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INDEBTEDNESS

Borrowings

At the close of business on 31 August 2003, being the latest practicable date for the purpose of this indebtedness statement, the Company had outstanding secured bank borrowings amounted to approximately RMB78.0 million and unsecured bank borrowings amounted to approximately RMB0.8 million. All the secured borrowings are denominated in RMB with interest rates ranging from 5.04% to 5.49% per annum where the unsecured borrowings are denominated in US dollar with interest rate of 3.9% per annum. The following table sets out the maturity profile of the bank borrowings:

	Unsecured bank borrowings <i>RMB million</i>
repayable in 2003	0.8
	<hr/> <hr/>
	Secured bank borrowings <i>RMB million</i>
repayable in February 2004	18.0
repayable in March 2004 and will be renewed to March 2008	30.0
repayable in May 2004 and will be renewed to May 2007	30.0
	<hr/>
	78.0
	<hr/> <hr/>

There was no default of loan repayment up to 31 August 2003. For details of the security for the banking facilities of the Company, please refer to the paragraph headed “Guarantee and security” in this section of the prospectus.

As at 31 August 2003, the Company had outstanding dividends payable of approximately RMB13.3 million. The dividends have been paid in full in September 2003.

On 30 September 2003, the Company has entered into a factoring agreement and has borrowed RMB12 million from Shanghai Pudong Development Bank with a pledge of RMB16 million of trade receivables due from UTStarcom.

Pursuant to the loan agreement entered into between the Agricultural Bank of China and the Company dated 28 March 2002, the Agricultural Bank of China agreed to grant a loan of RMB30 million to the Company as a medium term working capital for the purchase of raw materials at an interest rate of 5.49% per annum. The term of this loan is for a period of 2 years from 29 March 2002 to 28 March 2004. By a mortgage agreement dated 28 March 2002 entered into between the Agricultural Bank of China and the Company, the land use right of the Company in respect of No. 36 Gao Xin Liu Road, Xi’an National Hi-tech Industrial Development Zone and the buildings thereon (“the Properties”) were pledged as security for this loan. The Company has obtained an irrevocable written undertaking from the Agricultural Bank of China dated 3 June 2003. Pursuant to such undertaking, the Agricultural Bank of China has irrevocably undertaken to the Company to rollover or renew this loan on the same terms of borrowing when it becomes due. Accordingly, such loan will be renewed in March 2004 for a term of 2 years until March 2006, with a further renewal in March 2006 to March 2008. Such loan is expected to be repaid in full in March 2008. According to a supplemental undertaking dated 4 October 2003, the Agricultural Bank of China shall rollover or renew such loan irrespective of any change in interest rate or the value of the Properties.

Pursuant to the loan agreement entered into between the China Everbright Bank and the Company dated 30 May 2003, the China Everbright Bank agreed to grant a loan of RMB30 million to the Company as working capital at an interest rate of 5.31% per annum. The term of this loan is

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for a period of one year from 30 May 2003 to 30 May 2004. By a mortgage agreement dated 28 April 2003 entered into between the China Everbright Bank and the Company, the Properties were, with the consent of the Agricultural Bank of China, pledged as security for this loan. The Company has obtained an irrevocable written undertaking from the China Everbright Bank dated 9 June 2003, pursuant to which the China Everbright Bank has irrevocably undertaken to the Company to rollover or renew this loan for three years until May 2007 on the same terms of borrowing when it becomes due, subject to an annual renewal by the China Everbright Bank. This loan is planned to be repaid in full in May 2007. According to a supplemental undertaking dated 4 October 2003, the China Everbright Bank shall rollover or renew such loan irrespective of any change in interest rate or the value of the pledged Properties.

As advised by the Company's PRC legal advisers, Jingtian & Gongcheng, the irrevocable written undertakings issued by the Agricultural Bank of China dated 3 June 2003 and the China Everbright Bank dated 9 June 2003 have been affixed with the seal of the respective banks and reflected the true intention of the two banks. The undertakings are legally binding on the two banks and are legal and valid. Pursuant to Article 22 of the Commercial Bank Laws of the PRC and "Reply to the Questions Regarding the Civil Liabilities of the Branches of the Commercial Banks" issued by the PBOC, the branches of commercial banks do not have legal person status. They develop and conduct businesses within the scope authorized by the head office and their civil liabilities shall be borne by the head office. The liabilities borne by the branches of the commercial banks shall not be limited to the assets managed by them with the authority of the head office. If the assets managed by a branch are not sufficient to cover the civil liability, the excessive part of the civil liability shall be borne by its superior bank and all the way to the head office.

As advised by the Directors, according to the valuation given by Xi'an Zhengheng Asset Appraisal Co., Ltd. (a qualified firm of valuers in the PRC), the aggregate value of the Properties was higher than the aggregate amount of loan granted by the Agricultural Bank of China and the China Everbright Bank to the Company. As advised by Vigers Hong Kong Ltd., the PRC valuation was conducted on the basis of the proposed development plan for the industrial complex whilst the valuation performed by Vigers Hong Kong Ltd., was formulated on the basis of the existing state of the Properties as at the date of valuation, this gave rise to such a difference in the valuation made by Xi'an Zhengheng Asset Appraisal Company Limited and Vigers Hong Kong Ltd.

According to "An explanation regarding the security for a medium term working capital loan of RMB30 million granted to the Company" issued by Agricultural Bank of China on 30 July 2003 (關於西安海天天綫股份有限公司在我行3000萬元中期流動資金貸款抵押物的說明), the Agricultural Bank of China explained that the RMB30 million loan granted to the Company is secured by the Properties. The Properties were valued by Xi'an Zhengheng Asset Appraisal Co., Ltd., a qualified firm of valuers in the PRC at an amount higher than the aggregate amount of loan granted by the Agricultural Bank of China and the China Everbright Bank to the Company. At the time when the loan was granted, the Agricultural Bank of China has strictly complied with its loan procedure of reviewing and approving the loan, and has registered the pledge with the registration authority as required by the Guarantee Law of the PRC. If risks are encountered in recovering this loan, the Agricultural Bank of China will exercise its right as a creditor against the Company by, among other measures, sale of the Properties. If the sales proceeds of the Properties are insufficient to repay the debt owed to the Agricultural Bank of China, the Company is under an obligation to repay any outstanding amount by other assets.

