

# Report of the Directors

The directors have pleasure in submitting their annual report together with the audited financial statements for the fifteen months ended 31 March 2005 (“the Period”).

## PRINCIPAL ACTIVITIES

The principal activity of the Company is investment holding. The principal activities and other particulars of its principal subsidiaries are set out in note 44 on the financial statements.

The Group’s turnover is derived principally from the manufacturing, distribution and sale of healthcare products, electronic and electrical products, office equipment and the provision of related services, and media-related business.

The Group operates primarily in the People’s Republic of China (“PRC”) outside Hong Kong where its existing manufacturing facilities and distribution network are based. The Group’s activities in Hong Kong include the sourcing of electronic and electrical products, office equipment and component parts for processing, distribution and sale in the PRC.

## SEGMENTAL INFORMATION

An analysis of the Group’s turnover and contributions from operations by business segments for the Period is set out in note 15 on the financial statements. No analysis of the Group’s turnover and contributions from operations by geographical segment has been presented as almost all the Group’s operating activities are carried out in the PRC.

## MAJOR CUSTOMERS AND SUPPLIERS

For the Period, the five largest customers in aggregate accounted for less than 30% of the Group’s turnover. The five largest suppliers in aggregate and the largest supplier of the Group accounted for approximately 75% and 37% respectively by value of the Group’s total purchases.

At no time during the Period have the directors, their associates or any shareholder of the Company (which to the knowledge of the directors owns more than 5% of the Company’s share capital) had any interests (as defined in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”)) in these major customers and suppliers.

## FINANCIAL STATEMENTS

The results of the Group for the Period and the state of the Company’s and the Group’s affairs as at that date are set out in the financial statements on pages 29 to 98.

No interim dividend was paid during the Period (2003: HK\$Nil). The directors recommend the payment of a final dividend of HK1.3 cents per share for the Period (year ended 31 December 2003: special dividend of HK3 cents per share) to the shareholders whose names appear on the register of members of the Company on 25 August 2005.

# Report of the Directors

## CHANGE OF COMPANY'S NAME

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

## CHANGE OF FINANCIAL YEAR END DATE

As announced on 9 July 2004, the directors resolved to change the financial year end date of the Company from 31 December to 31 March. Accordingly, the audited financial statements submitted herewith cover a period of fifteen months from 1 January 2004 to 31 March 2005.

## TRANSFER TO RESERVES

Profits attributable to shareholders of HK\$160,426,000 (2003: HK\$801,186,000) have been transferred to reserves.

## PROPERTY, PLANT AND EQUIPMENT

Movements in property, plant and equipment during the Period are set out in note 17 on the financial statements.

## BANK LOANS AND OTHER BORROWINGS

Particulars of bank loans and other borrowings of the Group as at 31 March 2005 are set out in notes 29 and 30 on the financial statements.

## CONVERTIBLE NOTES

Particulars of convertible notes of the Group as at 31 March 2005 are set out in note 32 on the financial statements.

## DIRECTORS

The directors during the Period and up to the date of this report were:

### Executive directors

DUAN Yongji (*Chairman*)

SHI Yuzhu (*Chief Executive Officer*) (appointed on 9 August 2004)

SHEN Guojun

CHEN Xiaotao

ZHANG Disheng

LIU Wei (appointed on 26 March 2004)

ZHU Xiduo (resigned on 26 March 2004)

# Report of the Directors

## DIRECTORS *(Continued)*

### **Independent non-executive directors**

NG Ming Wah, Charles	(appointed on 1 September 2004)
Andrew Y. YAN	
LIU Ji	(appointed on 20 May 2005)
Prof. LIU Hongru	(retired on 27 May 2004)
YUAN Zhenyu	(appointed on 27 May 2004 and resigned on 20 May 2005)

In accordance with article 101 of the Company's articles of association, Mr. DUAN Yongji, Mr. SHEN Guojun and Mr. Andrew Y. YAN retire by rotation from the board at the forthcoming annual general meeting and being eligible, offers themselves for re-election.

