

NOTES

1. Basis of preparation and accounting policies

The unaudited condensed consolidated accounts of Sun Innovation Holdings Limited and its subsidiaries (together the "Group") as at and for the six months ended 30th June 2004 have been prepared in accordance with Statement of Standard Accounting Practice ("SSAP") 25 – Interim Financial Reporting issued by Hong Kong Institute of Certified Public Accountants.

The unaudited condensed consolidated accounts should be read in conjunction with the annual accounts of the Group as at and for the year ended 31st December 2003.

The accounting policies and method of computation used in the preparation of the condensed consolidated accounts are consistent with those used in the annual accounts as at and for the year ended 31st December 2003.

2. Turnover and segment information

The Group was principally engaged in the following businesses during the period:

- (i) telecommunications;
- (ii) media and content services including telecommunication value added services; and
- (iii) property investment.

The Group had disposed of fire protection and suppression business in Hong Kong and in Shanghai in September 2003 and June 2004 respectively. Comparative figures have been reclassified to conform to the current period's presentation.

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NOTES (continued)

2. Turnover and segment information (continued)

An analysis of the Group's revenues and results for the period by business segment is as follows:

	Six months ended 30th June 2004					
	Continuing operations			Discontinued operations		
	Telecomm-unications	Media and Content Services	Property Investment	Total Continuing Operations	Fire Protection and Suppression	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Turnover	4,018	18,053	1,602	23,673	9,424	33,097
Segment results	(2,098)	(34,819)	827	(36,090)	(1,274)	(37,364)
Loss on disposal of discontinued operations						(1,006)
Unallocated revenue						945
Unallocated costs						(8,336)
Finance costs						(2,628)
Loss before taxation						(48,389)
Taxation						(4)
Minority interests						1,049
Loss attributable to shareholders						(47,344)

NOTES (continued)**2. Turnover and segment information (continued)**

	Six months ended 30th June 2003				
	Continuing operations		Discontinued operations		
			Fire		
			Protection		
			and		
			Suppression		
Telecomm- unications HK\$'000	Property Investment HK\$'000	Total Continuing Operations HK\$'000	Fire Protection and Suppression HK\$'000		Total HK\$'000
Turnover	9	1,754	1,763	21,595	23,358
Segment results	(1,083)	(481)	(1,564)	(2,048)	(3,612)
Unallocated revenue					393
Unallocated costs					(8,568)
Finance costs					(303)
Loss before taxation					(12,090)
Tax credit					409
Minority interests					215
Loss attributable to shareholders					(11,466)

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NOTES (continued)

2. Turnover and segment information (continued)

An analysis of the Group's turnover and contribution to operating profit/(loss) for the period by geographical segment is as follows:

	Turnover		Contribution to profit/(loss)	
	Six months ended		Six months ended	
	30th June		30th June	
	2004	2003	2004	2003
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Continuing Operations				
Hong Kong	16,320	1,402	(10,120)	(9,524)
Mainland China	4,082	361	(34,827)	(546)
United States of America	3,271	—	(649)	—
	23,673	1,763	(45,596)	(10,070)
Discontinued Operations				
Hong Kong	—	13,972	—	500
Mainland China	9,424	7,623	(1,748)	(1,896)
	33,097	23,358	(47,344)	(11,466)

NOTES (continued)**3. Operating loss**

Operating loss is stated after crediting/charging the following:

	Six months ended 30th June	
	2004	2003
	HK\$'000	HK\$'000
<i>Crediting</i>		
Interest income	7	3
<i>Charging</i>		
Loss on disposal of fixed assets	182	6
Provision for litigation cases	–	750
Provision for legal costs for litigation cases	1,481	–
Staff costs (including directors' emoluments)	13,375	7,880
Amortisation of goodwill and patent	6,532	2,373
Depreciation of fixed assets	1,268	1,903

4. Taxation

The amount of taxation credit/(charge) in the unaudited condensed consolidated profit and loss account represents:

	Six months ended 30th June	
	2004	2003
	HK\$'000	HK\$'000
Current tax		
Hong Kong profits tax		
– current period	(1)	–
– over provision in prior years	–	494
Overseas tax	(3)	(85)
	(4)	409

Hong Kong profits tax has been provided at the rate of 17.5% on the estimated assessable profit for the period. Taxation on overseas profits has been calculated on the estimated assessable profit for the period at the rates of taxation prevailing in the countries in which the Group' subsidiaries operate.

