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INDEBTEDNESS

As at the close of business on 30th April, 2000, the Company did not have any banking facilities. As at the same date there were no outstanding borrowings, loans, finance lease or hire purchase payables, or contingent liabilities.

Disclaimers

Save as aforesaid or as otherwise disclosed herein, the Company did not have outstanding at the close of business on 30th April, 2000, any mortgages, charges or debentures or other capital or bank overdrafts, loans or other similar indebtedness, finance lease commitments, hire purchase commitments, liabilities under acceptances or acceptance credits or any guarantees or other material contingent liabilities.

The Directors have confirmed that, save as disclosed above, there has not been any material change in the indebtedness and contingent liabilities of the Company since 30th April, 2000.

DISCLOSURE UNDER CHAPTER 17 OF THE GEM LISTING RULES

The Directors have confirmed that as at 30th April, 2000, they were not aware of any circumstances which would give rise to a disclosure requirement under rules 17.15 to 17.21 of the GEM Listing Rules.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

Borrowings

The Company generally finances its operations with equity fundings.

As at the close of business on 30th April, 2000, the Company did not have any outstanding borrowings, loans or finance lease or hire purchase payables.

Commitments and contingent liabilities

As at 30th April, 2000, the Company had operating lease commitments of approximately RMB2,902,000 which expire through year 2002. As at the same date, the Company had no material contingent liability.

Net current assets

As at 30th April, 2000, the Company had net current assets of approximately RMB51,851,000. The current assets comprising cash and bank balances and cash in transit of approximately RMB66,059,000, accounts receivables of RMB1,714,000, due from related party balances of approximately RMB2,830,000, prepayments and other current assets of

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approximately RMB356,000 and inventories of approximately RMB2,430,000. The current liabilities comprising accounts payable and accrued liabilities of approximately RMB2,180,000 due to related party balances of approximately RMB2,881,000, taxes payable of approximately RMB619,000 and deferred revenue of RMB15,858,000.

Foreign exchange

Since substantially all of the Company's revenues are in RMB and expenses are paid in RMB, the Directors do not consider that the Company is exposed to any material foreign currency exchange risk.

TRADING RECORD

Set out below is a summary of the combined results of the Company for the years ended 31st December, 1998 and 1999. This summary is prepared on the basis of presentation set out in Note 2 of the accountants' report in Appendix 1 to this prospectus.

	1998 <i>RMB</i>	1999 <i>RMB</i>	1999 <i>HK\$</i> <i>(Note 3)</i>
REVENUES	3,029,002	10,419,234	9,807,261
COST OF REVENUES	<u>(2,958,731)</u>	<u>(7,153,681)</u>	<u>(6,733,510)</u>
Gross margin	<u>70,271</u>	<u>3,265,553</u>	<u>3,073,751</u>
SUBSIDY INCOME <i>(Note 1)</i>	<u>237,999</u>	<u>–</u>	<u>–</u>
OPERATING EXPENSES			
Research and development	(3,720,861)	(4,717,902)	(4,440,796)
Selling and marketing	–	(186,539)	(175,583)
General and administrative	<u>(1,555,100)</u>	<u>(2,741,268)</u>	<u>(2,580,260)</u>
Total operating expenses	<u>(5,275,961)</u>	<u>(7,645,709)</u>	<u>(7,196,639)</u>
Loss from operations	(4,967,691)	(4,380,156)	(4,122,888)
OTHER INCOME (LOSS), NET	<u>160,345</u>	<u>(106,087)</u>	<u>(99,856)</u>
LOSS BEFORE TAXATION	(4,807,346)	(4,486,243)	(4,222,744)
TAXATION	<u>–</u>	<u>–</u>	<u>–</u>
NET LOSS	<u><u>(4,807,346)</u></u>	<u><u>(4,486,243)</u></u>	<u><u>(4,222,744)</u></u>
LOSS PER SHARE – BASIC <i>(Note 2)</i>	<u>(0.069)</u>	<u>(0.064)</u>	<u>(0.060)</u>

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Notes:

- (1) The subsidy income was granted by the government for the development of ASIC technology and was non-recurring.
- (2) The loss per share for the years ended 31st December, 1998 and 1999 is based on the net loss during the years and assuming 70,000,000 shares in issue during those years as if the Reorganisation had been taken place on 1st January, 1998.
- (3) Translation of amounts from RMB into Hong Kong dollars ("HK\$") for the convenience of the reader has been made at the rate quoted by the PBOC on 30th June, 2000 of HK\$1.00 = RMB1.0624. No representation is made that the Renminbi amounts could have been, or could be, converted into Hong Kong dollars at that rate on 30th June, 2000 or any other certain rate.