In accordance with article 92 of the Company's articles of association, Mr. SHI Yuzhu, Mr. NG Ming Wah, Charles and Mr. LIU Ji retire from the board at the forthcoming annual general meeting and being eligible, offer themselves for re-election.

Mr. Andrew Y. YAN was appointed as an independent non-executive director of the Company for a term of 3 years commencing on 26 June 2001 and renewing on 26 June 2004 for a term of 3 years. Mr. NG Ming Wah, Charles and Mr. LIU Ji were appointed as independent non-executive directors of the Company for a term of 3 years commencing on 1 September 2004 and 20 May 2005 respectively. The independent non-executive directors are subject to retirement by rotation and re-election at the forthcoming annual general meeting of the Company in accordance with the Company's articles of association.

The Company has received annual confirmation from each of the independent non-executive directors as regards their independence to the Company and considers that each of the independent non-executive directors is independent to the Company.

## DIRECTORS' SERVICE CONTRACTS

Messrs DUAN Yongji and SHEN Guojun entered into service contracts with the Company, all of which are for a period of 3 years commencing on 23 July 1993 and will continue thereafter until terminated by either party to the agreements at 6 months' written notice. Mr. CHEN Xiaotao also entered into a service contract with the Company for a period of 2 years commencing on 1 June 2001 and will continue thereafter until terminated by either party to the agreement at no less than 2 months' written notice.

No director proposed for re-election at the forthcoming annual general meeting has an unexpired service contract which is not determinable by the Company or any of its subsidiaries within one year without payment of compensation, other than normal statutory obligations.

# Report of the Directors

## DIRECTORS' INTERESTS IN SHARES

The directors who held office at 31 March 2005 had the following interests in the shares, underlying shares and debentures of the Company or associated corporations (within the meaning of Part XV of the Securities and Future Ordinance ("SFO")) at that date as recorded in the register of directors' and chief executives' interests and short positions required to be kept under section 352 of the SFO:

Long positions in the shares and underlying shares of the Company:

Name of director	Nature of interests	Interest in shares	Interest in underlying shares pursuant to share options	Interest in underlying shares pursuant to convertible notes	Aggregate interest	Approximate shareholding percentage
DUAN Yongji	Personal (Note 1)	5,040,000	3,900,000	182,692,305	191,632,305	13.01
SHEN Guojun	Personal (Note 1)	–	4,000,000	–	4,000,000	0.27
CHEN Xiaotao	Personal (Note 1)	–	8,000,000	–	8,000,000	0.54
ZHANG Disheng	Personal (Note 1)	–	10,400,000	–	10,400,000	0.71
SHI Yuzhu	Corporate (Note 2)	–	–	744,678,162	744,678,162	50.57

Notes: (1) Beijing Stone Investment Company Limited together with its associates (as defined in the Listing Rules) holds a total of 407,110,053 shares in the Company. Beijing Stone Investment Company Limited is owned as to 42.3% by Stone Jiu Guang New Technology Development (Holdings) Company Limited, 6.7% by Stone Group Corporation and 51% by Beijing Stone Investment Company Limited Employees' Shareholding Society. In addition, Stone Group Corporation indirectly holds 92,374,413 shares in the Company. Messrs. DUAN Yongji, CHEN Xiaotao, SHEN Guojun and ZHANG Disheng (collectively as "the said Directors") are also directors of Stone Group Corporation. So long as the said Directors remain as directors of Stone Group Corporation, each of them together with the other employees collectively own interests in the assets of Stone Group Corporation but none of them has any specific interests in Stone Group Corporation.

(2) The interest of Ready Finance Limited is held by it as beneficial owner. Ready Finance Limited is wholly owned by Mr. SHI Yuzhu who is deemed under the SFO to be interested in the shares held by Ready Finance Limited.

Save as disclosed herein and in the "Share Option Scheme", none of the directors and chief executives of the Company had any interests or short positions in the shares, underlying shares or debentures of the Company or associated corporations, as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company pursuant to Model Code for Securities Transactions by Directors of Listed Companies.

