
RISK FACTORS

In evaluating an investment in the H Shares, potential investors should consider carefully all the information contained in this prospectus, including the risk factors as set out below.

RISKS ASSOCIATED WITH THE COMPANY

Limited operating history and a history of operating loss

Prior to the Reorganisation, the Company's operations in the design and development of embedded technology and embedded system products were carried out and conducted by the Predecessor Entities. For the two years ended 31st December, 1999, the Company incurred net losses of approximately RMB4.8 million and RMB4.5 million, respectively. The Company's past operating results have been, and its future operating results will be, subject to fluctuations due to a variety of factors, including competition, rapid changes in technology, frequent introduction of new products, success in implementing its business strategy and objectives, changes in the pricing basis of its products, and the Company's ability to maintain its leading position in the PRC as a developer of embedded system software and as a system designer in integrated circuits.

It is possible that the Company will incur operating losses in the foreseeable future if the increases in operating and capital expenditures as well as sales and marketing costs are not matched by corresponding increases in revenue in the near term.

Reliance on Peking University and the Four Domestic Promoters

The operating businesses of the Company immediately upon completion of the Reorganisation were transferred by the Predecessor Entities. These businesses were to a large extent developed by the Predecessor Entities with strong technological support from Peking University. In this regard, the loss of technological support from Peking University could result in a material and adverse impact on the Company's performance. To ensure continued technological support from Peking University, the Company and Peking University on behalf of the Institutes entered into a technological cooperation and support agreement on 17th April, 2000 pursuant to which the Institutes agreed to provide continuous technological support to the Company for an indefinite term. The Four Domestic Promoters have also entered into a similar technological cooperation and support agreement with the Company for an indefinite term. The Four Domestic Promoters are controlled directly and indirectly by Peking University.

In addition, the Company has entered into several other agreements directly or indirectly with Peking University and the Four Domestic Promoters relating to the business of the Company. Particulars of such agreements are set out in the section headed "Relationship with Peking University" in this prospectus. Further, the technical staff responsible for the research and development of the operating businesses of the Company were transferred from the Four Domestic Promoters to the Company upon completion of the Reorganisation. In this respect and to a certain extent, the Company continues to rely on Peking University and its associates

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for technological support. Potential investors should be aware that in the event of any early termination of any of the above agreements or any change in relationship between Peking University and the Company, the Company's performance may be adversely affected.

Reliance on key employees

As at the Latest Practicable Date, the Company has 5 executive Directors and 8 senior management staff, who are responsible for the implementation of the Company's business plan and overseeing the daily operation of the Company. Each of the executive Directors has signed service contracts with no provision for early termination with the Company for a fixed term of three years commencing from the date of incorporation of the Company. Each of the senior management staff has signed service contracts with a provision for early termination with the Company for a fixed term of three years commencing from the date of incorporation of the Company. The Company depends, to a significant extent, on the services of these key employees, the loss of any of whom may adversely affect the Company's performance.

Dependence on customers

For the two years ended 31st December, 1999, the Company's five largest customers in aggregate accounted for approximately 93.1% and 69.1% respectively of the Company's total turnover. Some of the Company's products have been developed at the request of government authorities, which have since become major customers of the Company. With its established relationship with the State, government bodies and enterprises established by government authorities such as Ministry of Public Security, 交通部 (the Ministry of Communications), 軍隊 (the People's Liberation Army) and 海關 (Customs) and semi-governmental organisations such as banks, these customers are expected to continue their purchase of the Company's products and to account for a substantial portion of the Company's revenue. Any reduction or delay in sales of the Company's products to these customers could have a material adverse effect on the Company's operating results.

For the two years ended 31st December, 1999, no revenues generated from sales of any embedded system products to members of the Jade Bird Group or Peking University. However, deferred revenue derived from sales to the Jade Bird Group and Peking University amounted to an aggregate of approximately RMB10,760,000 as at 31st December, 1999. To regulate the relationship between the Jade Bird Group and Peking University, the Company entered into master sales agreements with Beijing Tianqiao and Tian Mu Monitored Security System Company Limited (四川天目監控保安系統有限公司) (hereinafter called "Tian Mu"), the equity of which is owned as to 30% by Jade Bird, on 17th April, 2000 for the sale of embedded system products to Beijing Tianqiao and Tian Mu. In anticipation of the business expansion of the Jade Bird Group and the Company, the Directors believe that the Company will continue to engage in similar transactions with the Jade Bird Group and Peking University in the future. Should the Jade Bird Group and Peking University cease to place orders with the Company for the purchase of embedded system products, the Company's profits may be adversely affected.

