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INDEBTEDNESS

Borrowings

As at the close of business on 30th April, 2000, being the latest practicable date for the purpose of this indebtedness statement, the Group had aggregate outstanding secured bank loans of approximately HK\$46,000.

As at 30th April, 2000, the Group had in issue Convertible Notes of nominal value US\$13.6 million. The Convertible Notes were subsequently converted on 15th June, 2000, and 422,688 Shares representing approximately 21.13 per cent. of the then existing issued share capital of the Company were issued to the holders of the Convertible Notes.

On 15th June, 2000, the Company agreed to issue the Additional Convertible Note with a principal amount of HK\$47,220,278 to Alps, a wholly-owned subsidiary of Cheung Kong, for cash at par.

Securities and guarantees

As at 30th April, 2000, the Group's total banking facilities of HK\$5,550,000 were secured by the following:—

- (i) a charge over certain of the Group's land and buildings which had an aggregate carrying value of approximately HK\$3.1 million as at 30th April, 2000; and
- (ii) personal guarantee provided by a Director of the Group. On 16th April, 2000, a member of the Group executed a corporate guarantee in respect of the banking facilities, and on 9th May, 2000, the personal guarantee provided by the Director was released.

The Group also pledged a time deposit to a bank to obtain a bank guarantee of HK\$100,000 in favour of a customer to whom the Group provides IT consulting services. The bank guarantee expired on 15th May, 2000, and the Group is arranging for the pledge to be released.

Contingent liabilities

A member of the Group (the "member") entered into an agreement on 1st May, 1993 to acquire from a third party vendor, inter alia, a software programme at a consideration of HK\$2 million, and paid an initial deposit of HK\$200,000. A dispute arose between the Group and the third party vendor in respect of the completeness of the software programme that was delivered and the representations made at the time of sale, and the Group rejected delivery of the software programme. On 9th January, 1995, the third party vendor filed a claim against the member for payment of HK\$1.8 million plus damages and the costs of the legal action. However, the third party vendor did not place a security deposit for the litigation, and no further actions or proceedings had taken place in respect of the dispute since April, 1995. The Directors have been advised that as many years have elapsed since the commencement of the action, the member may apply to the court to strike out the claim of the third party vendor for want of prosecution. The court will take into account all circumstances of the case before exercising its discretion as to whether the striking out application would be granted.

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It is the intention of the Directors to defend the claim vigorously in the event the third party vendor continues legal action. Accordingly, no provision for the claim and legal costs in respect thereof has been made in the financial statements of the Group. Ms. Peggy Chan has agreed to indemnify the member for any losses up to HK\$2 million arising from the claim for the period up to and including 30th June, 2001.

Two members of the Group are in dispute with a firm of lawyers (the "Previous Lawyers") handling the Group's pre-listing restructuring, Convertible Notes issue and intellectual property registration in respect of several invoices for an aggregate amount of around HK\$2.3 million rendered by the Previous Lawyers and are currently seeking a taxation of such invoices. The Group has already paid HK\$2.5 million into court which covers the full amount of the bills and the costs of taxation. An amount of HK\$1 million (plus taxation fees) has been paid out from the HK\$2.5 million to the Previous Lawyers as interim payment without prejudice to demand for refund to the relevant members of the Group such amounts overpaid after taxation. The Previous Lawyers are required to lodge detailed bills of costs for the purpose of taxation within 45 days from 10th April, 2000. The members of the Group will raise objection to the detailed bills. The court will then decide and certify the ultimate amount to be paid by the relevant members of the Group. It is likely that the taxation process will take several months from the date the detailed bills are lodged with the court to a final assessment. As the dispute was in respect of work carried out subsequent to 31st December, 1999, no provision for the claim and legal costs in respect thereof has been made in the Group's financial statements included in the Accountants' Report set out in Appendix I to this prospectus. Ms. Peggy Chan has agreed to indemnify such two members of the Group for any loss in excess of the amount already paid by the two members of HK\$1 million, up to a limit of HK\$1.5 million arising from the dispute for the period up to and including 31st December, 2000. The Directors expect that the dispute with the Previous Lawyers is likely to have been resolved prior to such date.

Disclaimer

Save as aforesaid and apart from other intra-Group liabilities, as at the close of business on 30th April, 2000, neither the Company nor any of its subsidiaries had any outstanding mortgages or charges or debentures or other loan capital or bank overdrafts, loans or other similar indebtedness, finance lease commitments, hire purchase commitments, liabilities under acceptance or credits or any guarantees or material contingent liabilities.

