

# Executive Director's Statement

On behalf of the board of directors ("Directors") of China Northern Enterprises Investment Fund Limited (the "Company") I take pleasure in presenting to you the Group's annual report and audited financial statements of the Company and its subsidiaries (collectively the "Group") for the year ended 30 June 2005.

## **BUSINESS REVIEW**

During the year under review, the People's Republic of China (the "PRC") government continued to implement strict macro-economic measures to control the growth of various key industries that were seen as overheated. As a result, the price of PRC-related stocks experienced a prolonged downward trend since mid 2004. The upward trend of global interest rates as well as record high oil prices also cast further uncertainties in the global capital markets and hindered the progress of many of the Group's investment projects.

In the midst of such market conditions, the Group still maintained its positive long term view of the PRC market and continued to search for unique direct investment opportunities with the potential for steady returns even in times of volatile market conditions.

During the year under review the Group continued to actively pursue attractive investment opportunities primarily in the PRC market. While there were a number of potential projects on hand, the Group adhered to a strategy of focusing on investing in companies which either had a distinct market niche, held exclusive rights or licences or possessed proprietary technologies that allow them to gain extraordinary profits from their operations.

In order to strengthen its shareholder base and increase its financial resources to be in a more flexible position to take on potential investment projects, the Company entered into two share placement agreements during the year under review. The first placement was entered into on 18 November 2004, under which the Company placed 10,600,000 new shares at a price of HK\$0.47 per placing share. The net proceeds from the placing amounted to approximately HK\$4.8 million. A second placement agreement was entered into on 18 February 2005, under which the Company placed 10,600,000 new shares at a price of HK\$0.56 per placing share. The net proceeds from the second placing amounted to approximately HK\$5.8 million. The total proceeds from the two share placements have been used to increase the number of unlisted companies under the Company's portfolio and also to diversify the Company's investments in securities of listed companies.

As at 30 June 2005, 14% of the Group's portfolio of investment assets were in listed investments and 86% in unlisted investments.

## **INVESTMENT PORTFOLIO**

### **Ferndene Limited**

The Group acquired a 3.33% interest in Ferndene Limited ("Ferndene"). At the time of its initial inception, Ferndene was incorporated as a privately held investment fund to organize, operate and manage government designated Internet cafes in the PRC. A wholly-owned subsidiary of Ferndene has secured the exclusive rights from one of the six licensees permitted by the PRC Ministry of Culture to invest in and operate a franchise of Internet cafes in ten different administrative regions across the PRC.

### **Quidam Assets Limited**

The Group owns a 2.44% interest in Quidam Assets Limited ("Quidam"). Quidam's subsidiary Orbrich International Factors Company Limited ("OIF") is currently the only wholly foreign-owned financial guaranty and factoring company in China. OIF is licensed by the Tianjin Government and the PRC Ministry of Commerce to provide factoring services that include financing, sales ledger administration and debt collection. It serves companies primarily in Beijing, Tianjin, Shanghai and Dalian.

#### **Four Gold OG Limited**

During the year under review, the Group acquired approximately 3.04% interest in Four Gold OG Limited ("FGOG"), which develops, owns and operates the only real-time metering and billing infrastructure for digital content distribution in the PRC. FGOG is a Singapore based company which is engaged in the licensing and distribution of digital content, such as online games, music, education, entertainment and financial information, in the PRC. It is also the intellectual property owner of the FGOG L7 Platform which enables third party content providers to distribute their digital content in the PRC whilst being able to monitor the real-time sales and payment status of their services remotely from anywhere on the world. The FGOG L7 Platform is currently the only platform available in the PRC which can handle content and application based billing scenarios on a real time basis. Hence FGOG is in a strong position to benefit from the explosive growth in the coming years of e-commerce and Internet content services in the PRC.

#### **Mellow Anti-Counterfeit Net System Company Limited**

Mellow Anti Counterfeit Net System Company Limited ("Mellow") is principally engaged in the development and application of patented anti counterfeiting applications and devices to protect branded consumer level products such as cigarettes and wines. The Group currently holds a 12% stake in Mellow.

#### **China SMS Group Limited**

The Group currently owns a 10% interest in China SMS Group Limited ("China SMS"). China SMS is an ensemble of China and Hong Kong based Internet companies providing value-added multimedia products and services. Its primary business segments include corporate based SMS services as well as wireless data services and commercial enterprise solutions.

#### **CNI Bullion Limited**

During the year under review the Group acquired a 30% stake in CNI Bullion Limited ("CNI Bullion") at the inception of the company in March 2005. CNI Bullion is a member of the Chinese Gold and Silver Exchange Society and was formed in March 2005 by a group of experienced bullion traders. CNI Bullion's services include trading of London Gold, local Hong Kong Gold and London Silver; providing the latest news of major financial markets; and also other ancillary value-added services including price alerts through instant mobile phone messaging.

The Group believes that each of the above unlisted investee companies has a unique market position either through the holding of exclusive rights and licences or by providing high value added niche products and services. Hence the Group sees potential growth from its investee companies.

#### **Investments in Securities**

The Group also invested in a portfolio of securities mainly in listed companies engaged in a variety of unique and high-growth industries in the PRC market. The Group believes that the proven revenue models and strong company fundamentals of its investments will provide attractive returns to the Group in the long run.

## PROSPECTS

The vision of the Group is to become the world's premier listed absolute return fund focused on alternative investment opportunities in the PRC. The Group will continue to seek direct investment opportunities that capitalize on the PRC's evolving economy and developing regulatory and economic environment. The objective of these investments is to generate more consistent and less volatile returns and also to offer positive returns even in times of falling traditional market trends.

In the upcoming future the Group will be actively seeking investment projects in three key sectors of the PRC and Hong Kong markets, including financial services, telecommunications, and education. Under the Group's direct investment initiatives the investment projects must fulfill several prerequisites: (i) ownership of government-backed or exclusive operating rights; (ii) prospects of rapid expansion in revenue; and (iii) ownership of proprietary technologies or intellectual properties. The Group believes that companies which possess these competitive advantages are likely to sustain high growth potential and have a strong basis for an eventual IPO or equity sale at favorable valuations, hence having a positive impact on the Group's net asset value as well as generating consistent investment return in the long run.

In January 2005, the Group appointed one executive director and one non-executive director who has subsequently become an executive director in September 2005. The new management team will bring in a wealth of experience and expertise in the respective areas of fund management and corporate finance. Together with their industry experience with PRC companies, the new management team will be in a better position to seek and identify worthwhile investment opportunities in the PRC market.

The PRC economy is likely to face significant challenges ahead as the government continues to implement macro-economic policies to regulate the growth of the overheated economy. Rising interest rates and fluctuating oil prices will also lead to market uncertainties. However, the Group is confident that these short-term challenges will not undermine the assured long-term growth of the PRC economy. The Group will be increasingly stringent in selecting only quality investment projects with solid fundamentals that will bring in dividend income and capital appreciation in times of both rising and falling financial market trends.

## APPRECIATION

The Board would like to take this opportunity to express our gratitude to all management terms and staff members for their dedication and contribution this past year. We would also like to extend our sincere thanks and appreciation to our shareholders and business partners for their continued support and confidence in the Group.

**Chui Tak Keung, Duncan**

*Executive Director*

Hong Kong, 28 October 2005