The Agricultural Bank of China acknowledges and consents to the Company creating another pledge on the Properties as security for a consolidated credit of RMB40 million (representing RMB30 million bank loan and RMB10 million bills of exchange) granted by the China Everbright Bank.

The Agricultural Bank of China has confirmed in writing that it was aware that the value of the Properties as given by Vigers Hong Kong Ltd. is approximately RMB38 million. However, that valuation has no effect on the following decisions made by the Agricultural Bank of China: (a) the granting of the loan of RMB30 million to the Company as set out above and the irrevocable written undertaking dated 3 June 2003 issued by the Agricultural Bank of China in relation to the

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renewal of the loan; (b) the Agricultural Bank of China will not demand early repayment of the RMB30 million loan by the Company despite of the result of the said valuation of Vigers Hong Kong Ltd.; (c) it is the relevant branch to approve the loan to the Company and such branch is not required to seek its central office's approval for this loan; and (d) it has strictly complied with its loan procedure of reviewing and approving the loan to the Company.

According to "An explanation regarding the security for a consolidated credit of RMB40 million granted to Xi'an Haitian Antenna Technologies Co., Ltd." issued by the China Everbright Bank on 30 July 2003 (關於西安海天天綫股份有限公司在我行4000萬元綜合授信抵押物的說明), the China Everbright Bank explained that the consolidated credit of RMB40 million (representing RMB30 million bank loan and RMB10 million bills of exchange) granted to the Company is secured by the Properties. At the time when the consolidated credit was granted, the China Everbright Bank has strictly complied with its loan procedure of reviewing and approving the loan, and has registered the pledge with the registration authority as required by the Guarantee Law of the PRC. If risks are encountered in recovering the amount due under this consolidated credit, the China Everbright Bank will exercise its right as a creditor against the Company. If the sales proceeds of the Properties are insufficient to repay the debt owed to the China Everbright Bank, the Company is under an obligation to repay any outstanding amount by other assets.

The China Everbright Bank acknowledges and consents to the Company creating another pledge on the Properties as security for a loan of RMB30 million granted by the Agricultural Bank of China.

The China Everbright Bank has confirmed in writing that it was aware that the value of the Properties valued by Vigers Hong Kong Ltd. is approximately RMB38 million. However, that valuation has no effect on the following decisions made by the China Everbright Bank: (a) the granting of the consolidated credit RMB40 million (representing RMB30 million bank loan and RMB10 million bills of exchange) to the Company as set out above; and the irrevocable written undertaking issued by the China Everbright Bank dated 9 June 2003 in relation to the renewal of the loan; (b) the China Everbright Bank will not demand early repayment of the RMB40 million (representing RMB30 million bank loan and RMB10 million bills of exchange) consolidated credit by the Company despite of the result of the said valuation of Vigers Hong Kong Ltd.; (c) it is the relevant branch to approve the loan to the Company and such branch is not required to seek its central office's approval for this loan; and (d) it has strictly complied with its loan procedure of reviewing and approving the loan to the Company.

As advised by Jingtian & Gongcheng:

- (a) the aforesaid undertakings are legally binding and enforceable.
- (b) the form and substance of the aforesaid loan agreements and mortgage agreements comply with the relevant PRC laws and regulations and are legally binding and enforceable;
- (c) the Properties were valued in January 2002, by Xi'an Zhengheng Asset Appraisal Co., Ltd. (西安正衡資產評估有限責任公司);
- (d) Xi'an Zhengheng Asset Appraisal Co., Ltd. is a qualified firm of valuers in the PRC with the authority to issue the said valuation report;
- (e) it is a commercial decision of the banks to adopt the said valuation report to conclude whether the value of the Properties exceeds the secured indebtedness and such decision is not in breach of any relevant PRC laws and regulations;
- (f) it is provided under Section 35 of the Guarantee Law of the PRC 《中華人民共和國擔保法》, that "where a property is mortgaged and the value of the same exceeds the amount of indebtedness secured, the property can be further mortgaged to secure an amount not exceeding the excess." According to the said section, the Company was entitled to mortgage the Properties to two banks respectively;

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- (g) Vigers Hong Kong Ltd. gave their opinion of the market value of the Properties. By two written confirmations both dated 30 July 2003, the banks respectively confirmed that they are aware of the valuation opinion of Vigers Hong Kong Ltd. They maintain the view that it is appropriate for them to advance the loans to the Company and will not demand for early repayment of the loans by reason only of the valuation opinion of Vigers Hong Kong Ltd.;
- (h) the loans have been registered in the loan register of the PBOC, the relevant authority for loan registration, and the mortgage agreements have been registered with and the original land use right certificate in respect of No. 36 Gao Xin Liu Road, Xi'an National Hi-tech Industrial Development Zone has been kept in the Land and Property Management Bureau of Xi'an National Hi-tech Industrial Development Zone (西安高新技術產業開發區國土資源和房屋管理局). As confirmed by the Directors, loan register (貸款卡) is the sole centralized registry in the PRC which records loan position of a company and Certificate of Other Claims on Land (土地他項權力證明書) is the document issued by the Land and Property Management Bureau of Xi'an National Hi-tech Industrial Development Zone, which is the relevant authority governing the use of land in the PRC; and
- (i) the Agricultural Bank of China shall have priority over the claims of the China Everbright Bank in relation to the Properties as the same were first pledged to the Agricultural Bank of China.

Contingent liability

As at 31 August 2003, the Company had bills of exchange which amounted to approximately RMB32.5 million discounted to the bank with recourse.

Guarantee and security

As at 31 August 2003, the Company's banking facilities were secured by the following:

- (1) the Company's trade receivables of approximately RMB23.7 million;
- (2) the Company's land use right and buildings with a net book value of approximately RMB12.2 million and RMB24.5 million respectively; and
- (3) pledged bank deposits of approximately RMB5.8 million.

Disclaimer

Save as aforesaid, at the close of business on 31 August 2003, the Company had no mortgages, charges, debentures or other loan capital, bank overdrafts, loans or other similar indebtedness, liabilities under acceptance (other than normal trade bills), acceptance credits, guarantees, or finance leases and hire purchase commitments or other material contingent liabilities. Save as aforesaid, there were no material changes in indebtedness and contingent liabilities subsequent to 31 August 2003.

