and the nominal value of the shares.

The share options are exercisable at any time during a period of not more than 10 years from the date of grant, subject to the terms and conditions of the Scheme, the relevant PRC laws and regulations and any conditions of grant as may be stipulated by the board of directors.

The maximum number of shares in respect of which options may be issued upon exercise of all outstanding options granted and yet to be exercised under the Scheme and any other schemes shall not exceed 30% of the number of shares of the Company in issue from time to time. The total number of shares which may be issued upon exercise of all options to be granted under the Scheme and any other schemes must not, in aggregate, exceed 10% of the number of shares of the Company in issue as at the date of approval of the Scheme unless further shareholders' approval has been obtained pursuant to the conditions set out in the Scheme. No person shall be granted an option which, if all the options granted to the person (including both exercised and outstanding options) in any 12 months period up to the date of grant are exercised in full, would result in such person's maximum entitlement exceeding 1% of the number of issued shares of the Company.

No option has been granted by the Company under the Scheme since its adoption.

21. RESERVES

	Share premium account RMB'000	Contributed surplus RMB'000	Accumulated losses RMB'000	Total RMB'000
THE COMPANY				
At 1 January 2003 and 31 December 2003	–	–	–	–
Share swap in accordance with Reorganisation *(Note 1)*	–	64,401	–	64,401
New shares issued	63,111	–	–	63,111
Shares issued by conversion of convertible notes	29,470	–	–	29,470
Capitalisation issue of shares	(29,202)	–	–	(29,202)
Share issue expenses	(16,133)	–	–	(16,133)
Net profit for the year	–	–	28,626	28,626
Dividend	–	–	(31,869)	(31,869)
At 31 December 2004	47,246	64,401	(3,243)	108,404

Contributed surplus of the Company represents the excess of the net assets of the subsidiaries acquired by the Company under the thereof Reorganisation over the nominal value of the ordinary shares issued by the Company in exchange therefore.

In the opinion of the directors, at 31 December 2004, the Company's reserve available for distribution to shareholders consisted of share premium and contributed surplus of RMB111,647,000.

22. CONVERTIBLE NOTES

Pursuant to the subscription agreements entered into by the Company and SIIS Investment (No. 2) Limited and the subscription agreements entered into by the Company with each of the investors other than SIIS Investment (No. 2) Limited ("other Pre-IPO Investors"), the Company issued convertible notes of HK$13,000,000 to SIIS Investment (No. 2) Limited on 15 January 2004 and to other Pre-IPO Investors in the principal sums of HK$18,000,000 on 7 January 2004 with maturity of three years.

The convertible note issued to SIIS Investment (No. 2) Limited bears interest at 5% per annum for the first twelve months after the date of issue, at 15% per annum for the thirteenth month to the end of twenty-forth month after the date of issue and at 25% per annum for the remaining months of twenty-fourth month after the date of issue to the maturity date. The convertible notes issued to other Pre-IPO investors bear interest at 5% per annum. Unless previously redeemed by the Company, the total of principal amount and accrued interest of the convertible notes will be automatically converted into shares of the Company at the final price of the shares to be subscribed for and issued pursuant to the Company's initial public offering on a day preceding the date of listing of the Company's shares on the Stock Exchange.

On 17 September 2004, the total of the principal amount of RMB32,903,000 and accrued interest of the convertible notes of approximately RMB777,000 was converted into 39,691,267 ordinary shares of the Company at a price of HK$0.80 per share.

23. OPERATING LEASE COMMITMENTS

	THE GROUP	
	2004	2003
	RMB'000	*RMB'000*
Minimum lease payments paid under operating leases	**383**	390

At the balance sheet date, the Group had commitments payable in the following year under operating leases in respect of rented premises as follows:

	THE GROUP	
	2004	2003
	RMB'000	*RMB'000*
Within one year	**760**	170
In the second to fifth years	**760**	–
	1,520	170

Operating lease payments represent rentals payable by the Group for certain of its office premises. Leases are negotiated, and rentals are fixed, for an average term of two years.

The Company had no significant operating lease commitments as at the balance sheet dates.

24. CAPITAL COMMITMENTS

The Group and the Company had no significant capital commitments as at the balance sheet dates.

25. RETIREMENT BENEFITS SCHEME

The employees of the Group are members of state-managed retirement benefit schemes operated by the local government of Qingdao, and are required to contribute a certain percentage of their payroll costs to the retirement benefit schemes to fund the retirement benefits of the employees. The only obligation of the Company and its PRC subsidiaries with respect to the retirement benefit schemes is to make the specified contributions under the scheme.

The total contributions incurred by the Group in this connection during the year were RMB512,000 (2003: RMB430,000). There were no forfeited contributions of the Group for the year. No forfeited contributions are available to reduce the contribution payable by the Group in the future years.

26. RELATED PARTY TRANSACTIONS

The Group purchased hardware products of RMB8,657,000 from Zhongtian Technology for the year ended 31 December 2003. The transactions were based on the terms agreed by the parties. The Group did not purchase from Zhongtian Technology during the current year.