According to Rule 11.11 of the GEM Listing Rules, the latest financial period of the Company reported on by the reporting accountants must not have ended more than six months before the date of this prospectus. The accountants' report contained in this prospectus has been prepared to include the combined results of the Company for each of the two years ended 31st December, 1999 only. The Company has applied for and the Stock Exchange has granted a waiver from compliance with Rule 11.11 of the GEM Listing Rules. The Directors confirmed that they have performed sufficient due diligence on the Company to ensure that, save as disclosed herein, up to the date of the issue of the prospectus, there has been no material adverse change in the financial position of the Company since 31st December, 1999, and there is no event which would materially affect the information shown in the accountants' report of the Company as set out in Appendix 1 to this prospectus.

Overview

The Company's revenues were derived from the sale of embedded system products including ASIC, Network Security Products, Smart Card Application System, GPS Application System and WFAS, to various customers in the PRC. As the Company is at its high growth stage of development, its revenues increased rapidly following the introduction of different embedded system products to the market.

The Company's revenues increased by approximately 244% from approximately RMB3 million for the year ended 31st December, 1998 to approximately RMB10 million for the year ended 31st December, 1999. There was a significant increase in the gross margin in 1999 as compared to 1998 which also improved the overall operating results for the said period. Such improvement was mainly contributed by the introduction of Network Security Products in 1999 which accounted for approximately 77% of the total gross margin for the year. The increase in operating expenses during the track record period resulted from the expansion of the Company's business.

The rapid growth in turnover during the track record period reflects the gradual transformation of the Company from an infant company to a high growth company, through the production of some of its embedded system products and the successful introduction of these embedded system products to the market.

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Financial year ended 31st December, 1998

For the year ended 31st December, 1998, the Company recorded a turnover of approximately RMB3.0 million, of which approximately RMB2.1 million was attributable to sales of the GPS Application System, approximately RMB0.7 million was attributable to sales of WFAS and the remaining approximately RMB0.2 million was attributable to sales of Smart Card Application System.

The Company did not record any revenues from Network Security Products and ASIC in 1998. This was due to the fact that these two products were still in the development stage and not turned into final products at that time.

Financial year ended 31st December, 1999

For the year ended 31st December, 1999, the Company recorded revenues of approximately RMB10.4 million of which RMB6.1 million was attributable to sales of the Network Security Products, approximately RMB0.7 million was attributable to ASIC, approximately RMB2.5 million was attributable to Smart Card Application System, approximately RMB1.0 million was attributable to the sales of WFAS and the remaining was attributable to GPS Application System.

Approximately 58.2% of the turnover for the year ended 31st December, 1999 was generated from the sales of Network Security Products, which was introduced to the market in the beginning of 1999. The sales of GPS Application System reduced significantly since the sales agreement with Guangzhou Tian Mu Company was practically completed in 1998 and only a minimal amount of sales of GPS Application System was recorded in 1999.

Taxation

No provision for Hong Kong profit tax or PRC profit tax was made as the Company had no assessable profits in the respective jurisdictions for the two years ended 31st December, 1999.

Pursuant to an approval certificate dated 13th April, 2000, being Certificate No. HZ1386 granted by the People's Government of Beijing Municipality, the Company was certified as a new and high technology enterprise established in the experimental area designated under the "Interim Regulations of the Beijing Municipality Concerning the Experimental Area for Developing New Technology Industries" (promulgated on 20th May, 2000) for developing new technology industries in the PRC. The experimental area established under the Regulations is in the Haidan District of the Beijing Municipality, which has an area of approximately 100 square kilometres with the Zhongguancun area as its centre.

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Certification of the Company as a new and high technology enterprise in the experimental area will entitle the Company to enjoy certain preferential tax treatment, which principally include:

- (1) reduced income tax at the rate of 15%, which is further reduced to 10% if the output value of export products amounts to over 40% of the total output value of the same year; and
- (2) exemption from income tax in the first three years following its inauguration and shall, upon approval by the People's Government of the Beijing Municipality, be allowed a 50% reduction on the basis of the reduced income tax rates set out in (1) above in the fourth to sixth years.

Other preferential treatments in favour of the Company principally include, among other things: (1) no import license for imported raw materials and parts and components that are needed for the production of export products; (2) exemption from import duties and product tax on the link of import or value added tax; (3) exemption from export duties for products to be exported by the Company; (4) subject to approval by the examining and approving authorities and verification by the customs authorities, exemption from import duties for five years in respect of equipment imported by the Company for the development of new technology provided that such equipment is not capable of being produced in China; and (5) fast depreciation of equipment used by the Company for the development of new technology and the products thereof.

Other information

The Company has not declared or paid any dividend since the date of its incorporation.

PROPERTY INTERESTS

Hong Kong

The Company has rented Unit 02 on the 7th Floor, Asia Pacific Centre, 8 Wyndham Street, Central, Hong Kong as its principal place of business in Hong Kong. This office unit has a gross floor area of approximately 1,608 sq.ft. and is rented by the Company from an independent third party for a term of two years commencing from 1st June, 2000 at a monthly rental of HK\$28,944 exclusive of air-conditioning and management charges, Government Rates and other outgoings.