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Manufacturing and availability of components

While the Company is principally engaged in the research and development of software and design of integrated circuits, the Company's manufacturing operations consist primarily of final assembly, testing and quality control of hardware and parts. For the two years ended 31st December, 1999, the Company's five largest suppliers, in aggregate, accounted for approximately 26.7% and 26.6% respectively of the total purchases of the Company. Although the Directors believe that many of the hardware and parts used in the production of the Company's finished products are generally readily available from a variety of sources, there can be no assurance that the Company may not experience shortage of certain components which may have an adverse effect on the Company's business and operating results.

Non-competition undertakings

Peking University and the Four Domestic Promoters respectively entered into non-competition agreements with the Company on 17th April, 2000, pursuant to which Peking University and the Four Domestic Promoters have irrevocably undertaken to the Company and its associated enterprises that each of them will not directly or indirectly engage in any business activities that compete with the existing and future embedded system products of the Company. Further, pursuant to the technological support and cooperation agreement between Peking University on behalf of the Institutes and the Company, the Company has been given the first priority to obtain the transfer or license of the sole use of any technology independently researched and developed by the Institutes in accordance with the provisions of such agreement. Details of the non-competition agreements are set out in the section headed "Relationship with Peking University" in this prospectus.

The above non-competition agreements provide that if the aggregate shareholding percentage of the Four Domestic Promoters in the Company shall fall below 20% in the future, the non-competition agreements would be terminated. Potential investors should note that, although the Four Domestic Promoters cannot lawfully transfer their respective Promoters Shares within three years after the establishment of the Company, any such transfer which leads to termination of the non-competition agreements and which may adversely affect the Company's business, operating results and financial condition.

Taxation

Pursuant to an approval certificate dated 13th April, 2000, being Certificate No. HZ1386 granted by the People's Government of Beijing Municipality, the Company is certified as a new and high-technology enterprise in the experimental area and therefore entitles to certain preferential tax treatment which principally include a reduced income tax rate of 15% and an 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 rate of 15% in the fourth to sixth years. Please refer to the paragraph headed "Taxation" under the section headed "Financial information" in this prospectus for further details of the preferential tax treatment applicable to the Company.

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Investors should note that there can be no assurance that the preferential tax treatment referred to above will continue in the future and if not, the profitability of the Company may be adversely affected.

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Regulations for commercial cryptographic products and security products relating to computer information systems in the PRC

The Commercial Cryptographic Administration Regulations were introduced by the State Council on 7th October, 1999 in order to strengthen the licensing and regulation of commercial cryptographic products in the PRC. Such regulations govern the technology and production relating to encryption and use of security certificates on information not involving secret information of the State.

The regulations are only applicable to cryptographic products for commercial use. Under such regulations, research and development of cryptography for commercial use can only be undertaken by institutions with the requisite level of technical skills and research equipment and that such institutions have to be designated by the State Cryptography Control authorities. Likewise, manufacturing and sale of commercial cryptographic products can only be undertaken by those units designated by the State Cryptography Control authorities. Any unauthorised production of commercial cryptographic products is prohibited. Manufacturers of cryptographic products are required to have the requisite levels of skill and equipment for the manufacturing and production of commercial cryptographic products. All models of the cryptographic products have to be examined by the State Cryptography Control authorities prior to commencement of production.

Sales of commercial cryptographic products also have to be conducted through qualified sales organisations. Only organisations which satisfy the qualifications set by the regulations will be issued a 商用密碼產品銷售許可證 (Commercial Cryptographic Products Sales Permit). Details of the purchasers, including company name, address, identity number and the use of the cryptographic products have to be filed with the State Cryptography Control authorities.

