



SinoCom Software Group Limited
中訊軟件集團股份有限公司

(Incorporated in the Cayman Islands with limited liability)



Lay solid foundations Grow with new heights

Interim Report 2005

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Chairman's Statement

On behalf of the board of directors (the "Board") of the Company, I am delighted to present the interim results of the Group for the six months ended 30 June, 2005 (the "Period").

The turnover and net profit for the Period were approximately HK\$123 million and HK\$35.7 million, surged 52% and 41% respectively over that of same period last year. Basic earnings per share for the Period were HK\$0.13, representing an increase of 18%, when compared to the corresponding period in 2004. This was contributed by the respective record growth of the Group's outsourcing software and technical support services of 51% and 70%. Yet this encouraging growth was in turn contributed by the increase in outsourcing software business from two major clients.

The Board does not recommend the payment of an interim dividend for the Period (June, 2004: Nil).

REVIEW

Stepping into 2005, the global economy maintains its positive momentum, albeit at a slower pace than that of last year. The measured increase in U.S. Fed rate and the soaring oil price have created some uncertainty for the global economy. Nevertheless, the outsourcing software industry in China has in general not experienced any negative impact. On the contrary, it continued to grow.

During the Period, the Group was benefited by the sustaining growth of the software outsourcing industry and achieved encouraging business performance. In addition, the Group's niche business development strategy, which helps maximize return and improves shareholder value, has made the Group a rather unique company among its peers. Japan has always been the most important market for the Group. The brand name of "SinoCom" is now widely recognized by major Japanese enterprises and has built up reputable goodwill in Japan. Our edge in the Japan market has helped the Group to further enlarge its market share. I am also pleased to report that during the Period under review, the Group has entered into outsourcing software agreements with N&J Financial Solution Inc. (a joint enterprise established by NEC Corporation, Sumitomo Mitsui Banking Corporation and The Japan Research Institute, Limited) and a renowned software research institute.

Chairman's Statement

To our business, continuing investment in human capital is the key of business success. In the Period, the Group therefore opened a branch office in Dalian where human resources are plenty. We believe that it is imperative in order to strengthen our business foundation and to grow our business.

The Group acquired a software outsourcing company in Beijing that engaged in software localization and testing services. It has a good clientele in software outsourcing, mainly for U.S. companies and is also well versed in the European markets. We are confident that the acquisition will be beneficial to the Group's future expansion into these two markets of good potential. Apart from new employees that came with the acquisitions, we also did some new recruitment from the universities making our number of staff 1,273 by end of June this year.

FORWARD LOOKING

The Chinese government has made clear that it will continue to support the development of software outsourcing business in order to provide an optimal environment for the industry. China's technological capability in software development has been escalating, which has absorbed quality professionals from the academy. Yet our salary level remains competitive comparing with the advanced countries. Armed with this advantage, we believe that China will remain competitive in the industry.

Although there has been some political hiccup between China and Japan, our business relationship with Japan has never been negatively affected. With this stable relationship and our expertise in the Japanese market, the Group will be able to sustain its high growth throughout the rest of the financial year.

The 2% appreciation of Renminbi in July this year has brought us some slight impact on our cost. We will endeavor to monitor the possible foreign exchange issue so that the impact on our bottom line will be minimized.

Last but not the least, I would like to extend my appreciation to our Board, shareholders and business partners for their relentless support. And I would also like to thank for the hard work and dedication our staff has demonstrated.

Wang Zhiqiang
Chairman and CEO

Hong Kong, 26 August, 2005

Condensed Consolidated Income Statement

For the six months ended 30 June 2005

	Notes	Six months ended 30 June	
		2005 HK\$ (Unaudited)	2004 HK\$ (Unaudited)
Revenue		123,076,051	81,074,138
Cost of sales		(57,500,190)	(39,406,342)
Gross profit		65,575,861	41,667,796
Other income		1,108,472	174,829
Administrative expenses		(23,767,904)	(12,987,584)
Profit before tax	4	42,916,429	28,855,041
Income tax expense	5	(6,746,582)	(3,425,980)
Profit for the period		36,169,847	25,429,061
Attributable to:			
Equity holders of the Company		35,696,248	25,356,290
Minority interests		473,599	72,771
		36,169,847	25,429,061
Dividend	7	–	–
Earnings per share	8		
– Basic		0.134	0.114
– Diluted		0.128	0.114