5. Dividends

The Directors do not recommend the payment of an interim dividend for the six months ended 30th June 2004 (2003: Nil).

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NOTES (continued)**6. Loss per share**

The calculation of basic loss per ordinary share is based on the Group's loss attributable to the shareholders of HK\$47,344,000 (2003: HK\$11,466,000) and the weighted average number of 4,690,113,698 (2003: 4,301,992,046) ordinary shares in issue during the six months ended 30th June 2004.

The exercise of share options would have anti-dilutive effect on the basic loss per share and accordingly no information in respect of the diluted loss per share for 2004 and 2003 is disclosed.

7. Intangible Assets

	Goodwill HK\$'000	Patent HK\$'000	Total HK\$'000
Balance at 1 January 2004	61,745	755	62,500
Acquisition of subsidiaries	3,105	—	3,105
Amortization charge	(6,485)	(47)	(6,532)
Impairment charge	(27,978)	—	(27,978)
Disposal of subsidiaries	—	(708)	(708)
Balance at 30 June 2004	30,387	—	30,387

8. Trade receivables

The Group normally allows an average credit period of 60 days to trade customers. Included in trade and other receivables are trade receivables and their ageing analysis is as follows:

	30th June 2004 HK\$'000	31st December 2003 HK\$'000
Current	3,104	5,000
31 – 60 days	2,872	4,901
61 – 90 days	2,966	2,937
Over 90 days	3,509	3,234
	12,451	16,072

9. Trade payables

Included in trade and other payables are trade payables and their ageing analysis is as follows:

	30th June 2004 HK\$'000	31st December 2003 HK\$'000
Current	2,135	2,453
31 – 60 days	362	1,418
61 – 90 days	393	1,961
Over 90 days	6,731	4,112
	9,621	9,944

NOTES (continued)**10. Related Party Transactions**

- (a) The Group had paid consultancy fee of HK\$21,000 on normal commercial terms to a technology company. A director owned that technology company and subsequently disposed of it before March 2004.
- (b) During the period under review, a newly acquired subsidiary in Hawaii had paid approximately HK\$0.7 million for the content services and telecommunications networking services to a company which is owned by a director of the subsidiary. The transactions were made based on the contracts stipulated before that Hawaii company became the subsidiary of the Group. All these contracts were terminated by the end of August 2004.

BUSINESS REVIEW

The businesses of the Telecommunications Segment and the Media and Content Services Segment of the Group grew steadily during the period under review. Our Management has shown persistence effort in exploring and developing global business opportunities for the Group. The consolidated turnover of the Group amounted to HK\$33,097,000, increased by 42% when compared to that of the corresponding period last year. Gross profit was approximately HK\$15,076,000, increased by 36%. Loss for the period attributable to shareholders amounted to HK\$47,344,000, enlarged by 313% as compared to that of the corresponding period last year. During the period under review, the Group recognized impairment loss of goodwill on Mainland China operations of Media and Content Services Division of HK\$27,978,000 as a result of review of its recoverable amount.

The shareholders' funds were decreased to HK\$93,551,000 and the net current assets were amounted to HK\$7,506,000 as at 30th June 2004.

Acquisition and Disposal of Subsidiaries and Significant Capital Expenditure

During the period, the Group has acquired a wholly owned Hawaii subsidiary in January 2004, which engaged in IP network business in Hawaii and interconnected with Japan customers via fiber optic network to support customers' IP voice and data requirements. The acquisition of the Hawaii subsidiary resulted a goodwill of HK\$3.1 million. The Hawaii subsidiary generates HK\$3.3 million turnover and resulted HK\$0.6 million loss to the Group during the period under review. On 30th March 2004, the Group has entered into a sale and purchase agreement with Mr. Fang Gui Fang, the ultimate beneficial owner of the 49% interest in the ex-joint venture subsidiary, Mansion Wananda Fire System Co. Ltd. to dispose of a wholly-owned subsidiary to Mr. Fang at the consideration of RMB5 million. Details of the transaction are disclosed on the announcement dated 31st March 2004. The completion of this disposal has been taken placed on 30th June 2004.