In accordance with the Commercial Cryptographic Administration Regulations, application has to be made to the State Cryptography Control authorities by the Company for the production and sales permit for its encryption device. Jade Bird obtained an approval for product requirement standard from the State Cryptography Control authorities in respect of the Security ICs in 1999 (“Security ICs Approval”). On 7th June, 2000, the Company obtained an approval from the State Cryptography Control authorities to have the Security ICs Approval transferred to the Company so that the Company shall have the right to conduct research, production and related business activities in respect of the Security ICs. In the future, the Company plans to make applications to the State Cryptography Control authorities for the research, production and sales permit for each of its new encryption device or commercial cryptographic products to be developed by the Company. Potential investors should note that


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there is no assurance that the State Cryptography Control authorities will approve such permits or grant approval to the Company or that the Company will be able to engage an authorised manufacturer for production of its future commercial cryptographic products and in such event, there may be a material adverse effect on the Company's business, operating results and financial conditions. It should also be noted that the imposition of additional or more stringent regulations relating to commercial cryptographic products may adversely affect the future development of the Company's business.

Competition

In view of its relationship with Peking University and the nature of the majority of its product lines, the Directors do not consider that the Company at present faces any major competition in the PRC domestic market. Nevertheless, due to frequent product introductions with improved price and/or performance characteristics, the markets for the Company's product lines will be subject to growing competition. Even if the Company does introduce advanced products in a timely manner, there can be no assurance that such new products will gain market acceptance. The Directors anticipate that competition from other companies in each of its product lines may intensify in the future and the Company's overall profit margins may be affected if the Company is not able to respond with new products which meet market demands.

Trademark infringement

The Company is in the process of registering the symbol  as a trademark under Hong Kong law and the PRC law. The Company has applied to both the Intellectual Property Department of Hong Kong and the Trademark Administration for registration of its own trademarks and the Directors anticipate that the registration of such trademarks will complete by August 2000 and July 2001, respectively. Pending registration of the trademarks, the Company has entered into a trademark licence agreement with Jade Bird Software for use of the two trademarks registered by Jade Bird Software on its products. Further details of the licence are set out in the paragraph headed "Intellectual Property Rights" under the section headed "Business".

However, as infringement of intellectual property rights by way of sales of counterfeit goods occurs in the PRC as well as in Hong Kong, potential investors should be aware that even if registration of the symbol  as the Company's trademark is completed and protected by the relevant laws, there will always be a market for counterfeit products given the price difference between counterfeit goods and the original version. Total eradication of trademark infringement is very difficult. The Company's profitability may be adversely affected if its trademarks are infringed.

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Protection of non-patented technology

The Company has a strong research and development team, which has achieved significant results in developing embedded technology during the recent years. However, the Company has not applied for any patents on its research results and all such results are held by the Company as non-patented technology. As there are few provisions providing protections to non-patented technology under the PRC law, and notably only under Article 10 of the PRC Anti-Unfair Competition Law, the operating results of the Company may be adversely affected if the non-patented technology of the Company is infringed by any other persons.

GPS techniques

The GPS satellites are controlled by the US government, and the accuracy of the GPS positioning technique is also restricted by the US government. Potential investors should note that there is no assurance that the US government will not implement stringent policy to restrict the usage of the GPS satellites. In such event, this may have a material adverse effect on the future development of the Company's business, in particular, GPS Application System, operating results and profitability.

New product development

The business development of the Company in the near future will to a certain extent be dependent upon software and integrated circuits that are currently being developed by the Company. However, despite repeated trial testings by the Company, errors may still be found in the Company's developed software and integrated circuits, or, there can be no assurance that if errors are discovered, they will be corrected in a timely manner. In addition, the Company may experience difficulties in the research and development of new embedded system products or that the introduction of new products does not meet changes in market demands. If the Company is unable to develop new software and hardware on a timely basis or enhance its existing embedded systems, or if the embedded systems developed by it do not achieve the anticipated level of market acceptance, the Company's business, operating results and financial conditions may be adversely affected.

Technological changes

The market for the Company's products is characterised by frequent product introductions, rapidly changing technology and continued evolution of new industry standards which result in rapid product obsolescence and short life cycles. The development of technologically advanced products is a complex and uncertain process requiring extensive research and application, high levels of innovation as well as accurate anticipation of technological and market trends. There can be no assurance that the Company's research and development will be able to identify and develop new embedded software and hardware or improve its existing embedded system which effectively meets the market demands and to manufacture, market and support new or enhanced products successfully in a timely manner. Further, the Company

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or its competitors may introduce new products or product enhancements that shorten the life cycle of, or render obsolete, the Company's existing product lines. In such event, there may be a material adverse effect on the Company's business, operating results and financial conditions.