No material change

The Directors have confirmed that, save as disclosed in this "Financial information" section, there has not been any material change in the indebtedness and contingent liabilities of the Company and its subsidiaries since 30th April, 2000.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

Net current assets

As at 30th April, 2000, the Group had net current assets of approximately HK\$100.3 million. Current assets comprised cash and bank balances of approximately HK\$76.3 million, work in progress of approximately HK\$13.7 million, trade receivables of approximately

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HK\$16.2 million and other receivables and prepayments of approximately HK\$9.4 million. Current liabilities comprised bank loans due within one year of approximately HK\$46,000, trade payables of approximately HK\$6.7 million, and deferred income and other creditors and accrued expenses of approximately HK\$8.5 million.

Dividends of HK\$5,000,000 were paid to Ms. Peggy Chan on 8th March, 2000 in her capacity as a former shareholder of a subsidiary of the Company.

Borrowings and banking facilities

The Group generally finances its operations with internally generated cashflows and banking facilities provided by its principal bankers in Hong Kong.

As at 30th April, 2000, the Group had banking facilities of HK\$5,550,000. Such banking facilities were utilised to the extent of approximately HK\$46,000 as at 30th April, 2000 which are repayable within one year.

Capital commitments

As at 30th April, 2000, the Group authorised contracts for an amount of approximately HK\$2,900,000 in relation to the renovation of buildings.

Dividends

No dividends have been declared or paid by any member of the Group since 31st December, 1999, apart from HK\$5,000,000 paid to Ms. Peggy Chan in cash on 8th March, 2000 as noted under "Net current assets" above.

Disclosure under Chapter 17 of the GEM Listing Rules

The Group has not advanced any money to any entity which exceed 25 per cent. of the Group's combined net tangible assets as at the Latest Practicable Date, has not provided any financial assistance and guarantees to affiliated companies which exceed 25 per cent. of the Group's combined net tangible assets as at the Latest Practicable Date, did not have any pledge over the Shares by the controlling shareholder to secure debts, guarantees or support of other obligations of the Group, and has not entered into any loan agreements importing specific performance obligations on the controlling shareholder. The Directors have confirmed that as at the Latest Practicable Date, 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.

Working capital

The Directors are of the opinion that, taking into account the present available banking facilities and internal financial resources of the Group and the estimated net proceeds of the Share Offer, the Group has sufficient working capital for its present requirements.

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TRADING RECORD

Summary of combined results of the Group

The table below sets out a summary of the combined results of the Company and its subsidiaries for each of the three years ended 31st December, 1999 ("fiscal 1997", "fiscal 1998" and "fiscal 1999") as if the current Group structure had been in existence throughout such periods, based on the information included in the Accountants' Report as set out in Appendix I to this prospectus.

	Year ended 31st December,		
	1997	1998	1999
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
	<i>(except per Share data)</i>		
Turnover (<i>Note 1</i>)			
Fixed price projects	25,477	26,438	39,097
Hardware and software resale	22,982	15,506	35,699
Time and material projects	27,723	30,988	20,575
Maintenance services	944	2,052	2,700
	<u>77,126</u>	<u>74,984</u>	<u>98,071</u>
Total Turnover			
Cost of computer hardware and software	<u>(18,373)</u>	<u>(17,773)</u>	<u>(43,623)</u>
	58,753	57,211	54,448
Other revenue	1,282	1,007	847
Other net income	11	—	108
Staff costs	(42,673)	(43,093)	(52,359)
Depreciation	(1,560)	(1,582)	(2,614)
Other operating expenses	<u>(13,722)</u>	<u>(10,485)</u>	<u>(10,749)</u>
Profit/(Loss) from operations	2,091	3,058	(10,319)
Finance costs	<u>(529)</u>	<u>(569)</u>	<u>(566)</u>
Profit/(Loss) from ordinary activities before taxation	1,562	2,489	(10,885)
Taxation	<u>(382)</u>	<u>(764)</u>	<u>227</u>
Profit/(Loss) for the year	<u>1,180</u>	<u>1,725</u>	<u>(10,658)</u>
Dividends	<u>—</u>	<u>—</u>	<u>(5,000)</u>
Basic and diluted earnings/ (loss) per Share (<i>Note 2</i>)	<u>HK\$0.59</u>	<u>HK\$0.86</u>	<u>HK\$(5.33)</u>

Notes:

1. Turnover represents income from computer software sales, hardware and software resales and computer services rendered to customers during the year, net of returns and discounts allowed, after eliminating intra-Group transactions.
2. Based on 2,000,000 Shares (being the number of Shares in issue and outstanding prior to the conversion of the Convertible Notes), as if those Shares had been outstanding for each year presented.