Condensed Consolidated Balance Sheet

At 30 June 2005

	Notes	30/06/2005 HK\$ (Unaudited)	31/12/2004 HK\$ (Audited)
Non-current assets			
Property, plant and equipment	9	9,418,900	8,113,518
Goodwill	15	551,785	–
		9,970,685	8,113,518
Current assets			
Debtors, deposits and prepayments	10	42,543,424	32,831,203
Tax refund receivable		5,581,865	3,405,730
Bank balances and cash		251,452,825	247,305,655
		299,578,114	283,542,588
Current liabilities			
Creditors, deposits received and accruals	11	15,447,286	19,634,986
Amounts due to related companies	12	13,740	2,071,243
Income tax payable		4,821,798	3,492,434
Other tax payable		3,281,428	4,982,470
		23,564,252	30,181,133
Net Current Assets		276,013,862	253,361,455
Net assets		285,984,547	261,474,973
Capital and Reserves			
Share capital	13	27,008,278	26,589,078
Share premium and reserves		257,449,995	234,359,284
Equity attributable to equity holders of Company		284,458,273	260,948,362
Minority interests		1,526,274	526,611
Total Equity		285,984,547	261,474,973

Condensed Consolidated Statement of Changes in Equity

For the six months ended 30 June 2005

	Attributable to equity holders of the Company											Minority interests	Total
	Share capital	Share premium	Capital reserve	Other reserve	General		Translation reserve	Share		Retained profits	Total		
					reserve fund	Shareholder's contribution		options					
HK\$	HK\$	HK\$	HK\$	HK\$	HK\$	HK\$	HK\$	HK\$	HK\$	HK\$	HK\$	HK\$	
At 1 January 2004	19,941,078	21,883,922	10,657,000	5,077,863	3,589,024	2,725,949	(383,362)	-	51,878,890	115,370,364	465,044	115,835,408	
Exchange differences arising on translation of overseas operations recognised directly in equity	-	-	-	-	-	-	126,843	-	-	126,843	(5,555)	121,288	
Profit for the period	-	-	-	-	-	-	-	-	25,356,290	25,356,290	72,771	25,429,061	
Total recognised income and expense for the period	-	-	-	-	-	-	126,843	-	25,356,290	25,483,133	67,216	25,550,349	
Dividend paid	-	-	-	-	-	-	-	-	(9,970,539)	(9,970,539)	-	(9,970,539)	
Issue of shares	6,648,000	111,021,600	-	-	-	-	-	-	-	117,669,600	-	117,669,600	
Share issue expenses	-	(17,368,488)	-	-	-	-	-	-	-	(17,368,488)	-	(17,368,488)	
At 30 June 2004	26,589,078	115,537,034	10,657,000	5,077,863	3,589,024	2,725,949	(256,519)	-	67,264,641	231,184,070	532,260	231,716,330	
Exchange differences arising on translation of overseas operations recognised directly in equity	-	-	-	-	-	-	(246,236)	-	-	(246,236)	17,395	(228,841)	
Profit for the period	-	-	-	-	-	-	-	-	28,884,167	28,884,167	(23,044)	28,861,123	
Total recognised income and expense for the period	-	-	-	-	-	-	(246,236)	-	28,884,167	28,637,931	(5,649)	28,632,282	
Recognition of equity-settled share based payments expense	-	-	-	-	-	-	-	1,126,361	-	1,126,361	-	1,126,361	
Transfer	-	-	-	-	5,292,264	-	-	-	(5,292,264)	-	-	-	
At 31 December 2004	26,589,078	115,537,034	10,657,000	5,077,863	8,881,288	2,725,949	(502,755)	1,126,361	90,856,544	260,948,362	526,611	261,474,973	
Exchange differences arising on translation of overseas operations recognised directly in equity	-	-	-	-	-	-	440,605	-	-	440,605	(49,479)	391,126	
Profit for the period	-	-	-	-	-	-	-	-	35,696,248	35,696,248	473,599	36,169,847	
Total recognised income and expense for the period	-	-	-	-	-	-	440,605	-	35,696,248	36,136,853	424,120	36,560,973	
Exercise of share options	419,200	14,115,700	-	-	-	-	-	(4,054,900)	-	10,480,000	-	10,480,000	
Recognition of equity-settled share based payments expense	-	-	-	-	-	-	-	3,482,136	-	3,482,136	-	3,482,136	
Acquisition of subsidiary	-	-	-	-	-	-	-	-	-	-	575,543	575,543	
Dividend paid	-	-	-	-	-	-	-	-	(26,589,078)	(26,589,078)	-	(26,589,078)	
At 30 June 2005	27,008,278	129,652,734	10,657,000	5,077,863	8,881,288	2,725,949	(62,150)	553,597	99,963,714	284,458,273	1,526,274	285,984,547	