LIQUIDITY, FINANCIAL RESOURCES AND CAPITAL STRUCTURE

Net current assets

As at 31 August 2003, the Company had net current assets of approximately RMB62.4 million. The current assets mainly comprised inventories of approximately RMB32.9 million, trade receivables of approximately RMB123.1 million, bills receivable of approximately RMB0.3

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million, other receivables and prepayments of approximately RMB14.6 million, pledged bank deposits of approximately RMB5.5 million and bank balances and cash of approximately RMB17.6 million. The current liabilities comprised of trade payables of approximately RMB41.4 million, bills payable of approximately RMB5.4 million, other payables and accrued charges of approximately RMB11.5 million, taxation payable of approximately RMB11.2 million, dividends payable of approximately RMB13.3 million and bank borrowings due within one year of approximately RMB48.8 million. According to the Directors, the reasons for the decrease in the balances of “pledged bank deposit” and “bank balances and cash” as at 31 August 2003 as compared with those as at 31 May 2003 are as follows:

- The decrease of approximately RMB20.7 million in the balance of the pledged bank deposits was a result of the release of the RMB15 million pledged deposit after the repayment of a RMB15 million bank loan and the settlement of approximately RMB5.7 million for bills of exchange and letters of credit.
- The decrease of approximately RMB21.2 million in bank balances and cash was due to (i) payment of approximately RMB5.2 million for the expansion of testing centre under construction; (ii) repayment of bank loan (net of new loan advanced) of approximately RMB3.3 million and (iii) the use of approximately RMB12.7 million for the Company’s daily operations including payment of income tax of RMB1 million.

Borrowings and loan facilities

The Company generally relies on its internal cash flow and banking facilities available to the Company to meet the requirements of its operations. Save for the bank borrowings of approximately RMB78.8 million as disclosed in the paragraph headed “Indebtedness” in this section of the prospectus, as at the 31 August 2003, the Company had unutilised bills of exchange of approximately RMB4.6 million. As at 31 August 2003, the unutilised facility of factoring trade receivables granted by the China Everbright Bank amounted to RMB12 million.

The following table sets out the details of bank borrowings and banking facilities of the Company as at 31 August 2003:

Name of bank	Nature	Facilities		Collateral	Repayment Date	Renewal/ Expiry
		Available RMB million	Utilised RMB million			
Agricultural Bank of China	Loan	30	30	Land use right and buildings at No. 36 Gao Xin Liu Road, Xian National Hi-tech Industrial Development Zone, Xi’an	28 March 2004	28 March 2004 and will be renewed to 28 March 2008
China Everbright Bank	Loan and bills of exchange (Note 1)	40	30	Land use right and buildings at No. 36 Gao Xin Liu Road, Xian National Hi-tech Industrial Development Zone, Xi’an	30 May 2004	30 May 2004 and will be renewed to 30 May 2007
Shanghai Pudong Development Bank	Factoring (Note 2)	30	18	Trade receivables from China Unicom (Gansu), UTStarcom and China Unicom (Shaanxi)	19 February 2004	Revolving facilities; will be expired on 30 June 2004
Bank of East Asia, Limited Xi’an Branch (東亞銀行有限公司西安分行)	Loan	0.8	0.8	Unsecured	10 December 2003	10 December 2003
		<u>78.8</u>				

Note 1: In addition to RMB30 million bank loan, China Everbright Bank has also granted facilities of issuing bills of exchange of up to a maximum amount of RMB10 million to the Company on 28 April 2003. As at 31 August 2003, the Company had issued bills of exchange under such facilities amounted to approximately RMB5.4 million as at that date.)

Note 2: The facility was fully utilised on 30 September 2003 when an additional amount of RMB12 million was borrowed under the factoring facility on 30 September 2003.

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Pursuant to a document on overall facility granted to the Company issued by Shanghai Pudong Development Bank (上海浦東銀行關於對西安海天天綫科技股份有限公司綜合授信的說明) dated 11 August 2003 which provided that the Shanghai Pudong Development Bank has granted a consolidated facility of RMB90 million to the Company, comprising of stand-by facility for providing (i) a maximum amount of RMB65 million for discounting bills of exchange and pledging of trade receivables; and (ii) a maximum amount of RMB25 million for issuing bank guaranteed bills of exchange and issuing letter of credit in relation to trade financing. The expiry date of such consolidated facility is 30 June 2004. In relation to the aforesaid facility for providing a maximum amount of RMB65 million for both discounting bills of exchange and pledging of trade receivables, a maximum usable amount of facility for pledging of trade receivables is RMB30 million. The facilities of factoring trade receivables which is revolving in nature, provided that the Company pledges the trade receivables as specified by Shanghai Pudong Development Bank. After each repayment, the Company's credit limit will be restored automatically. Accordingly, the Company will have the flexibility in repaying and utilising such revolving facilities. Under the said document, the Company has entered into two factoring agreements dated 19 August 2003 and 30 September 2003 respectively with Shanghai Pudong Development Bank by which the Company has advanced RMB18 million and RMB12 million respectively.

Pledge of assets

The Company has pledged the following assets for the banking facilities granted to the Company and the carrying value of the assets are as follows:

	As at 31 August 2003 RMB
Bank deposits (<i>Note 1</i>)	5,810,774
Buildings	24,472,002
Land use right	12,219,722
Trade receivables (<i>Note 2</i>)	23,660,000
	<u>66,162,498</u>

Notes: 1. Among the deposit pledged, approximately RMB3 million was pledged for bills of exchange issued, approximately RMB2 million was pledged for letter of credit issued and approximately RMB0.8 million was pledged for letter of quality guarantee issued.

2. The trade receivables are pledged to banks according to factoring agreements.

Debt to equity ratio

The Company's investment in fixed assets for product research and development and testing will continue until the year 2005 as set out in the section headed "Statement of Business Objectives and Strategies" in this prospectus. For such reason, even if the Company will continue to generate cash inflow from its operations, the debt to equity ratio (which is defined as the total bank and other borrowings of the Company divided by the net assets of the Company and was 71.5% as at 31 August 2003) may not be lowered significantly before the end of the year 2005. After the year 2005, as the Company's investment in fixed assets is expected to be lower and assuming that no new business plan will be carried out, debt to equity ratio is expected to be lowered by the increasing cash inflow generated from operation.