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Management's discussion and analysis of financial condition and results of operation

The following is a discussion of the combined results of operations of the Group for the three years ended 31st December, 1999. It should be read in conjunction with the combined financial statements and related notes and other financial data set out in the Accountants' Report in Appendix I to this prospectus.

Overview of combined results of operations

The Group is presently engaged in (i) the development, sale and implementation of enterprise software, (ii) the operation of the ASP Business through a joint venture with iBusiness Corporation, (iii) IT consultancy and customised application system development, and (iv) systems integration and resale and maintenance of IT products.

Turnover

The Group enters into fixed price turnkey contracts with its customers where a number of different products and services are bundled together and offered in one contract. Products and services that may be included in a fixed price turnkey contract include licensing and implementation of enterprise software, customised development work, resale of IT products and training and warranty services. The contract price is fixed prior to the commencement of the project. Revenue from fixed price contracts are recorded as "turnover from fixed price projects", and are not further broken down into the individual product and service components.

There are other contracts entered into by the Group with its customers which relate solely to the resale and installation of IT products. The turnover from these contracts is separately accounted for under "turnover from hardware and software resale". The Group also generates revenue for providing consulting services where the services rendered are billed to customers based on the time spent and materials consumed. Such revenue is recorded as "turnover from time and material projects". The Group generates its remaining turnover from the provision of maintenance services.

Cost of computer hardware and software and staff costs

Resales of IT products are normally conducted on a back-to-back basis and the Group does not hold any inventory. The costs of sourcing IT products are recorded as "cost of computer hardware and software", and the revenue is recorded either as part of the "turnover from fixed price projects" (if the IT products are sold as a package together with other services and products) or as "turnover from hardware and software resale". Costs of staff engaged in research and development and in implementing IT projects (such as the provision of IT consultancy services, customised application development projects and systems integration projects) are recorded as "staff costs" and are expensed in the period incurred.

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Operating results

The Group generated profits of HK\$1.2 million in fiscal 1997 and HK\$1.7 million in fiscal 1998 and sustained losses of HK\$10.7 million in fiscal 1999. The Directors expect the results of operations of the Group to improve in the year 2000 for the following reasons:

- (i) *More enterprise software business.* The enterprise software business generally has a higher profit margin compared to the resale of IT products. At the beginning of fiscal 1998, the Group only offered five enterprise software, and during fiscal 1998, an additional two enterprise software were added to the portfolio of products offered. It was not until December, 1999 that all of the Group's nine enterprise software were launched. With the full suite of nine enterprise software contributing for a full year towards the enterprise software business of the Group in year 2000, the Directors expect the results of operations for the year 2000 to improve as compared to fiscal 1999.
- (ii) *Increased sales of new enterprise software.* Related to (i) above, there is usually a time lag between the incurrence of research and development expenses and the time when the Group can realise the benefits of the research efforts. Since the establishment of the Software Centre in 1996, the Group has focused on the research and development of new software products. The members of staff in the Software Centre increased from 40 when the Software Centre was first established in 1996 to 70 at the end of 1997, to 80 at the end of fiscal 1998 and to 120 at the end of fiscal 1999. This has resulted in a significant increase in staff costs which represented the largest component of operating expenses for the Group in fiscal 1997, fiscal 1998 and fiscal 1999. Staff costs in fiscal 1999 were HK\$52.4 million and represented an increase of 21.6 per cent. from HK\$43.1 million in fiscal 1998.
- (iii) *Year 2000 issue.* The Directors believe that in fiscal 1999, many of the Group's customers reduced investments in new IT-related projects (including investments in new software applications) and instead focused their resources and efforts on testing and rectifying their existing systems for year 2000 compliance. The Directors believe that this has had a negative impact on the Group's operations in fiscal 1999, but is not expected to continue to adversely affect the Group's operations in the year 2000.
- (iv) *Low margins in projects for governmental authorities.* Due to the reduction in non-year 2000 related IT spending in the private sector in fiscal 1999, the Group undertook an increased number of projects for governmental authorities which the Directors believe generated lower than expected margins for the Group. The Directors, however, expect that this factor is unlikely to have a material adverse effect on the performance of the Group in the year 2000 because (a) the Group has accumulated additional experience in undertaking projects for governmental authorities, and (b) the Directors expect IT spending in the private sector to increase, and the Group is therefore likely to engage itself in fewer projects for governmental or semi-governmental authorities.