Condensed Consolidated Cash Flow Statement

For the six months ended 30 June 2005

	Six months ended 30 June	
	2005	2004
	HK\$	HK\$
	(Unaudited)	(Unaudited)
Net cash from operating activities	20,775,815	36,604,608
Net cash used in investing activities:		
Acquisition of property, plant and equipment	(2,133,186)	(1,660,660)
Interest received	947,991	93,192
Acquisition of a new subsidiary	261,438	–
Other investing cash flow	14,176	–
	(909,581)	(1,567,468)
Net cash (used in) from financing activities:		
Dividend paid	(26,589,078)	(9,970,539)
Issue of shares	10,480,000	117,669,600
Share issue expenses	–	(17,368,488)
	(16,109,078)	90,330,573
Net increase in cash and cash equivalents	3,757,156	125,367,713
Cash and cash equivalents at 1 January	247,305,655	92,517,281
Effective of foreign exchange rate change	390,014	283,120
Cash and cash equivalents at 30 June	251,452,825	218,168,114
Analysis of the balances of cash and cash equivalents		
Bank balances and cash	251,452,825	218,168,114

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

1. BASIS OF PREPARATION

The condensed financial statements have been prepared in accordance with the applicable disclosure requirements of Appendix 16 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and with Hong Kong Accounting Standard 34 “Interim Financial Reporting”.

2. PRINCIPAL ACCOUNTING POLICIES

The condensed financial statements have been prepared on the historical cost basis.

The accounting policies used in the condensed financial statements are consistent with those followed in the preparation of the Group’s annual financial statements for the year ended 31 December 2004, except as described below:

In the current period, the Group has applied, for the first time, a number of new Hong Kong Financial Reporting Standards (“HKFRSs”), HKASs and Interpretations (hereinafter collectively referred to as “new HKFRSs”) issued by the Hong Kong Institute of Certified Public Accountants that are effective for accounting periods beginning on or after 1 January 2005. The application of the new HKFRSs has resulted in a change in the presentation of the income statement, balance sheet and the statement of changes in equity. In particular, the presentation of minority interests has been changed. The changes in presentation have been applied retrospectively.

The adoption of the new HKFRSs has resulted in changes to the Group’s accounting policies in the following areas that have an effect on how the results for the current or prior accounting periods are prepared and presented:

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

Share-based payments

In the current period, the Group has applied HKFRS 2 Share-based Payment which requires an expense to be recognised where the Group buys goods or obtains services in exchange for shares or rights over shares (“equity-settled transactions”), or in exchange for other assets equivalent in value to a given number of shares or rights over shares (“cash-settled transactions”). The principal impact of HKFRS 2 on the Group is in relation to the expensing of the fair value of directors’ and employees’ share options of the Company determined at the date of grant of the share options over the vesting period. Prior to the application of HKFRS 2, the Group did not recognise the financial effect of these share options until they were exercised. The Group has applied HKFRS 2 retrospectively to share options that were granted after 7 November 2002 and had not yet vested on 1 January 2005. Comparative figures have been restated (see Note 2A for the financial impact).

Goodwill

Goodwill arising on the acquisition of a subsidiary represents the excess of the cost of acquisition over the Group’s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary recognised at the date of acquisition. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill is allocated to each of the Group’s cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

The Group has not early applied the following new Standards or Interpretations that have been issued but are not yet effective. The directors of the Company anticipate that the application of these Standards or Interpretations will have no material impact on the financial statements of the Group.

HKAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 (Amendment)	The Fair Value Option
HKFRS 6	Exploration for and Evaluation of Mineral Resources
HKFRS-Int 4	Determining Whether an Arrangement contains a Lease
HKFRS-Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds

2A. SUMMARY OF THE EFFECTS OF THE CHANGES IN ACCOUNTING POLICIES

The effects of the changes in the accounting policies described above on the results for the current and prior period are as follows:

	30/06/2005 HK\$ (Unaudited)	30/06/2004 HK\$ (Unaudited)
Expenses in relation to share options granted to employees, included in administrative expenses	3,482,136	–
Decrease in profit for the period	3,482,136	–

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

The cumulative effects of the application of the new HKFRSs as at 31 December 2004 are summarised below:

	As at 31/12/2004 (originally stated)	Adjustment	As at 31/12/2004 (restated)
	HK\$	HK\$	HK\$
Share capital	26,589,078	–	26,589,078
Retained earnings	91,982,905	(1,126,361)	90,856,544
Share premium	115,537,034	–	115,537,034
Share options reserve	–	1,126,361	1,126,361
Capital reserve	10,657,000	–	10,657,000
Other reserve	5,077,863	–	5,077,863
General reserve fund	8,881,288	–	8,881,288
Shareholder's contribution	2,725,949	–	2,725,949
Translation reverse	(502,755)	–	(502,755)
Minority interest	–	526,611	526,611
Total effects on equity	260,948,362	526,611	261,474,973
Minority interest	526,611	(526,611)	–
	261,474,973	–	261,474,973

3. SEGMENT INFORMATION

The Group is principally engaged in the provision of outsourcing software development services. For the six months ended 30 June 2005, 93.6% of turnover are generated from outsourcing software development service (for the six months ended 30 June 2004 is 94.2%).