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Beijing

The Company has rented three offices in Beijing, the PRC. These office premises have an aggregate gross floor area of approximately 859.3 sq.m.. Particulars of the offices rented by the Company in Beijing are as follows:

1. Rooms 1117 and 1119, Zhongcheng Building, Haidian Road, Hai Dian District, Beijing

These two units have a gross floor area of approximately 150 sq.m. and are leased by the Company from the landlord, an independent third party, for a term commencing from 17th April, 2000 to 30th November, 2000 at a monthly rental of RMB22,813.

2. Rooms 1715-1717 on the 17th Level, Block A, Corporate Square, No. 35 Financial Street, Xi Cheng District, Beijing

These three office units with a gross floor area of approximately 420.38 sq.m. are leased by the Company from the landlord, an independent third party, for a term commencing from 17th April, 2000 to 31st December, 2002 at a monthly rental of US\$11.50 per sq.m. based on the gross floor area.

3. Room 16 on the 9th Level, North Office Block, New World Centre, No.3B Chongwenmenwai Dajie, Chongwen District, Beijing

This unit is sub-leased by the Company from Jade Bird Software for a term commencing from 17th April, 2000 to 24th November, 2002 at a monthly rental of US\$11.0 per sq.m. or approximately US\$3,178 per month. It has a gross floor area of approximately 288.92 sq.m..

Shenzhen

The Company has rented the whole floor of the 1st level of R3B6 Factory, City High Technology Industrial Village, Nan Shan District with a total gross floor area of 546.76 sq.m. in Shenzhen. These units are leased for a term commencing from 17th April, 2000 to 15th August, 2001 at a monthly rental of RMB16,403.

Property valuation

The property interests of the Company were valued by Sallmanns (Far East) Limited, an independent property valuer as at 30th April, 2000. The text of the letter and valuation certificate of Sallmanns (Far East) Limited are set out in Appendix 2 to this prospectus.

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DIVIDENDS

The Directors presently do not intend to recommend any dividend for the financial year ending 31st December, 2000. The Directors expect that, in future, dividend recommendation will be dependent upon the Company's earnings, financial condition, cash requirements and availability, and other relevant factors. Dividends for the H Shares, if any, will be paid in Hong Kong dollars.

The Directors expect, in future, interim and final dividends will be paid in or about June and December of each year, respectively, and that the interim dividend will normally represent approximately one-third of the expected total dividend for the full year.

WORKING CAPITAL

Taking into account the estimated net proceeds of the proposed Placing, the Directors are of the opinion that the Company has sufficient working capital for its present requirements.

DISTRIBUTABLE RESERVES

As at 31st December, 1999, the Company had not been incorporated. There was accordingly no reserves available for distribution to the shareholders of the Company as at that date.

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ADJUSTED NET TANGIBLE ASSETS

The following pro forma statement of adjusted net tangible assets of the Company is based on the audited combined net tangible assets of the Company as at 31st December, 1999 as shown in the accountants' report, the text of which is set out in Appendix 1 to this prospectus, and adjusted as follows:

	<i>RMB'000</i>
Audited combined net tangible assets of the Company as at 31st December, 1999	11,379
Combined loss after taxation of the Company for the four months ended 30th April, 2000 based on its unaudited management accounts	(2,473)
Net cash injected by the Promoters (<i>Note 1</i>)	51,174
Estimated net proceeds of the Placing (<i>Note 2</i>)	<u>248,600</u>
Adjusted net tangible assets	<u><u>308,680</u></u>
Adjusted net tangible asset value per Share (<i>Note 3</i>)	<u><u>RMB 3.28</u></u>

Notes:

- (1) Pursuant to the Promoter's Agreement entered into amongst the Promoters on 4th January, 2000, the registered capital of RMB70,000,000 of the Company was fully paid-up by the Promoters in April 2000. As part of the Reorganisation, approximately RMB18,826,000 of the capital paid-up by the Four Domestic Promoters were contributed towards settlement of the consideration for the transfers of the business and operations from the Predecessor Entities pursuant to various business transfer agreements entered into on 17th April, 2000. Accordingly, the net cash contribution by the Promoters amounted to approximately RMB51,174,000.
- (2) The estimated net proceeds from the Placing are based on the Placing Price of HK\$11.00 per H Share and take no account of any H Shares which may be issued pursuant to the Over-allotment Option. If the Over-allotment Option is exercised in full, the estimated net proceeds of the Placing will be approximately HK\$258 million.
- (3) The adjusted net tangible asset value per Share is arrived at based on 94,000,000 Shares in issue immediately after the Placing and taking no account of any additional H Shares to be issued pursuant to the Over-allotment Option.

NO MATERIAL ADVERSE CHANGE

The Directors confirm that there has been no material adverse change in the financial or trading position or prospects of the Company since 30th April, 2000.