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- (v) *Additional marketing efforts.* Armed with the full suite of nine enterprise software, the Group believes it is well-positioned to realise the benefits of its past investments in research and development, and plans to engage in additional marketing efforts to increase product sales and market recognition in the year 2000. The Directors believe that the increase of revenues resulted from the additional marketing efforts will more than offset the costs of these marketing efforts.

General

The Directors expect that repair and maintenance costs incurred to service warranty obligations will continue to remain insignificant as compared to the turnover and assets of the Group. Consequently, the Directors believe that it is not necessary to make provisions for warranty related expenses in the Group's financial statements. In addition, the Directors believe, on the basis of the Group's previous experience in transacting with its customers and the profile of those customers, that it is not necessary to make provisions for general or specific bad or doubtful debts in the Group's financial statements.

All figures appearing in this "Trading record — Management's discussion and analysis of financial condition and results of operation" section are approximate figures and are rounded to one decimal place.

Combined results of operations

Financial year ended 31st December, 1999 compared to financial year ended 31st December, 1998

Turnover

On a combined basis, the Group recorded turnover of HK\$98.1 million in fiscal 1999, an increase of 30.8 per cent. from turnover of HK\$75.0 million in fiscal 1998.

Turnover from fixed price projects increased by 48.1 per cent. from HK\$26.4 million in fiscal 1998 to HK\$39.1 million in fiscal 1999 partly as a result of the launch of new enterprise software InterTrade and iBank. The number of licences of enterprise software sold increased in fiscal 1999 as compared to fiscal 1998, and such increase in turn resulted in additional customisation work for the Group. Turnover from fixed price projects conducted for the Hong Kong governmental authorities increased in fiscal 1999, and a number of fixed price projects entered into in fiscal 1999 related to the proposed introduction in Hong Kong of the mandatory provident fund regime whereas there were no such contracts in fiscal 1998. Turnover from fixed price projects represented 39.9 per cent. of the Group's turnover in fiscal 1999 as compared to 35.2 per cent. of the Group's turnover in fiscal 1998.

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Turnover from hardware and software resale relates to turnover generated from transactions involving only the resale and installation of IT products. Turnover from hardware and software resale increased by 130.3 per cent. from HK\$15.5 million in fiscal 1998 to HK\$35.7 million in fiscal 1999. Turnover from hardware and software resale in fiscal 1999 includes contracts entered into by the Group with an aggregate contract value of HK\$19.2 million to resell products of Sun Microsystems and other IT products to the Hong Kong operations of a US bank. The Directors believe that the launch of InterTrade and iBank also led to an increase in the resale by the Group of IT products to customers who demanded more advanced computer systems to run the Group's enterprise software. Turnover from hardware and software resale represented 36.4 per cent. of the Group's turnover in fiscal 1999 as compared to 20.7 per cent. of the Group's turnover in fiscal 1998.

Turnover from time and material contracts decreased by 33.5 per cent. from HK\$31.0 million in fiscal 1998 to HK\$20.6 million in fiscal 1999. The Directors believe this decrease was due to the reduction by customers in their expenditure on technical support and consultancy services in fiscal 1999 as a result of the year 2000 problem, as well as to the Asian financial crisis. A number of customers did not renew their time and material contracts upon their expiration, and some other customers re-negotiated a lower price with the Group. Turnover from time and material projects represented 21.0 per cent. of the Group's turnover in fiscal 1999 as compared to 41.3 per cent. of the Group's turnover in fiscal 1998.

Turnover from maintenance services increased by 28.6 per cent. from HK\$2.1 million in fiscal 1998 to HK\$2.7 million in fiscal 1999 which the Directors believe was mainly a result of new fixed price projects completed in fiscal 1999 for customers who elected to retain the Group to provide on-going maintenance services, and renewals of maintenance contracts by existing customers to whom the Group provided maintenance services. Turnover from maintenance services represented 2.8 per cent. of the Group's turnover in each of fiscal 1999 and fiscal 1998.

Cost of computer hardware and software

This represents the cost of sourcing IT products by the Group for resale. Cost of computer hardware and software increased by 144.9 per cent. from HK\$17.8 million in fiscal 1998 to HK\$43.6 million in fiscal 1999. Cost of computer hardware and software includes the cost (which is estimated to be HK\$11.1 million in fiscal 1999 and HK\$4.3 million in fiscal 1998) of sourcing hardware and software products for resale as part of fixed price contracts.