For management purpose, the Group is currently engaged in the provision of service in two markets, People's Republic of China ("PRC") and Japan. The Group's primary format for reporting segment information is geographical segment.

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

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

Income statement for the six months ended 30 June 2005

	PRC HK\$	Japan HK\$	Consolidated HK\$
Revenue	12,440,353	110,635,698	123,076,051
Cost of sales	(7,923,380)	(49,576,810)	(57,500,190)
Segment result	4,516,973	61,058,888	65,575,861
Other income			1,108,472
Other expense			(6,189,622)
Unallocated corporate expenses			(17,578,282)
Profit before tax			42,916,429
Income tax expense			(6,746,582)
Profit for the period			36,169,847

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

Income statement for the six months ended 30 June 2004

	PRC HK\$	Japan HK\$	Consolidated HK\$
Revenue	4,635,903	76,438,235	81,074,138
Cost of sales	(3,432,112)	(35,974,230)	(39,406,342)
Segment result	<u>1,203,791</u>	<u>40,464,005</u>	41,667,796
Other income			174,829
Unallocated corporate expenses			(12,987,584)
Profit before tax			28,855,041
Income tax expense			(3,425,980)
Profit for the period			<u>25,429,061</u>

4. PROFIT BEFORE TAX

Consolidated profit before tax has been arrived at after charging (crediting) the following items:

	Six months ended	
	30/06/2005 HK\$	30/06/2004 HK\$
Depreciation of property plant and equipment	1,374,207	1,037,242
Loss on disposal of property, plant and equipment	34,492	–
Operating lease rentals in respect of premises	5,977,334	4,631,382
Share option expenses	3,482,136	–
Foreign exchange loss (gain)	6,189,622	(515,517)
Allowance for bad and doubtful debts	–	132,370
Interest income	(947,991)	(93,192)

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

5. INCOME TAX EXPENSE

	Six months ended 30 June	
	2005	2004
	HK\$	HK\$
PRC income tax	4,625,615	2,709,799
Japan income tax	2,120,967	716,181
	6,746,582	3,425,980

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

Other PRC subsidiaries of the Company are subject to PRC income tax rate of 33% of the estimated assessable profit for the period.

Taxation arising in Japan is calculated at a progressive statutory rate of 22% on the portion of taxable income not exceeding Yen8,000,000 (equivalent to approximately HK\$567,168) and 30% on the portion of taxable income in excess of Yen8,000,000.

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

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

	Six months ended	
	30/06/2005	30/06/2004
	HK\$	HK\$
Profit before tax	42,916,429	28,855,041
Tax at the PRC income tax rate of 15% (2004: 15%)	6,437,464	4,328,256
Effect of tax refund in respect of export revenue exceeding 70% of total income	(2,176,135)	(1,420,002)
Effect of different tax rates of subsidiaries operating in other jurisdictions	2,485,253	517,726
	6,746,582	3,425,980

No provision for deferred taxation has been recognised in the financial statements as the amount involved is insignificant.

6. SHARE OPTIONS

The Company has a share option scheme for eligible employees of the Group. Details of the share options outstanding during the current period are as follows:

	Number of share options
Outstanding at the beginning of the period	17,730,000
Granted during the period	–
Forfeited during the period	(100,000)
Exercised during the period	(4,192,000)
Expired during the period	–
Outstanding at the end of the period	13,438,000

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

The option may be exercisable during the period of ten years from the date of grant, being 10 November 2004 to 9 November 2014 (both days inclusive), in the following manner:

- (a) no part of the option may be exercisable prior to and including 10 May 2005, the first semi-anniversary of the date of grant (the “First Semi-anniversary”);
- (b) 25% of the option will be exercisable at any time after the First Semi-anniversary up to and including 9 November 2014;
- (c) a further 25% of the option will be exercisable at any time on or after the first anniversary of the First Semi-anniversary (that is, 10 May 2006) up to and including 9 November 2014;
- (d) another 25% of the option will be exercisable at any time on or after the second anniversary of the First Semi-anniversary (that is, 10 May 2007) up to and including 9 November 2014; and
- (e) the remaining 25% of the option will be exercisable at any time on or after the third anniversary of the First Semi-anniversary (that is, 10 May 2008) up to and including 9 November 2014.

As mentioned in Note 2, the Group has, for the first time, applied HKFRS 2 Share-based Payments to account for its share options in the current period. In accordance with HKFRS 2, fair value of share options granted to employees determined at the date of grant is expensed over the vesting period, with a corresponding adjustment to the Group’s share option reserve. In the current period, an amount of share option expense of HK\$3,482,136 has been recognised in the current period, with a corresponding adjustment recognised in the Group’s share option reserve. The Group has applied HKFRS 2 retrospectively, for detail financial impact of prior year refer to Note 2A.