In addition, the Group spent HK\$1,908,000 in purchasing fixed assets.

SUN INNOVATION HOLDINGS LIMITED**BUSINESS REVIEW *(continued)*****Telecommunications Division**

This Division recorded a turnover of HK\$4,018,000 and segment loss of HK\$2,098,000 for the six months ended 30th June 2004. This Division has expanded the business by the acquisition of a Hawaii company to develop United States market.

Telecommunications industry in Hong Kong is still in consolidation situation with keen competition, low profit margin. This Division closely monitors the Hong Kong market and adopts prudent manner to run and develop the business in Hong Kong. As at 30th June 2004, this Division provides wholesale voice services to 6 major international carriers and service providers.

Our Hawaii subsidiary will launch a new telecommunication services included "Talk4Less" long distance service in September 2004 and VOIP services in the year 2005. "Talk4Less" services allow customers to access our long distance network by dialling a local telephone number at lowest international rates and the services include residential prepaid service, business service, prepaid cards, credit card balance checking and recharge services.

Media and Content Services Division

During the period under review, this Division recorded a turnover of HK\$18,053,000, amounting to 55% of the Group's turnover. The operating loss for this Division for the period was HK\$34,819,000, amounting to 93% of the total segment loss. The heavy loss was mainly due to amortization and impairment of goodwill amounting to HK\$34,204,000.

Despite its popularity, the Company's primary musical product, such as mono and polyphonic ring tones, in the local telecommunications Value Added Services ("VAS") market is maturing. The poor operating environment was exacerbated by price reduction from the new market entrants during the first half of 2004. The Group's operating vehicle, Cellcast (Asia) Limited ("CAL"), continues to maintain market leadership through new musical products, e.g. true tone and new bundle offering of both musical and community product on prepaid cards. CAL also strengthened its market position by marketing arrangements with well known chain stores partners, e.g. Wilson Communications Limited. By entering into joint marketing effort with new partners, CAL has been able to save on promotional cost and achieve high gross margin of 47%. CAL also diversified its business and became a platform and services provider for mobile network operators. CAL has been selected as a service provider of Hutchison's 3 G services since its service launch. CAL also provides platform and services for other network operators on 2.5 G and 2.75 G platform.

BUSINESS REVIEW (continued)**Property Investment Division**

The Group has several investment properties in Hong Kong and Guangzhou, PRC. Most of the properties were leased out. This Division generates stable cash flow for the Group.

The results of this Division improved from a loss of HK\$481,000 to a profit of HK\$827,000 because of significant reduction in depreciation expenses. In year 2003, this Division had made provision for impairment losses on furniture and fixtures of approximately HK\$5.7 million.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

The Group had drawn down HK\$35 million long term loan in accordance with loan agreement with Station Investments Limited and used that fund to settle payable for acquisition of subsidiaries in 2003 of HK\$33.5 million in January 2004. The long term loan is secured by an equitable charge on the entire issued share capital of a subsidiary which is investment holding company and its subsidiary engages in property investment. Details of the loan agreement, equitable charge on a subsidiary's share capital and the acquisition of subsidiary were disclosed in the announcement dated 17th December 2003.

In order to cope with the development and expansion of the Group's businesses, the Group has explored different ways to strength liquidity and financial resources. During the period under review, the Group had increased the banking facilities amount, issued new shares and agreed with the lender to convert HK\$69 million long term loan into convertible preference shares.

The Group has consolidated all its banking facilities into DBS Bank (Hong Kong) Limited. As at 30th June 2004, the Group has total banking facilities at HK\$52 million which are secured by properties with a total net book value of HK\$125 million and cross guaranteed by the Company and its certain subsidiaries. The new banking facilities are interest bearing at prevailing market rates. In February 2004, the Group had issued 475,000,000 shares to settle HK\$11.4 million liabilities of one subsidiary. Details of the issue of shares were disclosed in the announcement dated 27th February 2004. During the period under review, 23.8 million share options at total consideration of HK\$476,000 were exercised. Furthermore, the Group agreed with the lender to convert HK\$69 million long term loan into convertible preference shares and issued 3,066,666,666 convertible preference shares on 12th July 2004. Details of the issue of convertible preference shares was disclosed in the circular dated 5th June 2004 of the Company.