Other revenue and other net income

Other revenue in fiscal 1999 included interest income, rental and management fee income from Net Fun Limited amounting to HK\$0.4 million in aggregate for sharing the office space at China Resources Building and the provision of administrative services to Net Fun Limited, and other income derived from providing IT recruitment services to other companies. Other revenue decreased by 20 per cent. from HK\$1.0 million in fiscal 1998 to HK\$0.8 million in fiscal 1999. In addition, in fiscal 1999, the Group generated other net income of HK\$0.1 million, representing profits on disposal of property, plant and equipment.

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Staff costs

Staff costs increased by 21.6 per cent. from HK\$43.1 million in fiscal 1998 to HK\$52.4 million in fiscal 1999, primarily due to the increase in the number of staff employed by the Group. Staff costs represented 79.7 per cent. of operating expenses in fiscal 1999 as compared to 78.1 per cent. of operating expenses in fiscal 1998. The number of full-time employees of the Group increased from 142 as at the end of fiscal 1998 (of which 80 were members of the Group's development and implementation teams in the Software Centre) to 170 as at the end of fiscal 1999 (of which 120 were members of the Group's development and implementation teams in the Software Centre). Costs of staff engaging in research and development activities represented 18.6 per cent. of total staff costs in fiscal 1999 as compared to 21.4 per cent. of total staff costs in fiscal 1998 as the Group stated to re-deploy product development staff to engage in project implementation.

Depreciation and other operating expenses

Depreciation increased by 62.5 per cent. from HK\$1.6 million in fiscal 1998 to HK\$2.6 million in fiscal 1999. Following a re-appraisal, the estimated useful lives of the Group's computer and office equipment were reduced from five to three years with effect from 1st January, 1999. This resulted in an increased depreciation charge of HK\$0.9 million for fiscal 1999. Other operating expenses include items such as rent, rates and management fees, insurance costs and professional expenses. Other operating expenses increased 1.9 per cent. from HK\$10.5 million in fiscal 1998 to HK\$10.7 million in fiscal 1999.

Finance costs

Finance costs decreased by 0.5 per cent. in fiscal 1999 compared to fiscal 1998. Finance costs for fiscal 1999 comprised interest on bank loans and advances as well as interest on the loan advanced to the Group pursuant to the sponsorship obtained under the Applied Research and Development Scheme from the Applied Research Council of the Industry Department.

Loss from ordinary activities before taxation

Loss from ordinary activities before taxation was HK\$10.9 million in fiscal 1999 despite a 30.8 per cent. increase in turnover. The Directors believe this was due to the increase in staff costs in fiscal 1999, including as a result of the addition of development staff in the Software Centre for the development and enhancement of the Group's enterprise software, the reduction or postponement of investments in new IT related projects by customers in the last few months of fiscal 1999 in view of the year 2000 problem, the relatively lower margins for projects conducted for governmental authorities, and the larger proportion of turnover in fiscal 1999 attributable to the resale of IT products which the Directors believe generates lower margins compared to the Group's IT consultancy and custom development services.

Taxation and profit/loss for the year

No provision for Hong Kong profits tax was made for fiscal 1999 as all of the operating companies now comprising the Group and which were in existence as at 31st December, 1999 sustained losses for taxation purposes during the year. Tax credit for fiscal 1999 amounted to HK\$0.2 million, which was largely made up of a tax rebate from the Hong Kong government,

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and the reversal of deferred taxation provided for in fiscal 1998. The tax charge in fiscal 1998 amounted to HK\$0.8 million. There were no extraordinary items for both fiscal 1998 and fiscal 1999. The loss for fiscal 1999 was HK\$10.7 million and the profit for fiscal 1998 was HK\$1.7 million.

Financial year ended 31st December, 1998 compared to financial year ended 31st December, 1997

Turnover

On a combined basis, the Group recorded turnover of HK\$75.0 million in fiscal 1998, a decrease of 2.8 per cent. from turnover of HK\$77.1 million in fiscal 1997. The Directors believe the decrease in turnover was principally attributable to the Asian financial crisis, which slowed spending on IT products by the banking and finance sector in Asia.

Turnover from fixed price projects increased by 3.5 per cent. from HK\$25.5 million in fiscal 1997 to HK\$26.4 million in fiscal 1998 as new enterprise software (namely, EZ-File and HRMS) were developed and launched. Turnover from fixed price contracts represented 35.2 per cent. of the Group's turnover in fiscal 1998 as compared to 33.0 per cent. of the Group's turnover in fiscal 1997.

Turnover from hardware and software resale decreased by 32.6 per cent. from HK\$23.0 million in fiscal 1997 to HK\$15.5 million in fiscal 1998, following completion of a server consolidation project by a major customer of the Group in late 1997. Turnover from hardware and software resale represented 20.7 per cent. of the Group's turnover in fiscal 1998 as compared to 29.8 per cent. of the Group's turnover in fiscal 1997.