Entry into WTO

As the PRC laws and regulations currently impose control on the imports of certain foreign security-related embedded products into the PRC, foreign competitors which have comparatively more advanced security-related embedded technology currently do not impose any direct threat to the Company so far as the PRC market is concerned. However, there can be no assurance that such protective regulations will remain in place following the PRC's entry into the WTO and in such event, the Company's sales may be adversely affected as a result.

Regulations for radio frequency in the PRC

According to the PRC Radio Frequency Administration Regulations, radio frequency resources are owned by the State. The Ministry of Information Industry Wireless Management Authority has the right to plan, manage and allocate different radio frequencies. Before any user may use a radio frequency, it must apply to the state or local level of the Ministry of Information Industry Wireless Management Authority which has discretion in granting a radio frequency usage permit. A radio frequency usage permit is granted for a fixed term, during which no unit or individual holding a radio frequency usage permit may transfer, directly or indirectly, the allocated radio frequency without having first obtained the prior approval of the appropriate level of the Ministry of Information Industry Wireless Management Authority and must observe the related regulations regarding State management of the radio frequency. The lease or disguised lease of the radio frequency usage permit is prohibited.

The Company has obtained a Radio Transmission Equipment Type Approval Certificate from the Ministry of Information Industry Wireless Management Authority for its JB230M GPS products which is valid for a period of five years from the date of issue on 27th January, 2000. Potential investors should note that there can be no assurance that the Company will be able to obtain the relevant approval certificate from the Ministry of Information Industry Wireless Management Authority for its future products.

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PRC political and economic considerations

All of the Company's operations are located in the PRC. Potential investors should note that changes in the economic and political situation in the PRC and policies adopted by the State to regulate the PRC economy may affect the Company's operations in the PRC and its performance and profitability.

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The PRC economy has traditionally been a centrally planned economy subject to a series of state economic plans adopted by the State. Over the past twenty years, the State has been reforming the economic and political systems in the PRC. Such reforms have resulted in significant economic and social advancement. Many of the reforms are unprecedented and are expected to be refined and improved upon while political, economic and social factors may also lead to further readjustment of the reform measures. The refinement and readjustment process, however, may not always have a positive effect on the operations of the Company. There is also no assurance that the State will continue to pursue economic reforms.

There is no assurance that the Company's performance and profitability will not be adversely affected by changes in the political, economic and social conditions in the PRC and by changes in the State policies such as changes in laws and regulations (or the interpretations thereof), the introduction of measures to control inflation, changes in the rate or method of taxation, and the imposition of additional restrictions on currency conversion and overseas remittances.

Legal system

The PRC legal system is a civil law system which is based on written statutes and in which decided legal cases have little precedential value. Although since 1979, many laws and regulations governing economic matters have been promulgated and amended in the PRC to provide general guidance on economic and business practices, the PRC legal system is still considered to be underdeveloped in comparison with the legal systems of some western countries. The interpretation of the PRC law may be inconsistent and somehow influenced by policy changes reflecting domestic political and social changes. In addition, the enforcement of existing laws can be uncertain and unpredictable.

Significant progress has been made in the promulgation of laws and regulations dealing with economic matters such as corporate organisation and governance, foreign investment, commerce, taxation and trade. The promulgation of new laws, changes of existing laws and the abrogation of local regulations by national laws could have a negative impact on the business and prospects of the Company's business.

Different regulatory framework

As substantially all of the Company's business is conducted in the PRC, the Company's operations are governed principally by the laws of the PRC. As a PRC company offering and listing its shares outside the PRC, the Company is subject to the Special Regulations and to the Mandatory Provisions. The Mandatory Provisions contain certain provisions that are required to be included in the articles of association of PRC companies to be listed abroad and are intended to regulate the internal affairs of those companies. The Company Law and the Special Regulations, in general, and provisions for the protection of shareholders' rights and

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access to information, in particular, are less developed than those applicable to companies incorporated in Hong Kong, the United Kingdom, the United States and other developed countries or regions.

The Company Law is different in certain important aspects from company laws in Hong Kong, the United States and other common law countries or regions, particularly with regard to investor protection, including in such areas as derivative actions by minority shareholders and other minority protections, restrictions on directors, financial disclosure, variations of class rights, procedures at general meetings and payments of dividends.