As at 30th June 2004, the Group had cash and bank balances of approximately HK\$13.5 million (including pledged deposit of approximately HK\$8.6 million), bank overdrafts of approximately HK\$0.5 million, short term loan of HK\$7 million and the current portion of long term bank loan amounted to HK\$1.8 million. The current ratio as at 30th June 2004 was 1.26 (at 31st December 2003: 0.75).

SUN INNOVATION HOLDINGS LIMITED**LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE *(continued)***

As at 30th June 2004, the Group's gearing ratio, representing the Group's total liabilities divided by the shareholders' funds of the Group, is 1.27 (at 31st December 2003: 0.97).

EXCHANGE RATES EXPOSURE

Most of the income and expenditure of the Group were denominated either in Renminbi, United States dollars or Hong Kong dollars. In view of the stability of the exchange rate among these currencies, the Group has not been subject to material exchange rate fluctuation exposure and thus no financial instruments have been adopted for hedging purposes.

CONTINGENT LIABILITIES AND MATERIAL CHANGES

As at 30th June 2004, there was material outstanding litigation which was commenced by a third party contractors in July 2002, claiming against a bank which had served a third party notice to the Company, for a performance bond amounting to HK\$8,600,000 given by the Company to a former subsidiary in order for it to undertake an installation project with the third party contractor. The Group's bank deposits of HK\$8,630,000 were pledged for the purpose of this performance bond. The Directors, having sought independent legal advice, are of the opinion that the case is unclear at this stage as the amount of liability could not be measured with sufficient reliability. Accordingly, no provision has been made in respect of the claim.

Save as disclosed above, there have been no material changes in respect of any matters since the publication of the annual report for the year ended 31st December 2003.

EMPLOYEE

The Group adopts a competitive remuneration package for its employees based on their performance. Aside from salary payments, other benefits include contributions to provident fund schemes and medical subsidies. Salary review is conducted annually. The Group has provided various training and development programs and study leave to its staff.

As at 30th June 2004, the Group has 90 employees who are remunerated in accordance with job nature and market trend.

PROSPECTS

The Group has successfully developed a platform for gaming and value added services in Macau and has soft launched the services in August 2004. The customers can use their personal computers or mobile phones to access the gaming services via internet easily and efficiently. The Group has contracted with a major carrier in Macau and will invent more games with various content providers in the world for the coming future.

The Group's strategy in telecommunications field will be focused in gaming and content services and explore new business opportunities in Asia Pacific region and international global market as well.

PROSPECTS (continued)

Regarding the Media and Content business, according to the statistics released by the Office of Telecommunications Authority ("OFTA"), the number of 2.5 G mobile subscribers has exceeded 1 million by the end of June 2004. As the critical mass of mobile data users is forming, the Group will consider creating or aggregating more mobile data related product including mobile games and video. While voice based mobile subscriber penetration per population in Hong Kong has reached 111.5% in June 2004 (according to OFTA's statistics), the data based mobile subscriber penetration per population is only 14.7%. The Group considers there is a lot of room for expansion in this area.

The telecommunications VAS market for PRC has been very competitive during the first half of 2004 as a lot of large market participants are fighting for market share regardless of profitability. The Group's PRC operating vehicle faces severe competitive environment with a lot of well funded competitors. In this connection, the Group has adjusted its marketing and pricing strategy to a more defensive manner in PRC.

Despite all the external competition and difficulties, the management still considers global telecommunication and VAS markets, especially in PRC, will be a substantial growing market and therefore we are still optimistic in the long run.