Turnover from time and material contracts increased by 11.9 per cent. from HK\$27.7 million in fiscal 1997 to HK\$31.0 million in fiscal 1998, partly as a result of an increase in the value of time and material contracts awarded by governmental authorities. Turnover from time and material projects represented 41.3 per cent. of the Group's turnover in fiscal 1998 as compared to 35.9 per cent. of the Group's turnover in fiscal 1997.

Turnover from maintenance services increased by 133.3 per cent. from HK\$0.9 million in fiscal 1997 to HK\$2.1 million in fiscal 1998. The Directors believe that this increase was principally brought about by the increased number of enterprise software licensed to the Group's customers and the resultant increase in the value of maintenance contracts with enterprise software customers for providing on-going maintenance support following completion of the customisation and implementation of the enterprise software. Turnover from maintenance services represented 2.8 per cent. of the Group's turnover in fiscal 1998 as compared to 1.2 per cent. of the Group's turnover in fiscal 1997.

Cost of computer software and hardware

Cost of computer hardware and software decreased by 3.3 per cent. from HK\$18.4 million in fiscal 1997 to HK\$17.8 million in fiscal 1998. Cost of computer hardware and software includes the cost (which is estimated to be HK\$4.3 million in fiscal 1998 and HK\$6.1 million in fiscal 1997) of sourcing hardware and software products for resale as part of fixed price contracts.

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Other revenue and other net income

Other revenue in fiscal 1998 included a training grant from Sun Microsystems and a government grant amounting in aggregate to HK\$0.4 million, as well as interest income. Other revenue in fiscal 1997 included interest income and income derived from providing IT recruitment services to other companies. Other revenue decreased by 23.0 per cent. from HK\$1.3 million in fiscal 1997 to HK\$1.0 million in fiscal 1998. In addition, in fiscal 1997, the Group generated other net income of HK\$0.01 million, representing profit on disposal of property, plant and equipment. There was no other net income recorded for fiscal 1998.

Staff costs

Staff costs increased by 0.9 per cent. from HK\$42.7 million in fiscal 1997 to HK\$43.1 million in fiscal 1998. Staff costs represented 78.1 per cent. of operating expenses in fiscal 1998 as compared to 73.6 per cent. of operating expense in fiscal 1997. The number of full-time employees of the Group increased from 139 as at the end of 1997 (of which 70 were members of the Group's development and implementation teams in the Software Centre) to 142 as at the end of fiscal 1998 (of which 80 were members of the Group's development and implementation teams in the Software Centre). Costs of staff engaging in research and development activities in fiscal 1998 represented 21.4 per cent. of total staff costs.

Depreciation and other operating expenses

Depreciation increased slightly by 1.3 per cent. from HK\$1.56 million in fiscal 1997 to HK\$1.58 million in fiscal 1998. Other operating expenses decreased by 23.4 per cent. from HK\$13.7 million in fiscal 1997 to HK\$10.5 million in fiscal 1998. The two largest components in other operating expenses for both fiscal 1998 and fiscal 1997 were fees paid to consultants who provided services to the Group and rent, rates and management fees. The primary reason for the reduction in operating expenses was the reduction in consultancy fees which decreased from HK\$7.3 million in fiscal 1997 to HK\$3.6 million in fiscal 1998 as the Group increased dependence on its own staff to provide services to customers and placed less reliance on the services of external consultants.

Finance costs

Financial costs increased by 7.6 per cent. in fiscal 1998 compared to fiscal 1997. In addition to interest on bank loans and advances, finance costs in fiscal 1998 also comprised interest on a loan provided to the Group by a company wholly owned by Ms. Peggy Chan. This loan was repaid in full by the Group in June, 1998.

Profit from ordinary activities before taxation

Despite the reduction in turnover in fiscal 1998 as compared to fiscal 1997, profit from ordinary activities before taxation was HK\$2.5 million in fiscal 1998, representing an increase of 56.3 per cent from HK\$1.6 million in fiscal 1997. The Directors believe that this increase was principally attributable to (i) the increase in turnover from time and material projects which the Directors believe generate higher margins compared to the resale of hardware and software

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products, (ii) the increase in turnover from maintenance services the provision of which involved minimal additional variable costs for the Group, and (iii) the reduction in other operating expenses which, as explained above, was largely a result of the reduction in the number of consultants hired by the Group.