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According to the Directors, the Company is taking the steps as disclosed in the sub-paragraph headed “Basis of making allowance” and sub-paragraph headed “Inventory” under the section headed “Business” to improve its management of trade receivables and inventory. The improvement in management of these two areas is expected to improve the Company’s cash position. According to the Directors, the RMB10 million cash in excess of the amount needed for daily operation will provide sufficient cash reserve for the Company. If the Company accumulates cash that is more than such sufficient cash benchmark, the Company plans to use the additional cash to gradually reduce the level of bank borrowings.

Capital commitments

As at 31 August 2003, the Company had commitments of approximately RMB12 million for capital expenditure contracted for but not provided in the financial statements in respect of the acquisition of property, plant and equipment. Of such amount, nil was paid after 31 August 2003.

Among the approximately RMB12 million commitments, approximately RMB11 million are for further empowering of the Company’s research and development capabilities and approximately RMB1 million for testing equipment used in product research and development.

According to the terms of the contracts, amounts contracted for are to be settled by letter of credit and telegraphic transfer and for such total amounts, the latest payment is a sum of approximately RMB6 million which will be settled by the end of year 2003. The balance of approximately RMB6 million will be settled in January 2004. The Company has pledged bank deposit of approximately RMB2 million in August 2003 as security for letter of credit issued for settlement of RMB12 million contracted for.

Financial resources

At the close of business on 31 August 2003, the Company had cash and bank deposits of approximately RMB17.6 million. The Company intends to finance the Company’s future operations, capital expenditure and other capital requirements with internally-generated cashflow, the existing banking facilities available to the Company, bank balances available and the net proceeds from the Placing.

Foreign exchange

Renminbi currently is not a freely convertible currency. Currently, the Company receives all of its revenue from sales in the PRC in Renminbi while the export revenue is denominated in US dollars. A portion of the Company’s Renminbi revenues must be converted into other currencies to meet the Company’s foreign currency obligations including the purchasing of imported equipment and payment of any dividend declared in respect of the H shares. Currently, the Company purchases all of its raw materials for production from the PRC suppliers. The Directors believe that except for payment of imported equipment and payment of any dividend declared in respect of the H Shares, the Company does not have any material foreign exchange exposure.

Under the current foreign exchange system in the PRC, the Company is not able to hedge effectively against currency risk, including future depreciation of Renminbi. Any appreciation or depreciation in value of Renminbi versus the US dollars and Hong Kong dollars could affect the ability of the Company to export its products or to import equipment and materials and to pay dividends in foreign currencies. Please refer to the section headed “Risk Factors – Risks relating to the PRC – Currency conversion and foreign exchange” for details of the Company’s foreign exchange risk exposures.

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TRADING RECORD

The following table is a summary of the Company's audited results for the two years ended 31 December 2002 and the five months ended 31 May 2003. The summary should be read in conjunction with the accountants' report set out in appendix I to this prospectus.

	For the year ended 31 December		For the five months ended 31 May
	2001 RMB	2002 RMB	2003 RMB
Turnover (Note 1)	74,905,651	164,525,831	79,258,672
Cost of sales	(31,174,702)	(73,091,608)	(40,010,304)
Gross profit	43,730,949	91,434,223	39,248,368
Other operating income	159,362	2,120,260	462,948
Distribution costs	(9,659,559)	(17,974,095)	(11,330,755)
Administrative expenses	(6,976,440)	(11,897,950)	(7,583,129)
Other operating expenses	(6,967,389)	(15,095,329)	(7,232,455)
Profit from operations	20,286,923	48,587,109	13,564,977
Finance costs	(671,329)	(4,025,294)	(2,403,029)
Profit before taxation	19,615,594	44,561,815	11,161,948
Taxation (Note 2)	–	(8,168,467)	(2,661,209)
Net profit for the year/period	<u>19,615,594</u>	<u>36,393,348</u>	<u>8,500,739</u>
Dividends	<u>–</u>	<u>15,000,000</u>	<u>–</u>
Earnings per share, basic (Note 3)	<u>RMB0.039</u>	<u>RMB0.073</u>	<u>RMB0.017</u>

Notes:

- Turnover represents the amounts received and receivable for goods sold exclusive of value added taxes, less returns and allowances to third parties during the year/period.
- The amount represents provision for PRC corporate income tax on the Company's estimated assessable profit for the year/period.

The charge for the year/period can be reconciled to the profit as shown in the income statements as follows:

	Year ended 31 December 2001		Year ended 31 December 2002		Five months ended 31 May 2003	
	RMB	%	RMB	%	RMB	%
Profit before taxation	<u>19,615,594</u>		<u>44,561,815</u>		<u>11,161,948</u>	
Tax at the domestic income tax rate of 15%	2,942,339	15	6,684,272	15	1,674,292	15
Tax effect of expenses that are not deductible in determining taxable profit	–	–	2,986,833	6.7	1,959,253	17.5
Tax effect on additional tax allowance in respect of domestic acquired machineries	–	–	(832,719)	(1.9)	(566,039)	(5.1)
Tax effect on additional tax allowance in respect of the research and development costs	–	–	(669,919)	(1.5)	(398,047)	(3.5)
Tax effect on additional tax allowance in respect of the government subsidy for export sales	–	–	–	–	(8,250)	(0.1)
Tax effect of tax holiday	(2,942,339)	(15)	–	–	–	–
Tax expense and effective tax rate	<u>–</u>	<u>–</u>	<u>8,168,467</u>	<u>18.3</u>	<u>2,661,209</u>	<u>23.8</u>

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The Company is regarded by the Xi'an Municipal Bureau of Science and Technology as a high technology enterprise located at the Xi'an National Hi-tech Industrial Development Zone. Pursuant to relevant laws and regulations in the PRC, the Company is exempted from income tax for the two years starting from their first production year followed by an income tax rate of 15% in the remaining years of operation. Therefore, the Company was exempted from income tax for the first two years since its production commenced in 2000 and is subject to an income tax rate of 15% thereafter.

The increase in effective tax rate for the five months ended 31 May 2003 is mainly attributable to the increase in salaries and bonus payment. As such payment exceeded the maximum amount allowable for deduction, the non-deductible salary expenses increased. As a result, a higher effective tax rate was recorded.

3. The calculation of the basic earnings per Share for the relevant year/period is based on the profit for the year/period and on the basis of 500,000,000 Shares in issue as at the date of this prospectus and assuming that the sub-division of Shares had taken place at the beginning of the Track Record Period.