SHARE OPTION SCHEMES

Details of the share options outstanding as at 30th June 2004 are as follows:

	Subscription Price/share HK\$	Exercisable period	Option Grant Date	No. of Options Granted '000	No. of options held at 1st January 2004 '000	No. of option exercised during the period '000	No. of option lapsed during the period '000	No. of Options outstanding at 30th June 2004 '000
Directors:								
Michele Matsuda	0.020	28/6/2004-27/6/2014	28/6/2004	200,000	-	-	-	200,000
Leung To Kwong, Valiant	0.020	2/12/2003-1/6/2006	2/6/2003	43,800	43,800	11,000	-	32,800
Cheung Chi Fai, Frank	0.022	18/3/2004-17/3/2006	18/3/2004	22,000	-	-	-	22,000
Yiu Ying Fai *	0.020	2/12/2003-1/6/2006	2/6/2003	43,800	43,800	12,800	-	31,000
Continuous contract employees (1)	0.020	2/12/2003-1/6/2006	2/6/2003	33,350	21,450	-	300	21,150
Continuous contract employees (2)	0.022	18/3/2004-17/3/2006	18/3/2004	92,350	-	-	-	92,350
Continuous contract employee (3)	0.020	30/6/2004-29/6/2006	30/6/2004	10,000	-	-	-	10,000
Others	0.020	2/12/2003-1/6/2006	2/6/2003	5,000	5,000	-	-	5,000

* Mr. Yiu has resigned as Director of the Company on 12th July, 2004.

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SHARE OPTION SCHEMES *(continued)*

The Directors consider it is inappropriate to value the options as a number of factors that are crucial for the valuation cannot be determined accurately. Accordingly, such information is not disclosed in the interim report.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN SHARES

As at 30th June 2004, the interests and short positions of the directors and chief executive of the Company and their associates in the shares and the underlying shares of the Company as recorded in the register required to be kept under Section 352 of the Securities and Futures Ordinance ("SFO") were as follows:

Name of director	Notes	Nature of interest	Number of shares	% of shares held
Michele Matsuda	(1)	Corporate	805,570,000	16.50%
Leung To Kwong, Valiant		Personal	11,000,000	0.23%
Cheung Chi Fai, Frank	(2)	Family	6,000,000	0.12%
Yiu Ying Fai	(3)	Personal	12,800,000	0.26%

Notes:

- (1) 805,570,000 shares are held by e-Compact Limited, a company wholly owned by Anglo Japan Enterprises Limited and beneficially owned by Mr. Michele Matsuda.
- (2) 6,000,000 shares are held beneficially by the spouse of Mr. Cheung Chi Fai, Frank.
- (3) Mr. Yiu Ying Fai has resigned as director of the Company on 12th July 2004.

Certain executive directors of the Company have been granted share options under the Company's share option schemes (details are set out under the section of Share Option Schemes above). These constitute interests in underlying share of the Company under the SFO.

DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS IN SHARES (continued)

Save as disclosed above, as at 30th June 2004, no interests and short position in the shares or underlying shares were held or deemed or taken to be held under Part XV of the SFO by any director or chief executive of the Company or any of their respective associates which are required pursuant to Section 352 of the SFO to be entered in the register referred to therein.

SUBSTANTIAL SHAREHOLDERS

As at 30th June 2004, the interests or short positions of the persons in the shares and underlying shares of the Company as recorded in the register required to be kept under Section 336 of the SFO, were as follows:

Name of shareholder	Notes	Number of ordinary shares	Number of convertible preference shares
Michele Matsuda	(1)	1,005,570,000	—
e-Lux Corporation	(2)	390,000,000	—
Circle Asia Inc.	(3)	475,000,000	—
Leung Kin Cheung, Patrick	(4)	371,240,000	3,066,666,666

Notes:

- (1) Mr. Matsuda held 805,570,000 ordinary shares of the Company through e-Compact Limited which are beneficially owned by him and 200,000,000 share options of the Company, representing approximately 16.50% and 4.10% of the issued capital of the Company respectively.
- (2) e-Lux Corporation held 390,000,000 shares of the Company, representing approximately 7.99% of the issued capital of the Company.
- (3) Circle Asia Inc. held 475,000,000 shares of the Company, representing approximately 9.73% of the issued capital of the Company.
- (4) Mr. Leung held 191,240,000 shares and 180,000,000 options of the Company, from which 178,770,000 shares and 180,000,000 options are held through Station Investments Limited which are beneficially owned by Mr. Leung. The total ordinary shares and underlying shares representing 7.61% of the issued capital of the Company. Mr. Leung also held 3,066,666,666 convertible preference shares of the Company through Station Investments Limited on 12th July 2004.