Taxation and profit for the year

Tax charge for fiscal 1998 amounted to HK\$0.8 million as compared to HK\$0.4 million for fiscal 1997. The provision for Hong Kong profits tax is calculated on the taxable profit of each company comprising the Group at 16.5 per cent. and 16 per cent. during fiscal 1997 and fiscal 1998, respectively. There were no extraordinary items for both fiscal 1997 and fiscal 1998. The profit for fiscal 1998 was HK\$1.7 million and the profit for fiscal 1997 was HK\$1.2 million.

TAXATION

(a) *Bermuda*

The Company was incorporated under the laws of Bermuda and, under current Bermuda law, is not subject to tax on income or on capital gains. The Company has received an undertaking from the Ministry of Finance of Bermuda pursuant to the provisions of the Exempted Undertakings Tax Protection Act, 1966, as amended, that in the event that Bermuda enacts any legislation imposing tax computed on profits or income, including any dividend or capital gains withholding tax, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of any such tax shall not be applicable to the Company or to any of its operations or the shares, debentures or other obligations of the Company, until 28th March, 2016.

(b) *Hong Kong*

Each company within the Group will be subject to Hong Kong profits tax if it derives Hong Kong sourced profits from a business carried on in Hong Kong. Such Hong Kong sourced profits, as adjusted in accordance with Hong Kong tax law, will generally be subject to tax at the rate of 16 per cent. However, there are certain profits which are specifically not subject to Hong Kong tax, including dividend income, most interest income from bank deposits and profits derived from the sale of capital assets.

(c) *Effective tax rates*

The effective tax rate of the Group in fiscal 1997 was approximately 24.5 per cent., which was higher than the then applicable profits tax rate of 16.5 per cent. This was, in part, due to the depreciation charged to the profit and loss account of a member of the Group in that fiscal year exceeding its allowable depreciation for taxation purposes by approximately HK\$0.4 million. The effective tax rate of the Group for fiscal 1998 was approximately 31 per cent., which was higher than the then applicable profits tax rate of 16 per cent. The tax loss of approximately HK\$2.1 million for fiscal 1998 sustained by a member of the Group could not be used to offset against the taxable profits of other companies comprising the Group. All of the operating companies now comprising the Group which were in existence as at 31st December, 1999 sustained losses for taxation purposes in fiscal 1999.

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PROPERTY INTERESTS

The Group leases and occupies Rooms 3306 and 3307 on 33rd Floor, China Resources Building, 26 Harbour Road, Wan Chai, Hong Kong as its head office which has a total saleable area of approximately 4,910 sq.ft..

The Group also leases three office units on 10th Floor and an office unit on 14th Floor, Great Eagle Centre, 23 Harbour Road, Wan Chai, Hong Kong with a total saleable area of approximately 5,348 sq.ft.. Such offices are occupied by the operation/product teams of the Group, and part of the property with a saleable area of approximately 1,704 sq.ft. is (with the consent of the landlord) sub-leased to Net Fun Limited.

In addition, the Group leases the whole of 46th Floor, The Center, 99 Queen's Road Central, Hong Kong for its Software Centre. The saleable area of the property is approximately 18,889 sq.ft.. Part of the property with a saleable area of approximately 9,232 sq.ft. (with the consent of the landlord) is sub-leased to i21 Limited for running the ASP Business.

The Group owns Flat B on 21st Floor of Block 5 and a car parking space in Braemar Hill Mansions, 15-43 Braemar Hill Road, North Point, Hong Kong with a gross floor area of approximately 1,640 sq.ft. and Flat D on 9th Floor, Floral Tower, 22 Robinson Road, Mid-levels, Hong Kong with a gross floor area of approximately 779 sq.ft.. Such residential flats are occupied by two Directors as staff quarters.

Chesterton Petty Limited, an independent valuer, valued the property interests of the Group as of 30th April, 2000 at HK\$14 million. The text of the letter and the valuation certificate issued by Chesterton Petty Limited for this purpose is set out in Appendix III to this prospectus.

PROFIT FORECAST AND DIVIDEND POLICY

Profit forecast

The Directors forecast that, on the bases set out in Appendix II to this prospectus and an Offer Price of HK\$1.40 and in the absence of unforeseen circumstances, the combined profit after taxation but before extraordinary items of the Group for the year ending 31st December, 2000 will not be less than HK\$13 million. The forecast combined profit after taxation but before extraordinary items includes the share of forecast loss in an associated company.