The limited nature of investor protection under the Company Law is compensated for, to a certain extent, by the introduction of the Mandatory Provisions and certain additional requirements that are imposed by the GEM Listing Rules with a view to reducing the scope of differences between Hong Kong company law and the Company Law. The Mandatory Provisions and those additional requirements must be included in the articles of association of all PRC companies applying to be listed in Hong Kong. The Articles of Association incorporate the provisions required by the Mandatory Provisions and the GEM Listing Rules. Despite the incorporation of those provisions, there can be no assurance that shareholders of the Company will enjoy protections that they may be entitled to in other jurisdictions.

Securities laws and regulations

At present, the regulatory framework for the securities industry in China is at an early stage of development. The CSRC is responsible for administering and regulating the national securities markets and drafting relevant regulations for the regulation of the national securities markets. Regulations of the State Council and the relevant implementing measures of the CSRC, such as provisions dealing with acquisitions of listed PRC companies and disclosure of information, apply to listed companies in general without being confined to companies listed on any particular stock exchange. Hence it is possible that those provisions may be applicable to a joint stock company with limited liability with shares listed on a stock exchange outside the PRC, such as the Company.

On 1st July, 1999, 中華人民共和國證券法 (the PRC Securities Law) became effective. The PRC Securities Law is the fundamental law comprehensively regulating the securities markets in the PRC and applies to the issuance and trading in the PRC of shares, company bonds and other securities designated by the State Council according to law. The Company Law, the rules and regulations recently promulgated thereunder and laws relating to PRC companies whose shares are offered overseas provide, to a certain extent, a legal framework governing the corporate behaviour of companies, such as the Company, and their directors and shareholders. Investors should note that the regulatory framework for the securities industry in China is at an early stage of development, any change of which is beyond the control of the Company.

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Enforceability of judgments and arbitration

The PRC has not entered into treaties or arrangements providing for the recognition and enforcement of judgments of courts in Hong Kong or most other jurisdictions. Accordingly, it may be difficult to secure recognition and enforcement in the PRC of the judgments of courts in other jurisdictions. It should also be noted that under the Articles of Association, if a holder of H Shares has a dispute with the Company, a Director, a Supervisor, a manager, an officer or has a claim arising out of the Articles of Association or any rights or obligations conferred or imposed by Company Law and regulations concerning the affairs of the Company, that person shall, unless otherwise provided in the Articles of Association, submit the dispute or claim to the Hong Kong International Arbitration Centre or the China International Economic and Trade Arbitration Commission for arbitration. The arbitral award shall be final and binding on all parties.

The PRC is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”) which has historically permitted reciprocal enforcement in the PRC of awards of arbitral bodies located in other New York Convention signatory countries. Following the resumption of sovereignty over Hong Kong by the PRC on 1st July, 1997, the New York Convention no longer applies to the enforcement of Hong Kong arbitration awards in other parts of the PRC. On 21st June, 1999, an arrangement was made between Hong Kong and the PRC for the mutual enforcement of arbitration awards. This new arrangement was approved by the Supreme Court of the PRC and the Hong Kong Legislative Council, and became effective on 1st February, 2000.

Further information on arbitration, including the “Arbitration Law of the People’s Republic of China” which became effective on 1st September, 1995 is set out in the paragraph headed “Arbitration and Enforcement of Arbitral Awards” in Appendix 3.

Currency conversion and exchange rate risks

Substantially all the operating revenues of the Company are denominated in RMB. To pay dividends to shareholders outside the PRC, a portion of the Company’s RMB revenues must be converted into Hong Kong dollars. As part of PRC currency reforms, with effect from 1st January, 1994, the PRC government abolished its two-tier exchange rate system and replaced it with a unified system which is subject to market demand and supply. Under the new system, the PBOC quotes a daily exchange rate for RMB to US dollars based on the previous day’s dealings in the inter-bank foreign exchange market. Despite such development, the RMB is still not freely convertible.

As the exchange rate is based largely on market forces, the exchange rates for the RMB against other currencies, including US dollars and Hong Kong dollars, are susceptible to movements based on external factors and there can be no assurance that the RMB will not be subject to devaluation. Should RMB be devalued, the value of the profitability of the Company’s business in term of Hong Kong dollars will be adversely affected.