MANAGEMENT DISCUSSION AND ANALYSIS

Prior to 2000, the turnover of the Company was mainly derived from sales of WLL/PHS base station antenna series due to the fact that the PRC's market for equipment of GSM/CDMA antenna series was predominated by foreign manufacturers. However, following the issue and implementation of Technical Specifications of Base Station as the industry standard for domestic production of base station antennas in May 2000, the Company adopted a strategy to develop its GSM/CDMA antennas. Since then, the Company's sales of GSM/CDMA antenna series have grown significantly. In addition, growth in sales of the indoor distribution system has been increasing due to the strong demand from mobile communication network operators in improving signal coverage in indoor and outdoor out-of-reach ("blind") areas to attract more mobile communication service subscribers and/or to maintain the existing subscriber base. During the second half of the year ended 31 December 2002, the construction work of PHS network started in provinces/municipalities/regions such as Guangdong, Hebei and Beijing. As a result, orders for WLL/PHS base station antenna series increased substantially. Such increasing trend continued in the five months ended 31 May 2003. At the same time, the sales of GSM/CDMA increased from approximately RMB12.45 million for the five months ended 31 May 2002 to approximately RMB21.27 million for the five months ended 31 May 2003. However, during the five months ended 31 May 2003, the sale of WLL/PHS base station antennas as a percentage of totals was greater than those of GSM/CDMA base station antennas as a percentage of total sales. Sales of WLL/PHS base station antennas as a percentage of total turnover increased from approximately 28.8% for the year ended 31 December 2002 to approximately 65.2% for the five months ended 31 May 2003. On the other hand, although sales of GSM/CDMA base station antenna has increased, such sales as a percentage of total turnover decreased from approximately 56.9% for the year ended 31 December 2002 to approximately 26.8% for the five months ended 31 May 2003. The following is a table showing the turnover breakdown by the Company's product lines:

<i>(in RMB million)</i>	Year ended 31 December				Five months ended 31 May	
	2001	%	2002	%	2003	%
WLL/PHS base station antenna series	28.41	37.9	47.4	28.8	51.7	65.2
GSM/CDMA antenna series	41.16	55.0	93.7	56.9	21.3	26.8
Indoor distribution system series	–	0.0	21.5	13.1	4.6	5.8
Others <i>(Note)</i>	5.34	7.1	1.9	1.2	1.7	2.2
Total	74.91	100.0	164.5	100.0	79.3	100.0

Note: Sales grouped under "Others" represent sales of antenna products which were specifically produced for certain low volume orders such as 450MHz Yagi antenna. The sales made under this category are non-recurring in nature because those products are tailor-made according to the specific requests from the customer. Hence, sales made under this category fluctuated significantly during the Track Record Period.

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Revenue derived from the Company's domestic sales accounted for approximately 97.7%, 91.8% and 96.2% of the Company's total turnover during the Track Record Period respectively. However, the sales contribution generated from overseas has been increasing. The increase in overseas sales was mainly attributable to (i) the initiative of the Company to assign a specific team of 4 sales and marketing staff to promote the Company's products; (ii) the establishment of the international business department in May 2001 for the purpose of expanding its geographical coverage into some overseas markets; and (iii) the appointment of the agent in India to promote the Company's products. The following is a table showing the turnover breakdown by geographical locations:

<i>(in RMB million)</i>	Year ended 31 December				Five months ended 31 May	
	2001	%	2002	%	2003	%
PRC	73.2	97.7	151.1	91.8	76.3	96.2
Asia other than the PRC <i>(Note 1)</i>	1.7	2.3	13.3	8.1	1.3	1.7
Others <i>(Note 2)</i>	–	–	0.1	0.1	1.7	2.1
Total	74.9	100.0	164.5	100.0	79.3	100.0

Notes:

1. These countries/regions include Taiwan, Thailand, Indonesia, India, Singapore, Saudi Arabia, Sri Lanka and United Arabian Emirates.
2. These countries include the U.S., Germany and Tanzania.

The Directors believe that the Company has great growth potential in the international market and are expecting higher turnover from overseas markets in the future. During the five months ended 31 May 2003, while sales to countries/regions in Asia other than the PRC were about the same as in the same period of the year 2002, sales to countries outside Asia increased by approximately RMB1.7 million.

During the Track Record Period, the Company recorded a gross profit margin of approximately 58.4%, 55.6% and 49.5% respectively and a net profit margin of approximately 26.2%, 22.1% and 10.7% respectively. The reason for decrease in both gross and net profit margin during the Track Record Period was owing to (i) the increase in sales contribution from lower profit margin product lines, namely the GSM/CDMA antenna series, than that from the WLL/PHS base station antenna series; and (ii) the decrease in gross profit margin of WLL/PHS base station antenna series as a result of the Company lowering the selling price of WLL/PHS base station antenna series in order to compete with other manufacturers. The following is a table showing the profit analysis of the Company:

	Year ended 31 December		Five months ended 31 May
	2001	2002	2003
	<i>RMB million</i>	<i>RMB million</i>	<i>RMB million</i>
Revenue	74.9	164.5	79.3
Cost of sales	31.2	73.1	40.0
Gross profit	43.7	91.4	39.3
Net profit	19.6	36.4	8.5
Gross profit margin	58.4%	55.6%	49.5%
Net profit margin	26.2%	22.1%	10.7%

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The following is a table showing the profit analysis of the Company by product lines:

Gross profit margin

	For the year ended 31 December		For the five months ended 31 May
	2001	2002	2003
WLL/PHS base station antenna series (<i>Note 1</i>)	70.8%	60.3%	48.7%
GSM/CDMA antenna series (<i>Note 2</i>)	48.6%	53.0%	50.9%
Indoor distribution system series (<i>Note 3</i>)	–	60.1%	51.8%
Others (<i>Note 4</i>)	67.6%	11.6%	50.3%
Total	58.4%	55.6%	49.5%

Notes:

