

## CHAIRMAN'S STATEMENT



I am pleased to present our annual report for the year ended 31 December 2005 to the shareholders.

### OPERATING RESULTS

Total revenues for the year ended 31 December 2005 increased by 24.7% to RMB1,426.4 million compared with the same period last year. Revenues from our Internet value-added services ("IVAS") increase by 79.2% to RMB786.7 million, revenues from our mobile and telecommunications value-added services ("MVAS") decreased by 19.3% to RMB517.3 million and revenues from online advertising increased by 105.9% to RMB112.8 million.

The Group's audited profit after tax for the year ended 31 December 2005 was RMB485.4 million, an increase of 10.0% compared with the results for the year ended 31 December 2004. Basic and diluted earnings per share for the year ended 31 December 2005 were RMB0.274 and RMB0.267 respectively.

### BUSINESS REVIEW

Our R&D investment and the successful execution of product strategies in 2005 have laid solid foundation for the long term growth of our businesses. In 2005, we achieved new records for peak simultaneous online user accounts for our Instant Messaging ("IM") platform and QQ Game portal, as well as drove significant traffic growth on QQ.com portal and our 2.5G/3G WAP portal. We have also broadened monetization by rolling out a large collection of value-added service, including online identities products such as Qzone and QQ Pet; online games such as our first self-developed advanced casual game, QQ Tang, and our first self-developed Massive Multi-player Online Game ("MMOG"), QQ Fantasy. In addition, revenue from our online advertising business increased by more than 100% during the last 12 months. To position us for market opportunities in the longer term, we ventured into e-commerce via the launch of a C2C auction platform, Paipai.com, along with an escrow online payment system, TenPay.

In 2005, our QQ IM platform showed healthy growth notwithstanding the implementation of certain measures to reduce idle logins and to limit the usage of our platforms for “spam” messaging. As at the end of 2005, our IM platform had approximately 202 million active registered user accounts, a growth of 49.8% over 2004. The peak simultaneous online user accounts for our IM services was approximately 18.4 million, a growth of 95.7% over 2004. According to i-Research's annual survey of IM usage in China, 78.8% respondents chose QQ as their “most frequently used IM software” in 2005, an increase from 76.7% in 2004.

As at the end of 2005, QQ Game portal registered 2 million peak simultaneous online user accounts. We released a number of new mini casual games during the year and to date offered a total of 34 mini casual games as at the end of 2005. In relation to MMOG, QQ Fantasy was commercialized in December.

Revenue of our online advertising business for 2005 increased by more than 100% over 2004 as a result of increased IM and portal traffic and brand marketing of QQ.com. As we dedicate further resources in the business, we believe our online platforms will become increasingly popular to advertisers, bringing in additional revenues for the Group.

2005 proved to be a tough year for our MVAS business. The termination of the 161 M-chat fee sharing arrangement with China Mobile had a negative impact on our business. In addition, we continued to experience “cleaning up” of inactive user accounts by mobile operators. These factors resulted in a decrease in our fee-based mobile and telecommunications value-added services registered subscriptions and revenues.

### DIVIDEND

The directors have recommended the payment of a final dividend of HKD 0.08 per share (2004: HKD0.07) for the year ended 31 December 2005. The dividend will be payable on 7 June 2006, to shareholders whose names appear on the Register of Members of the Company on 24 May 2006.

### BUSINESS OUTLOOK

During 2005, we continued to witness rapid growth in the China Internet and wireless markets. According to China Internet Network Information Center (“CNNIC”), China's Internet population increased by 18% during 2005 and reached 111 million at the end of 2005. Despite the rapid multi-year growth, Internet penetration in China remained low at 8.5% as at 31 December 2005, providing potential additional growth. Also according to CNNIC, mobile population in China increased by 17% during 2005 and reached 393 million at the end of 2005. To cater for the user market and in anticipation of further growth, we invested heavily in R&D during 2005. During the year, we launched many new products and services in key business areas including new IM functionalities, Internet value-added services, online games and content for our QQ.com portal. In addition, we have also dedicated special efforts to strengthening our payment platforms to bill and collect revenues from our users. These efforts have helped us achieve significant growth in our Internet value-added services and doubled our online advertising revenue during the last 12 months. More importantly, these investments are intended to build a strong foundation for us to better serve our users and provide more compelling value-added services to them going forward. We believe that it is extremely important to keep strengthening our R&D and our pool of talents in order to stay ahead in this attractive yet increasingly competitive market.

In our core IM platform, our QQ IM service remained the most popular IM service in China and has achieved a new record of over 200 million active user accounts and our estimated active peak simultaneous online user accounts was 16.7 million. We aim to better serve this large community of users not only through enhancing the platform's functionalities and safety, but also through providing more value-added services that address the many facets of our users' online lives, including staying in touch with others, access to content, getting entertained and conducting commercial transactions.

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During the fourth quarter of 2005, our Internet value-added services were driven by favorable user responses to our family of online identities products and strong growth in our online games business. In the area of online identities products, we built on the success of QQ Show and launched Qzone and QQ Pet in the course of 2005. Qzone and QQ Pet have received good initial response from our users and have accumulated a sizable user base. Our plan is to continue upgrading our technical platforms and refining our products accordingly such that we can provide better experiences to our users. In our online games business, QQ Game portal remained the leading casual games platform in China with over 2 million peak simultaneous online user accounts. We aim to monetize its leadership by increasing paid subscriptions and game item sales. We also plan to leverage this popular platform to present advanced casual games, which generally have stronger monetization mechanism, to our users. In 2005, our first self-developed advanced casual game, QQ Tang, was quite successful in generating both user traffic and revenue. We plan to launch more advanced casual games, including both licensed and self-developed, during the course of 2006. In the fourth quarter of 2005, our first self-developed MMOG, QQ Fantasy, made a remarkable debut by achieving 660,000 peak simultaneous online user accounts online during open beta testing. We began charging for the game in December and believe it will increase our online games revenue. After significant investments in online games, we expect our online games revenue to increase significantly.

During 2005, our mobile and telecommunications value-added services were negatively affected by changes in industry policies and intensifying competition. While visibility remains low in the near term, we are making proactive steps to manage these challenges by cooperating closely with telecom operators and strengthening our own competitiveness. We are looking into developing new features and products to create more value for our users. To prepare us for the advent of 3G, we are also customizing our Internet-based services, such as networked mini-casual games, music and online community services, for our wireless platforms.

The online advertising industry in China continued its secular growth trend in 2005 as the Internet gained increasing popularity as a mass media. We believe we will benefit from this secular trend. In addition, we also aim to grow our advertising revenue by developing better advertising solutions to leverage our unique suite of online properties, investing in the branding of QQ.com, building a strong sales team, and cultivating strong relationships with leading advertisers and media agencies in China.

### APPRECIATION

The dedication of the management and staff of the Group is an important ingredient necessary to meet the challenges and opportunities ahead. We would like to take this opportunity to record our cordial thanks to them all.

**Ma Huateng**

*Chairman*

Hong Kong, 22 March 2006