The closing price of the Company’s shares on 10 November 2004, the date of grant of options, was HK\$ 2.50.

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

The closing price of the Company's shares on 10 May 2005, the date on which the options were exercised, was HK\$5.50.

The share options were granted on 10 November 2004. The fair value of the options determined at the date of grant using the Black-Scholes pricing model were HK\$0.92 per share.

The following assumptions were used to calculate the fair value of share options:

	10 November 2004
Market price on date of grant	HK\$2.50
Exercise price	HK\$2.50
Expected life of options	10 years
Expected volatility	37%
Expected dividend yield	2.5%
Risk free rate	3.6%

For the purposes of calculating of fair value, the number of share options granted on 10 November 2004 has been reduced to reflect historical experience of forfeiture of 2% of options granted.

The Black-Scholes option pricing model requires the input of highly subjective assumptions, including the volatility of share price. Changes in subjective input assumptions can materially affect the fair value estimate.

7. DIVIDEND

On 20 May 2005, a dividend of HK10 cents per share (2003: HK5 cents) was paid to shareholders as final dividend for the year ended 31 December 2004.

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

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

8. EARNINGS PER SHARE

The calculation of the basic and diluted earnings per share attributable to the ordinary equity holders of the Company is based on the following data:

	Six months ended	
	30/06/2005 HK\$	30/06/2004 HK\$
Earnings		
Earnings for the purpose of basic and diluted earnings per share (profit for the period attributable to equity holders of the Company)	35,696,248	25,356,290

	Six months ended	
	30/06/2005	30/06/2004
Number of shares		
Weighted average number of ordinary shares for the purpose of basic earnings per share	267,071,953	221,692,540
Effect of dilutive potential ordinary shares:		
Share options	11,282,113	–
Weighted average number of ordinary shares for the purposes of diluted earnings per share	278,354,066	221,692,540

9. MOVEMENTS IN PROPERTY, PLANT AND EQUIPMENT

During the period, the Group spent approximately HK\$2,133,000 (for the six months ended 30 June 2004: HK\$1,661,000) on additions to property, plant and equipment.

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

10. DEBTORS, DEPOSITS AND PREPAYMENTS

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

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

	30/06/2005	31/12/2004
	HK\$	HK\$
0-30 days	22,523,474	16,972,295
31 – 60 days	10,744,162	7,095,255
61 – 90 days	1,705,513	1,378,145
Over 90 days	2,041,408	275,793
Trade debtors	37,014,557	25,721,488
Other debtors	2,500,422	4,138,028
Deposits	2,580,935	2,097,182
Prepayments	447,510	874,505
	42,543,424	32,831,203

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

11. CREDITORS, DEPOSITS RECEIVED AND ACCRUALS

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

	30/06/2005	31/12/2004
	HK\$	HK\$
0 – 30 days	384,557	711,051
31 – 60 days	189,101	231,437
61 – 90 days	170,386	67,107
Over 90 days	15,997	51,317
Trade creditors	760,041	1,060,912
Other creditors	2,264,092	586,132
Accruals	12,081,547	17,683,956
Deposits received	341,606	303,986
	15,447,286	19,634,986

12. AMOUNTS DUE TO RELATED COMPANIES

	30/06/2005	31/12/2004
	HK\$	HK\$
Amounts due to directors	1,600	2,027,647
Amount due to a shareholder	12,140	43,596
	13,740	2,071,243

Those amounts are unsecured, interest free and repayable on demand.

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

13. SHARE CAPITAL

	Number of shares	HK\$
Ordinary shares of HK\$0.10 each		
Authorised:		
At 1 January 2004,		
31 December 2004 and 30 June 2005	1,000,000,000	100,000,000
Issued and fully paid:		
At 1 January 2004	199,410,782	19,941,078
Issue of shares (Note 1)	66,480,000	6,648,000
At 31 December 2004	265,890,782	26,589,078
Exercise of share options (Note 2)	4,192,000	419,200
At 30 June 2005	270,082,782	27,008,278

Notes:

- (1) The Group issued 66,480,000 ordinary shares of HK\$0.10 each at HK\$1.77 per share by way of placing and public offer in connection with the listing of its shares on The Stock Exchange of Hong Kong Limited on 30 April 2004.
- (2) The Group granted 17,730,000 ordinary shares of HK\$0.10 each as option for eligible employees. During the period, 4,192,000 ordinary shares were exercised at HK\$2.5 per share after 10 May 2005, the first exercisable date.