# Report of the Directors

## DIRECTORS' INTERESTS IN CONTRACTS

No contracts of significance to which the Company, its holding company or any of its subsidiaries was a party and in which a director of the Company had a material interest subsisted at the end of the Period or at any time during the Period.

## SHARE OPTION SCHEME

The Company has adopted a share option scheme on 12 April 2002 ("the Scheme"). The purpose of the Scheme is to encourage the participants to perform their best in achieving the goals of the Group and at the same time allow the participants to enjoy the results of the Company attained through their effort and contribution. Participants include any employee and director of the Company or any of its subsidiaries or associates as absolutely determined by the directors of the Company.

The directors of the Company may, at their discretion, invite any participant to take up options. An option is deemed to have been accepted by the grantee upon his or her signing the duplicate letter comprising acceptance of the option and paying HK\$1 by way of consideration for the grant thereof.

The subscription price for shares in the Company under the Scheme will be the highest of (i) the closing price of the shares of the Company as stated in The Stock Exchange of Hong Kong Limited's (the "Stock Exchange") daily quotations sheet on the date on which the option is offered, which date must be a business day, (ii) a price being the average of the closing prices of the shares of the Company as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the option is offered, and (iii) the nominal value of a share of the Company.

The total number of shares of the Company which may be issued upon exercise of all options to be granted under the Scheme and any other share option schemes of the Company must not in aggregate exceed 10% of the total number of shares of the Company in issue as at the date of approval of the Scheme. The Company may seek approval of the shareholders in general meeting to renew the said 10% limit such that the total number of shares in respect of options that may be granted under the Scheme or any other share option schemes of the Company shall not exceed 10% of the total number of shares of the Company in issue as at the date of approval to renew the limit. Notwithstanding the above, the maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the Scheme and any other share options schemes of the Company shall not exceed 30% of the total number of shares of the Company in issue from time to time.

The maximum entitlement for any one participant is that the total number of shares issued and to be issued upon exercise of the options granted to each participant (including exercised or outstanding options) in any 12-month period must not exceed 1% of the total number of shares of the Company in issue. Any further grant of options in excess of the said 1% limit shall be subject to shareholders' approval in general meeting with such participant and his or her associates abstaining from voting. An option may be exercised during a period to be determined by the directors in its absolute discretion and in any event such period shall not be longer than 10 years after the date the grant of the option. The Scheme will remain in force for a period of 10 years from 12 April 2002.

The total number of shares available for issue under the Scheme as at 31 March 2005 was 191,312,000 shares, which represented 12.99% of the issued share capital of the Company at 31 March 2005.

# Report of the Directors

## SHARE OPTION SCHEME (Continued)

At 31 March 2005, the directors and employees of the Company had the following interests in options to subscribe for shares of the Company (market value per share at 31 March 2005 is HK\$0.57). Each option gives the holder the right to subscribe for one share.

	Number of options				Date of grant	Exercisable period	Exercise price HK\$	Market value at date of grant HK\$	Market value on exercise of options HK\$	% of the total issued shares
	Outstanding at 1.1.2004	Exercised during the Period	Lapsed during the Period	Outstanding at 31.3.2005						
DUAN Yongji (Note a)	3,900,000	-	-	3,900,000	22-05-2002	22-08-2002 to 21-05-2012	0.792	0.78	-	0.26
SHEN Guojun (Note a)	4,000,000	-	-	4,000,000	22-05-2002	22-08-2002 to 21-05-2012	0.792	0.78	-	0.27
ZHU Xiduo (Note a & f)	3,000,000	-	-	3,000,000	22-05-2002	22-08-2002 to 21-05-2012	0.792	0.78	-	0.20
CHEN Xiaotao (Note b)	8,000,000	-	-	8,000,000	22-05-2002	22-05-2002 to 21-05-2012	0.792	0.78	-	0.54
ZHANG Disheng (Note c)	10,400,000	-	-	10,400,000	22-05-2002	22-05-2002 to 21-05-2012	0.792	0.78	-	0.71
Contracted employees (Note d)	63,106,000	-	7,950,000	55,156,000	22-05-2002	22-05-2002 to 21-05-2012	0.792	0.78	-	3.75
Contracted employees (Note a)	3,000,000	-	-	3,000,000	22-05-2002	22-08-2002 to 21-05-2012	0.792	0.78	-	0.20
Contracted employees (Note e)	113,856,000	10,000,000	-	103,856,000	31-12-2002	31-12-2002 to 30-12-2012	0.476	0.47	0.83	7.06