- (1) In 2002, in respect of WLL/PHS base station antenna series, the Company was operating under a competitive environment and lowered the price charged to its customers by 8% to 15% on average. Accordingly, gross profit margin decreased. For the five months ended 31 May 2003, because of intensifying competition, the Company further lowered the selling price by 5% to 21%. As the result, the gross profit margin decreased further.
- (2) In 2002, the gross profit margin of GSM/CDMA antenna series increased due to a higher price charged on the upgraded models with some new customers. For the five months ended 31 May 2003, there were not many new or upgraded models sold and the gross profit margin was stable, in comparison with that for the year 2002.
- (3) Gross profit margin for the indoor distribution system series was lower for the five months ended 31 May 2003 comparing with that for the whole year of 2002 because the certification of completion of the installation of indoor distribution systems were delayed due to the outbreak of SARS in the PRC in the first few months of 2003. Sales of indoor distribution system are on contract basis and usually involve installation works which normally last for less than one year. On average, an indoor distribution system project lasts for approximately six months. Costs for installation of indoor distribution systems mainly consist of staff expenses in relation to installation works, material costs and subcontracting fee. The relevant direct costs, such as sub-contracting fee, cost of materials for the installation projects are charged to cost of sales at the time when the revenue is recognised, in accordance with the matching principle. However, indirect costs such as the salaries paid to the maintenance team and depreciation of equipment, as they are fixed costs and are not directly associated with each separate contract, are charged to the income statement when incurred. Though some of the installation projects have been completed, certification of completion could not be finalised due to the implementation of quarantine measures as a result of the outbreak of SARS. Therefore, those indirect costs have been recorded as expenses in the income statement while related revenue has not been recognised. Accordingly, gross profit margin for indoor distribution system was lower.

However, sales of WLL/PHS and GSM/CDMA base station antennas have not been severely affected as such sales would only involve delivery of physical goods. If, for any reasons, such as the outbreak of SARS, such antennas could not be delivered to customers, sales would not be recognised and cost of goods would be recorded as inventory. Therefore, gross profit margins for the Company's sales of WLL/PHS and GSM/CDMA base station antennas were not significantly affected by SARS.

- (4) Sales grouped under "Others" represent sales of antenna products which were specifically produced for certain low volume orders such as 450 MHz Yagi antenna. As the selling prices of "Others" antenna and related products are negotiated with the customers on a case-by-case basis in accordance with specific customer's requirements, gross profit margin for "Others" antenna and related products fluctuates significantly.

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The following table is the breakdown of administrative expenses and other operating expenses during the Track Record Period:

Administrative expenses	For the year ended		Five months
	31 December		ended
	2001	2002	31 May
	<i>RMB</i>	<i>RMB</i>	2003
			<i>RMB</i>
Amortisation for land use right	43,820	259,089	107,954
Audit fee	220,000	250,000	150,000
Bank charges	–	299,140	45,460
Directors' emolument	1,548,362	1,542,835	837,900
Depreciation	856,551	1,096,624	544,768
Education fund expenses	149,462	235,315	163,156
Entertainment	280,834	282,619	216,664
Insurance	51,201	257,258	129,699
Motor vehicle expenses	466,104	425,880	295,926
Other tax (utility, land, building, stamp)	60,133	519,042	348,615
Others	1,308,855	2,562,127	1,444,307
Rental Expenses	551,739	–	–
Salaries	707,977	2,986,782	1,882,887
Staff welfare	342,217	614,022	636,724
Traveling expenses	132,156	108,464	438,790
Union fund expenses	197,029	313,753	205,279
Professional fee	60,000	145,000	135,000
	<u>6,976,440</u>	<u>11,897,950</u>	<u>7,583,129</u>
Other operating expenses	For the year ended		For the
	31 December		five months
	2001	2002	ended
	<i>RMB</i>	<i>RMB</i>	31 May
			2003
			<i>RMB</i>
Amortisation for technological know-how	1,000,000	1,000,000	416,667
Loss on disposal of property, plant and equipment	–	626,465	18,455
Deposits for acquisition of materials written off	–	126,220	–
Allowance for doubtful debts	694,398	4,252,215	1,696,472
Research and development			
Salaries for research and development	2,752,706	3,903,279	2,450,081
Staff welfare for research and development	385,268	546,445	343,009
Depreciation for research and development	426,195	1,650,846	915,291
Miscellaneous expenses for research and development	1,708,822	2,989,859	1,392,480
	<u>6,967,389</u>	<u>15,095,329</u>	<u>7,232,455</u>

The following is a discussion of the results of operations of the Company for each of the two years ended 31 December 2002 and the five months ended 31 May 2003. Such discussion should be read in conjunction with the accountants' report set out in appendix I to this prospectus.

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For the year ended 31 December 2001

For the year ended 31 December 2001, the turnover of the Company amounted to approximately RMB74.9 million. The Company developed its GSM/CDMA antenna series to capture a portion of the market share for these products following the issue and implementation of Technical Specifications of Base Station as the industry standard for domestic production of base station antennas. Despite sales of WLL/PHS base station antenna series recorded RMB28.4 million, sales contribution from this product line represented only about 37.9% of the turnover. This was a result of the Company's effort in diversification and expansion of business lines. The new product line, namely the GSM/CDMA antenna series, contributed approximately RMB41.2 million, representing 55.0% of the turnover.

The Company's gross profit for the year amounted to approximately RMB43.7 million and the gross profit margin reached 58.4%.

The Company recorded other operating income of approximately RMB0.2 million in 2001, which mainly comprised of (i) interest income; (ii) sale of raw materials to the designated suppliers that are used in the production of the parts of the Company's products (the raw materials sold are sample of raw materials which the Company requires the designated suppliers to use; and (iii) sales of scrap.

The Company's distribution costs amounted to approximately RMB9.7 million. These expenses represented approximately 12.9% of total turnover in 2001. Distribution costs mainly comprised of traveling expenses, salaries, entertainment expense and expenses incurred for providing guidance and supervision for installation of antennas at the site of the Company's customers.

Administrative expenses, include mainly Directors' emolument, salaries and staff welfare, depreciation of office equipment and motor vehicles expenses, amounted to approximately RMB7.0 million.

Others operating expenses include mainly product research and development related expenses, amounted to approximately RMB7.0 million. The product research and development related expenses represent depreciation for the equipment, salary costs of the personnel in the research and development department, etc. There is no specific/particular project that directly assigned on each activity and therefore, the cost of the research and development cannot be separately identifiable in different projects. Accordingly, those are treated as daily operating costs and charged to the income statement when incurred.