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

14. OPERATING LEASE COMMITMENTS

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

	30/06/2005	31/12/2004
	HK\$'000	HK\$'000
Within one year	13,838	9,167
In the second to fifth year inclusive	11,700	10,147
	25,538	19,314

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

15. ACQUISITION OF A SUBSIDIARY

On 1 January 2005, the Group subscribed for 60% equity interests in Artm Technology Co., Ltd., whose name was changed to SinoCom – Artm Technology Co., Ltd. on 25 January 2005, at a cash consideration of HK\$1,415,100. This transaction has been accounted for using the purchase method of accounting.

Notes to the Condensed Financial Statements

For the six months ended 30 June 2005

The net assets acquired in the transaction, and the goodwill arising, are as follows:

	Carrying amount before acquisition and fair value
	HK\$
<hr/>	
Net assets acquired:	
Property, plant and equipment	584,260
Trade receivables	1,894,839
Bank and cash balances	1,676,538
Trade and other payable	(2,642,479)
Other tax payable	(74,300)
	<hr/>
	1,438,858
Minority interest	(575,543)
Goodwill	551,785
	<hr/>
Total consideration, satisfied by cash	1,415,100
	<hr/> <hr/>
Net cash inflow arising on acquisition	
Cash consideration paid	(1,415,100)
Cash and cash equivalents acquired	1,676,538
	<hr/>
	261,438
	<hr/> <hr/>

The goodwill arising on the acquisition of SinoCom – Artm Technology Co., Ltd. is attributable to the anticipated profitability of the distribution of the Group's service in the new markets and the anticipated future operating synergies from the acquisition.

SinoCom – Artm Technology Co., Ltd. contributed HK\$5.31 million to the Group's revenue and HK\$0.79 million to the Group's profit before tax for the period between the date of acquisition and the balance sheet date.

Management Discussion and Analysis

FINANCIAL REVIEW

Operating results for the Period

Turnover

Turnover of the Group for the six months ended 30 June, 2005 (the “Period”) amounted to approximately HK\$123 million, representing an increase of approximately HK\$42 million, or 52%, over the same period in 2004. Revenue was derived from outsourcing software development services and from technical support services, which accounted for approximately 94% and 6% of the total revenue respectively. Market segments remained unchanged. Outsourcing software development services and technical support services were provided solely to customers located in Japan and China during the Period. Increase in turnover was mainly contributed to the increase sales of approximately 65% and 66% respectively from the same period in 2004 to the two largest customers in Japan. Revenue from these two customers accounted for approximately 80% of the total revenue. Revenue from customers in China recorded a surge of growth at approximately 168% as compared to the same period in 2004. The growth was mainly generated from testing and localization service revenue of approximately HK\$5.3 million derived from customers of the newly acquired subsidiary and from technical support service revenue derived from both new and existing customers. Revenue proportion of outsourcing software development business models under project basis and agreed man-month basis was 49:51 during the Period.

Gross profit and cost of sales

Gross profit of the Group for the Period amounted to approximately HK\$65.6 million, representing an increase of approximately HK\$23.9 million or 57.4%, over that for the same period in 2004.

Management Discussion and Analysis

Cost of sales increased to approximately HK\$57.5 million, representing an increase of approximately HK\$18.1 million or 45.9% compared to the same period in 2004. Employee costs consisted of basic salary, welfare and project bonus were the largest components of the cost of sales, which accounted for approximately 73.3% of the total cost of sales. Full time employees of the Group increased by 40% from 909 as at 30 June, 2004 to 1,273 as at 30 June, 2005, representing an addition of 364 headcount. Associated employee costs increased by approximately HK\$12.7 million or 43% as compared to the same period in 2004. Sub-contracting out fees, rent and utilities, and traveling and accommodation accounted for approximately 6%, 9%, and 7% of the total cost of sales for the Period respectively also recorded increases due to additional headcount requirements, new space to house additional headcounts, and more frequent travel to work with customers in Japan.

Foreign exchange loss

The Group's major revenue and foreign currency assets are denominated in Japanese Yen which depreciated against Hong Kong dollars during the Period. The Group suffered foreign exchange loss of approximately HK\$6.2 million as a result. However, the loss was mainly made up of unrealized exchange loss when translating its foreign currency assets at Period end to the reporting currency.

Operating expenses

Operating expenses during the Period increased to approximately HK\$17.6 million, representing an increase of approximately HK\$4.6 million or 35.4% over the same period in 2004. HK\$3.5 million of the increase was attributable to the share option expenses charged for the Period. The remaining increase was attributable to salary and headcount increments of management staff.

Management Discussion and Analysis

LIQUIDITY AND FINANCIAL RESOURCES

Net assets

As at 30 June, 2005, the Group recorded total assets of approximately HK\$309.6 million which were financed by liabilities of HK\$23.6 million, minority interests of HK\$1.5 million and equity of HK\$284.5 million. The Group's net assets value as at 30 June, 2005 increased by 9.4% to approximately HK\$286 million as compared to approximately HK\$261.5 million as at 31 December, 2004.