Notes:

- (a) The options granted to these grantees shall be exercisable in the following four batches ("Vesting Period"):
- (i) Not more than 25% of options granted exercisable from 22-08-2002 to 21-08-2003;
  - (ii) Not more than 50% of options granted exercisable from 22-08-2003 to 21-08-2004;
  - (iii) Not more than 75% of options granted exercisable from 22-08-2004 to 21-08-2005; and
  - (iv) Free to exercise from 22-08-2005 to 21-05-2012.
- (b) Free to exercise 4,000,000 options from 22-05-2002 to 21-05-2012 and the remaining 4,000,000 options are subject to the Vesting Period set out in Note (a).
- (c) Free to exercise 5,000,000 options from 22-05-2002 to 21-05-2012 and the remaining 5,400,000 options are subject to the Vesting Period set out in Note (a).
- (d) Free to exercise 8,356,000 options from 22-05-2002 to 21-05-2012 and the remaining 46,800,000 options are subject to the Vesting Period set out in Note (a).
- (e) Free to exercise 103,856,000 options from 31-12-2002 to 30-12-2012.
- (f) Mr. ZHU Xidao resigned as a director of the Company on 26-03-2004. He has stayed at the Company as an employee.

# Report of the Directors

## SHARE OPTION SCHEME (Continued)

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

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

Apart from the foregoing, at no time during the Period was the Company, or any of its holding company, subsidiaries or fellow subsidiaries a party to any arrangement to enable the directors or chief executives of the Company or any of their spouses or children under eighteen years of age to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

## MANAGEMENT CONTRACTS

Pursuant to an agreement dated 24 September 2003 between the Company and Stone Group Corporation, the latter agreed to provide, inter alia, secretarial and other related services and the use of office equipment to the Group for a term of five years commencing from 23 July 2003 at reimbursement costs which shall not exceed HK\$3,500,000 per annum.

## SUBSTANTIAL INTERESTS IN THE SHARE CAPITAL OF THE COMPANY

As at 31 March 2005, to the best knowledge of the directors, the following parties were recorded in the register kept by the Company under section 336 of the SFO as being directly or indirectly interested in 5% or more of the issued share capital of the Company:

Long positions in the shares and underlying shares of the Company:

Name	Nature of interest	Interest in shares	Interest in underlying shares pursuant to share options	Interest in underlying shares pursuant to convertible notes	Aggregate interest	Approximate shareholding percentage
Beijing Stone Investment Company Limited	Corporate (Note 1)	407,110,053	–	–	407,110,053	27.65
Beijing Stone Investment Company Limited Employees' Shareholding Society	Corporate (Note 2)	407,110,053	–	–	407,110,053	27.65
Stone Jiu Guang New Technology Development (Holdings) Co. Ltd.	Corporate (Note 2)	407,110,053	–	–	407,110,053	27.65
Shenyang Huguang Group Co. Ltd.	Corporate (Note 2)	407,110,053	–	–	407,110,053	27.65
Stone Group Corporation	Corporate (Note 2)	499,484,466	–	–	499,484,466	33.92
深圳發展銀行深圳人民橋支行	Corporate (Note 3)	230,000,000	–	–	230,000,000	15.62
Ready Finance Limited	Corporate (Note 4)	–	–	744,678,162	744,678,162	50.57
DUAN Yongji	Personal (Note 5)	5,040,000	3,900,000	182,692,305	191,632,305	13.01