Due to the Company's status of being recognised as a high-technology enterprise, according to the PRC tax regulations, the Company is exempted from income tax for the year ended 31 December 2001.

For the year ended 31 December 2002

For the year ended 31 December 2002, the turnover of the Company amounted to approximately RMB164.5 million, representing an increase of 119.6% over that of the previous year. The reasons for the increase in sales include the following: (a) better sales of WLL/PHS base station antenna series as construction of new PHS network by fixed line telecommunication network operators of the PRC (China Telecom Group and China Netcom Group) in provinces/municipals/regions such as Guangdong, Hebei and Beijing started; (b) better sales of GSM/CDMA antenna series as members of China Unicom Group were satisfied with the Company's products and ordered more of the Company's antennas for the construction of CDMA network (sales to members of China Unicom Group in aggregate increased from approximately RMB7.3 million in the year 2001 to approximately RMB60.0 million in the year 2002); and (c) contribution from a new product line, indoor distribution system series which was launched in December 2001. Sales of

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WLL/PHS base station antenna series contributed approximately RMB47.4 million, represented approximately 28.8% of the Company's total turnover. Sales of GSM/CDMA antenna series recorded approximately RMB93.7 million, represented approximately 56.9% of the Company's total turnover. The new product line, namely the indoor distribution system series, recorded sales of approximately RMB21.5 million, represented approximately 13.1% of the Company's turnover.

The Company's gross profit for the year 2002 increased to approximately RMB91.4 million. During this period, the gross profit margin decreased from 58.4% in 2001 to 55.6% for the year ended 31 December 2002 because of the decrease in gross profit margin of WLL/PHS base station antenna series from 70.8% to 60.3% as a result of the lowering of the selling price of WLL/PHS base station antenna series in order to compete with other manufacturers.

The Company recorded other operating income of approximately RMB2.1 million for the year ended 31 December 2002, which mainly comprised of (i) interest income; (ii) subsidy for export sales received from the PRC Government that is calculated at 0.1% to 0.3% of the amount of export sales made (such subsidy is granted to all companies exporting products as specified by the PRC Government, such as hi-tech products when the companies convert the foreign exchange received from export. Such subsidy is granted to the Company for the implementation of the national policy of encouraging export of the products and has ceased to be granted after the PRC's accession to WTO) The Company had not received subsidy income during the year 2001 because the procedures of application and approval of the subsidy had not been completed before the end of year 2001; (iii) receipt from sale of scraps and sales of raw materials to designated suppliers (the raw materials sold are sample of raw materials which the Company requires the designated suppliers to use); and (iv) income received from services of inspecting networks of the Company's customers and providing independent test on antennas and related products to the Company's customers. The services of inspecting networks of the Company's customers include inspecting the performance of the networks by using testing equipment and providing enhancement recommendations if necessary. The services are provided to the Company's customers as a value added service currently, not as a major business line.

The Company's distribution costs increased by 86.1% to approximately RMB18.0 million comparing to the previous year of approximately RMB9.7 million. It was mainly due to the increase in sales and expansion of product lines and establishment of five new sales contact points in the PRC in addition to the one for the year ended 31 December 2001. During the year ended 31 December 2002, the Company paid commission which amounted to approximately RMB0.6 million to the agent appointed in India who had introduced sales of approximate RMB6.0 million to the Company during the year. No commission expense was recorded for the year ended 31 December 2001. The commission was paid according to a "Sole Selling Agency Agreement" entered into by the agent and the Company pursuant to which a commission was payable to the agent and calculated as 10% of sales introduced by the agent. Distribution costs accounted for approximately 10.9% of turnover for the year ended 31 December 2002.

Administrative expenses increased by 70.6% to approximately RMB11.9 million. Salaries increased from approximately RMB0.71 million to approximately RMB3.0 million because (i) a bonus of approximately RMB0.6 million was paid in January 2002; (ii) the salary to administrative staff increased by approximately 10% to 15% in general (although the number of administrative staff decreased from 66 to 45 due to internal redeployment of staff); and (iii) the recruitment of four senior management staff during 2002 who formulated internal policy and control procedure in monitoring the progress of business expansion, including sale and marketing, product research and development and coordination with Beijing sales contact points. The reason for paying a bonus of approximately RMB0.6 million in January 2002 was because the operating result of the Company exceeded the target set by the Shareholders. However, as the incentive scheme had not been implemented during the year ended 31 December 2001, no bonus was paid during the year. The reason for the salary increment for administrative staff was to maintain the stability of the staff and to reward the staff who have contributed to the development of the Company. Directors'

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remuneration did not change significantly as both the number of Directors and their basic salaries had not been changed. Other administrative expenses increased from approximately RMB1.3 million to RMB2.6 million because (i) expenses of approximately RMB0.2 million related to the initial preparation of the listing of the Company's shares on the second board of the Shenzhen Stock Exchange in the PRC, which was contemplated by the Directors prior to pursuing the listing application to the Stock Exchange, were incurred and new comparing with the year 2001; and (ii) the increase in office supplies, telephone expense and other expense as result of the expansion of the Company's scale of operation. For example telephone expenses increased substantially due to increased contact with staff stationed outside Xi'an. On the other hand, no rental expenses were recorded during the year ended 31 December 2002. As confirmed by the Directors, rental expenses for the year ended 31 December 2001 represented the rental expenses for office buildings of the Company's then principal place of business. In January 2002, the Company has moved to the leasehold land and building acquired by the Company, which is the Company's current principal place of business and therefore, no such rental expenses were incurred since January 2002. The rental expense for the sales contact points and warehouse are charged to the distribution cost and cost of sales respectively but not administrative expenses.

Other operating expenses increased from approximately RMB7.0 million for the year ended 31 December 2001 to approximately RMB15.1 million. It was mainly due to the increase in product research and development expenses by 72.4% from RMB5.3 million for the year ended 31 December 2001 to RMB9.1 million for the year ended 31 December 2002 as a result of the development of the Company's new products which include various specifications of power amplifier, coupler, low noise amplifier module for repeater, trunk amplifier module and trunk amplifier for the uses in indoor distribution system series. Further, the provision for doubtful debts increased from approximately RMB0.69 million for the year ended 31 December 2001 to approximately RMB4.3 million for the year ended 31 December 2002 because some of the trade receivables have been outstanding for relatively long time and was perceived to be riskier by the Directors and the Directors made full provisions for those debts considered to be doubtful. Higher provision for the year 2002 was also because of stricter approach taken in assessing doubtfulness of the Company's trade receivables. The reason for the increase in amounts overdue was mainly because of the delay of customer construction progress in relation to the Company's indoor distribution system. In addition, loss on disposal of property, plant and equipment increased from nil to approximately RMB0.6 million because the Company disposed of furniture and fixture and production facilities installed in the former production site after the Company had moved into the current site in early 2002. Deposits for acquisition of materials written off increased from nil to approximately RMB0.1 million because a deposit for usage of a mould for processing a part of the Company's antenna products has been forfeited due to termination of production of such part which became outdated.