On the basis of the above profit forecast and on the weighted average number of 858,557,892 Shares expected to be in issue during the year ending 31st December, 2000, the forecast earnings per Share for the year ending 31st December, 2000 would be HK\$0.015 representing a price/earnings multiple of 93 times based on an Offer Price of HK\$1.40. On a pro forma fully diluted basis and on (i) the assumption that the Company had been listed since 1st January, 2000 and had a total of 1,000,000,000 Shares in issue during the year; and (ii) the assumption that the interest income that would have been earned on the net proceeds of the Share Offer of approximately HK\$188 million had been received from that date and assuming an interest rate of 5 per cent. per annum had been applicable to the Group's deposits, the forecast pro forma fully diluted earnings per Share would be HK\$0.018, representing a price/earnings multiple of 78 times based on an Offer Price of HK\$1.40.

FINANCIAL INFORMATION

The figures in the preceding paragraph do not take into account Shares which may be issued upon exercise of the Over-allotment Option or of any options which may be granted under the Share Option Scheme or upon the conversion of the Additional Convertible Note or which may be allotted and issued or repurchased by the Company pursuant to the general mandates for the allotment and issue or repurchase of Shares described under "Shareholders' resolutions of the Company passed on 16th June, 2000" in Appendix VI to this prospectus.

The texts of the letters from the reporting accountants, KPMG, and from HSBC Investment Bank Asia in respect of the profit forecast are set out in Appendix II to this prospectus.

Dividend policy

The Directors presently do not intend to recommend any dividend for the financial year ending 31st December, 2000. The Directors expect that in future interim and final dividends will be paid in or about October and July of each year. Interim dividends will normally represent approximately one-third of the expected total dividends for each year. The declaration, payment and amount of dividends will be subject to the discretion of the Directors and will be dependent upon the Company's earnings, financial condition, cash requirements and availability, the provisions of relevant laws and all other relevant factors.

DISTRIBUTABLE RESERVES

The Company was incorporated on 21st January, 2000 and consequently had no distributable reserves as at 31st December, 1999.

FINANCIAL INFORMATION

ADJUSTED NET TANGIBLE ASSETS

The following statement of adjusted net tangible assets of the Group is based on the combined net assets of the Group as at 31st December, 1999 as set out in the Accountants' Report in Appendix 1, adjusted as described below:

	Based on an Offer Price of HK\$1.35 HK\$'000	Based on an Offer Price of HK\$1.40 HK\$'000
Combined net assets of the Group as at 31st December, 1999 as set out in the Accountants' Report in Appendix I	3,039	3,039
Unaudited combined profit for the four months ended 30th April, 2000 based on management accounts	1,611	1,611
Conversion of Convertible Notes into Shares (<i>Note 1</i>)	105,819	105,819
Estimated net proceeds of the Share Offer (<i>Note 2</i>)	<u>180,417</u>	<u>187,729</u>
Adjusted net tangible assets	<u>290,886</u>	<u>298,198</u>
Adjusted net tangible asset value per Share (<i>Note 3</i>)	<u>HK\$0.29</u>	<u>HK\$0.30</u>

Notes:

- (1) On 2nd March, 2000, the Company issued Convertible Notes of US\$13,600,000 principal value for cash at par, which have been translated into HK dollars at an exchange rate of US\$1 = HK\$7.78. The Convertible Notes have been converted into Shares on 15th June, 2000. Further details in respect of the Convertible Notes are set out under "Business — Group structure".
- (2) No account has been taken of the Shares which may be issued upon the exercise of the Over-allotment Option.
- (3) The adjusted net tangible asset value per Share is arrived at after the adjustments referred to in this section and on the basis of 1,000,000,000 Shares in issue and to be issued as mentioned herein but it takes no account of any Shares which may be issued upon the exercise of the Over-allotment Option or any options which may be granted under the Share Option Scheme or upon conversion of the Additional Convertible Note or which may be allotted and issued or repurchased by the Company pursuant to the general mandates for the allotment and issue or repurchase of Shares described under "Shareholders' resolutions of the Company passed on 16th June, 2000" in Appendix VI to this prospectus.
- (4) The surplus on revaluation of the Group's owned properties has not been incorporated into the Group's combined net assets as at 31st December, 1999 and will not be incorporated into the Group's financial statements for the year ending 31st December, 2000. The Group's owned properties were revalued at 30th April, 2000 at HK\$14,000,000 and the surplus arising from revaluation of the Group's property interests as at 30th April, 2000 amounted to HK\$6,890,000. If the properties were to be included at their revalued amounts, an additional depreciation charge of approximately HK\$105,000 would be incurred for the year ending 31st December, 2000.

FINANCIAL INFORMATION

NO MATERIAL CHANGE

Save as disclosed in this prospectus, the Directors are not aware of any material adverse change in the financial or trading positions or prospects of the Group since 31st December, 1999.