Liquidity

The Group had a total cash and bank balances of approximately HK\$251.5 million as at 30 June, 2005 (As at 31 December, 2004: approximately HK\$247.3 million). There was neither bank borrowing nor non-current liability and hence the Group is at a nil gearing position. As at 30 June, 2005, the current ratio was increased to 12.7 from 9.4 as at 31 December, 2004.

Treasury policies

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

Foreign exchange exposure

The Group generates most of the revenue in Japanese Yen and incurs most of the costs in RMB. Any depreciation of Japanese Yen against RMB will result in decrease in the income of the Group, which will have an adverse impact on the Group's profitability. To minimize exposure on foreign exchange fluctuations, the Group will from time to time review its foreign exchange position and adopt appropriate measures. As at 30 June, 2005, cash and bank balances of the Group consist of Hong Kong dollars, United States dollars, Japanese Yen, and RMB in the proportion of approximately

Management Discussion and Analysis

26%, 12%, 41%, and 21%. The Group's RMB balance is enough to finance its RMB expenses for the coming half year. The Group will convert its foreign currencies into RMB whenever exchange rates are favorable as reserve. Given the Group's recurring foreign exchange cash flow pattern, there are not many matching hedge tools available.

OUTLOOK

In the first half of 2005, the trend of software outsourcing from Japan to China continued to grow. Directors believe that this trend will continue as more Japanese customers are exploring to outsource software development work in China. The Group signed up two new agreements with another two renowned Japanese customers during the Period. Given the strong demand and the Group's operating scale, the Directors believe that it is a seller's market in which the Group is able to select long term large scale projects among its customers.

During the Period, a subsidiary was also set up in Dalian where human resources are concentrated in order to recruit engineers located there. Other than to grow organically, the Group is actively seeking opportunities to acquire companies engaged in Japan outsourcing software development in both China and Japan.

Directors expect technical support services will continue to grow. The Group's existing service network has expanded to cover 18 major cities in China already. This network will bring new business opportunities to the Group when more foreign companies enter into China after the fully open of WTO.

The Group also developed business relations with US companies in China and will lever the resources from the newly acquired subsidiary to handle the business. The Directors are also exploring cooperation possibility with India companies in this regard.

EMPLOYEE AND REMUNERATION POLICIES

As at 30 June, 2005, the Group employed approximately 1,273 employees in China and Japan. Employees are remunerated based on their performance, work experience and the prevailing market rates. Performance related bonuses are granted on a discretionary basis. Other employee benefits include pension fund, insurance and medical coverage, training programs and participation in the Group's share option scheme.

Management Discussion and Analysis

DIRECTOR'S INTEREST IN SECURITIES

As at 30 June, 2005, the interests and short positions of the Directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any of its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) (the "SFO") as recorded in the register maintained by the Company under section 352 of the SFO or otherwise notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies were as follows:

(a) Interests in the Company

Name of Director	Capacity/ Nature of interest	No. of shares of the Company	Note	Approximate percentage of shareholding
Mr. Wang Xubing	Interest of a controlled corporation	140,750,000(L)	1	52.11%
Mr. Wang Zhiqiang	Interest of a controlled corporation	140,750,000(L)	2	52.11%
Dr. Shi Chongming	Beneficial owner	1,010,800(L)		0.37%
Mr. Siu Kwok Leung	Beneficial owner	1,070,000(L)		0.40%

Notes:

1. These shares are beneficially owned by China Way International Limited ("China Way"). By virtue of his 51% shareholding interest in China Way, Mr. Wang Xubing is deemed or taken to be interested in the 140,750,000 shares of the Company owned by China Way for the purpose of the SFO.
2. These shares are beneficially owned by China Way. By virtue of his 49% shareholding interest in China Way, Mr. Wang Zhiqiang is deemed or taken to be interested in the 140,750,000 shares of the Company owned by China Way for the purpose of the SFO.
3. The letter "L" denotes a long position in shares.

Management Discussion and Analysis

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

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

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

Save as disclosed above, as at 30 June 2005, there was no other Director or chief executive of the Company who had any interest or short position in shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO) which were recorded in the register maintained by the Company under section 352 of the SFO or otherwise notified to the Company and the Stock Exchange pursuant to the Model Code.

DIRECTORS' RIGHTS TO ACQUIRE SHARES

As at 30 June, 2005, no option was granted to Directors to acquire shares in the Company. At no time during the Period were rights to acquire benefits by means of the acquisition of shares in the Company granted to any Director or any of their respective associates (as defined in the Rules Governing the Listing of Securities on the Stock Exchange), or were any such rights exercised by them; or was the Company or any of its subsidiaries a party to any arrangement that enabled any Directors to acquire such rights in any other body corporate.