# Report of the Directors

## SUBSTANTIAL INTERESTS IN THE SHARE CAPITAL OF THE COMPANY *(Continued)*

Notes:

1. The shareholding of 407,110,053 shares comprised the combined shareholdings of Beijing Stone Investment Company Limited and its associates (as defined in the Listing Rules).
2. Beijing Stone Investment Company Limited is owned as to 42.3% by Stone Jiu Guang New Technology Development Holdings Co. Ltd., 6.7% by Stone Group Corporation and 51% by Beijing Stone Investment Company Limited Employees' Shareholding Society which are accordingly deemed to be interested in the said 407,110,053 shares. Stone Jiu Guang New Technology Development Holdings Co. Ltd. is owned as to 56.14% by Shenyang Huguang Group Co. Ltd. which is accordingly also deemed to be interested in the said 407,110,053 shares. In addition, Stone Group Corporation also beneficially held 92,374,413 shares.
3. The interest of 深圳發展銀行深圳人民橋支行 was held by it as person having a security interest in shares.
4. The interest of Ready Finance Limited was held by it as beneficial owner.
5. The interest of DUAN Yongji is held by him as beneficial owner. Please also refer to note 1 on page 17.

Saved as disclosed above, the Company has not been notified of any other interests representing 5% or more of the issued share capital of the Company and recorded in the register of substantial shareholders maintained under section 336 of the SFO as at 31 March 2005.

## CONNECTED TRANSACTION

During the Period, the Group entered into and completed the following connected transaction:

An agreement dated 28 February 2004 made between Beijing Stone New Technology Industrial Company Limited and Mr. Ji Guoming, Ms. Ni Liming and Ms. Ji Ying for the disposal of a property situated at No.71, Wuai North Road, Wuxi, PRC by Beijing Stone New Technology Industrial Company Limited to Mr. Ji Guoming, Ms. Ni Liming and Ms. Ji Ying at a consideration of RMB2,050,000.

The disposal constitutes a connected transaction of the Company and the details were announced by the directors of the Company on 20 September 2004.

Further details of the above and other related party transactions during the Period are set out in note 40 on the financial statements.

## PURCHASE, SALE AND REDEMPTION OF THE COMPANY'S LISTED SECURITIES

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

## PROPERTIES

Particulars of the major properties and property interests of the Group are shown on page 100 of the annual report.

# Report of the Directors

## RETIREMENT SCHEMES

Particulars of the retirement schemes of the Group are set out in note 14 on the financial statements.

## COMPLIANCE WITH THE CODE OF BEST PRACTICE

In the opinion of the Board, the Company has, during the fifteen months ended 31 March 2005, complied with the Code of Best Practice as set out in Appendix 14 (in force prior to 1 January 2005) of the Listing Rules. On 1 January 2005, the Code of Best Practice has been replaced by the Code of Corporate Governance Practice ("New Code"). Pursuant to the New Code, listed issuers are expected to comply with the code provisions starting from 1 January 2005.

The audit committee was established with written terms of reference which deal clearly with its authority and duties in pursuance of paragraph 14 of Appendix 14 of the Listing Rules. Amongst the audit committee's principal duties are the review and supervision of the Company's financial reporting process and internal control, including the review of the audited financial statements for the Period.

The Company has adopted the Model Code set out in Appendix 10 to the Listing Rules as the Code of Conduct regarding securities transactions by the directors. Having made specific enquiry of all directors of the Company, the Company confirmed that all directors have complied with the required standard set out in the Model Code.

## PUBLIC FLOAT

Based on the information that is publicly available to the Company and within the knowledge of its directors, as at the date of this annual report, there is sufficient public float of not less than 25% of the Company's issued shares as required under the Listing Rules.

## AUDITORS

KPMG retire and, being eligible, offer themselves for reappointment. A resolution for the reappointment of KPMG as auditors of the Company is to be proposed at the forthcoming annual general meeting.

On behalf of the Board

**DUAN Yongji**

*Chairman*

Hong Kong, 19 July 2005