Management Discussion and Analysis

SUBSTANTIAL SHAREHOLDERS

As at 30 June, 2005, the following parties (other than the Directors or the chief executive of the Company) were recorded in the register kept by the Company under section 336 of the SFO as being directly or indirectly interested, or had short positions, in the shares and underlying shares of the Company.

Name of shareholder	Capacity/ Nature of interest	No. of shares of the Company	Note	Approximate percentage of shareholding
China Way	Beneficial owner	140,750,000 (L)		52.11%
Legend New-Tech Investment Limited	Beneficial owner	14,960,782 (L)		5.54%
Right Lane Limited	Interest of a controlled corporation	14,960,782 (L)	1	5.54%
Legend Holdings Limited	Interest of a controlled corporation	14,960,782 (L)	2	5.54%
Chinese Academy of Sciences Holdings Co., Ltd.	Interest of a controlled corporation	14,960,782 (L)	3	5.54%
Employee's Stock Society of Legend Holdings Limited	Interest of a controlled corporation	14,960,782 (L)	4	5.54%
Madam Zhang Yue	Interest of spouse	140,750,000 (L)	5	52.11%
Madam Yuan Yue Ling	Interest of spouse	140,750,000 (L)	6	52.11%

Management Discussion and Analysis

Notes:

1. Right Lane Limited is beneficially interested in the entire issued share capital of Legend New-Tech Investment Limited (“Legend New-Tech”). By virtue of its 100% interest in Legend New-Tech, Right Lane Limited is deemed or taken to be interested in the 14,960,782 shares beneficially owned by Legend New-Tech.
2. Legend Holdings Limited is beneficially interested in the entire issued share capital of Right Lane Limited. By virtue of its 100% interest in Right Lane Limited, Legend Holdings Limited is deemed or taken to be interested in the 14,960,782 shares beneficially owned by Legend New-Tech.
3. Chinese Academy of Sciences Holdings Co., Ltd. is beneficially interested in a 65% equity interest in Legend Holdings Limited. By virtue of its interest in Legend Holdings Limited, Chinese Academy of Sciences Holdings Co., Ltd. is deemed or taken to be interested in the 14,960,782 shares beneficially owned by Legend New-Tech.
4. Employee’s Stock Society of Legend Holdings Limited is beneficially interested in 35% equity interest in Legend Holdings Limited. By virtue of its interest in Legend Holdings Limited, Employee’s Stock Society of Legend Holdings Limited is deemed or taken to be interested in the 14,960,782 shares beneficially owned by Legend New-Tech.
5. Madam Zhang Yue is the wife of Mr. Wang Xubing and is deemed to be interested in the 140,750,000 shares in which Mr. Wang Xubing is deemed or taken to be interested for the purposes of the SFO.
6. Madam Yuan Yue Ling is the wife of Mr. Wang Zhiqiang and is deemed to be interested in the 140,750,000 shares in which Mr. Wang Zhiqiang is deemed or taken to be interested for the purposes of the SFO.
7. The letter “L” denotes a long position in shares.

Save as disclosed above, as at 30 June 2005, there was no other person (not being a Director or a chief executive of the Company) who had any interest or short position in shares or underlying shares of the Company which were recorded in the register required to be kept under section 336 of the SFO.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY’S SECURITIES

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

Management Discussion and Analysis

REVIEW BY AUDIT COMMITTEE

The existing audit committee of the Company comprises all the three independent non-executive directors, namely Mr. Lee Kit Wah who has professional accounting qualification, Mr. Pang Chor Fu and Professor Li Weian. The audit committee has reviewed with the management the accounting principles and practices adopted by the Group. The audit committee has also discussed auditing, internal control and financial reporting matters with the management and reviewed the unaudited interim financial statements of the Group set out in this interim report.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted a code of conduct regarding Directors' securities transactions on terms no less exacting than the required standard set out in the Model Code. Having made specific enquiries to all Directors, all Directors have complied with the required standard set out in the Model Code and its code of conduct regarding Directors' securities transactions.

CORPORATE GOVERNANCE

The Company has applied the principles and complied with all code provisions except code provision A.2.1, that Mr. Wang Zhiqiang is acting as both chairman and chief executive officer of the Company, of the Code on Corporate Governance Practices as set out in Appendix 14 of the Listing Rules throughout the Period.

Mr. Wang Zhiqiang, founder of the Group, plays an important role as the chairman to formulate corporate strategies of the Group at the board level. On the other hand, his management experience accumulated since establishment of the Group in its daily operations is indispensable in the outsourcing software development industry in the PRC which is a relatively new industry and the Group is one of the first movers. He will continue to play these two roles in the near future.