Finance costs increased from approximately RMB0.7 million for the year ended 31 December 2001 to approximately RMB4.0 million for the year ended 31 December 2002 as a result of the increase in the Company's bank borrowings to finance the expansion of the Company's operation although the Company had been granted a lower rate of interest.

Taxation increased by approximately RMB8.2 million, or 100% in 2002. According to the PRC tax regulations, the Company was subject to an income tax rate of 15% during the year ended 31 December 2002. The effective tax rate for 2002 was approximately 18.3% as certain of the expenses are not deductible when determining taxable profit. Accordingly, the effective tax rate is slightly higher than the statutory tax rate.

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For the five months ended 31 May 2003

For the five months ended 31 May 2003, the turnover of the Company increased by approximately 156.0% to approximately RMB79.3 million comparing with the turnover for the five months ended 31 May 2002 which amounted to approximately RMB31 million. The Directors consider that such increase in turnover is mainly due to the continuing network construction of the Company's customers. For the five months ended 31 May 2003, approximately 65.2% of the turnover was attributable to sales of WLL/PHS base station antenna series. Orders of WLL/PHS base station antennas increased because of continued construction of new PHS network as a result of the increasing popularity of Xiaolingtong in the PRC and the success of the Company's existing strategy of maintaining market share by lowering the selling price of the product line. Due to its relatively low hourly rate of service charge, PHS system is an alternative to services provided by the two existing mobile telecommunication operators in the PRC. Therefore, the construction or expansion of PHS networks continued in the PRC. According to the Directors, the business strategy of the Company has not been changed for the five months ended 31 May 2003.

Gross profit for the period amounted to approximately RMB39.2 million. During the period, average gross profit margin decreased from 55.6% for the year 2002 to 49.5%. The gross profit margin of WLL/PHS base station antenna series decreased by a range from 5% to 21% because the Company had adopted a strategy of lowering the selling price for the product line. The Company started subcontracting certain parts of the production process of WLL/PHS base station antenna series since the second half of the year 2002 in order to minimise investment in property, plant and equipment for expanding the Company's production capacity. As a result, for the product line of WLL/PHS base station antenna series, percentage of direct labour costs and factory overheads to total cost of sales decreased while percentage of materials purchase increased. The total cost of production, which included subcontracting cost of WLL/PHS base antenna series, was lower than that recorded in the previous years as a result of subcontracting. However, as the Company continued to lower selling price of existing models of WLL/PHS base station antenna series to maintain its market share and the extent of selling price being lowered was greater than the extent of total cost of production being lowered, gross margin for the product line decreased. The sales of WLL/PHS base station antenna series accounted for approximately 65.2% of the total turnover of the Company for the period. The gross profit margin of GSM/CDMA antenna series was stable as there were not many new or upgraded models sold. Gross profit margin for the indoor distribution system series was lower in the five months ended 31 May 2003 comparing with that in 2002 because the certification of completion of the installation of indoor distribution systems were delayed due to the outbreak of SARS in the PRC in the first few months of 2003 and the implementation of the related quarantine measures. Costs for installation of indoor distribution systems mainly consist of staff expenses in relation to installation works, material cost and subcontracting fee. Though some of the installation projects have been completed, certification of completion could not be finalised due to the implementation of quarantine measures as a result of the outbreak of SARS. Therefore, those indirect costs have been expensed to the income statement while related revenue has not been recognised. Accordingly, gross profit margin for indoor distribution system was lower.

The Company recorded other operating income of approximately RMB0.5 million for the five months ended 31 May 2003, which mainly comprised of subsidy for export sales and network inspection service income. According to the Directors, the settlement terms of the subsidy are based on the amount of RMB converted from foreign currency received by the Company through export sales. Therefore, the calculation for the subsidy granted by the PRC government to the Company was not based on the amount of export sales. In addition, time lag arose between the application and the approval of such subsidy. During the five months ended 31 May 2003 as the foreign currency received and converted through the Company's export sales in 2002 was larger than those received and converted in 2002 for the export sales in 2001, the subsidy received by the Company also increased.

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For the five months ended 31 May 2003, distribution costs increased by approximately 59.2% to approximately RMB11.3 million comparing with the distribution costs for the five months ended 31 May 2002 which amounted to approximately RMB7.1 million. The distribution costs represented 14.3% of total turnover for the five months ended 31 May 2003, which is approximately 3.4% higher than that of the year 2002. Distribution costs increased mainly due to (i) an increase in commission expenses by approximately RMB1 million because the Company has been expanding its customer base through referral; (ii) the setting up of another international business division for newly explored markets such as the U.S. so that there are salespersons whom are specifically responsible for the markets of different characteristics; (iii) transportation expenses increased by approximately RMB1 million because 65.2% of the Company's sales during the five months ended 31 May 2003 (comparing with 37.9% and 28.8% respectively for each of the two years ended 31 December 2002) were sales of WLL/PHS base station antenna series to its major customer, UTStarcom, which is located in the city of Hangzhou and not in the city of Xi'an where the Company is located; and (iv) salaries and staff welfare of salespersons increased by approximately RMB0.6 million because the number of staff in sales and marketing department increased as the result of new employment and deployment from other department and there was a general salary increase of approximately 5% to 10% in early 2003. During the five months ended 31 May 2003, the Company paid commission which amounted to approximately RMB1.5 million. Among the approximately RMB1.5 million paid, approximately RMB50,000 was paid to the agent appointed in India who has introduced sales of approximately RMB0.5 million to the Company during the five months; the commission was paid according to a "Sole Selling Agency Agreement" entered into by the agent and the Company pursuant to which a commission was payable to the agent and calculated as 10% of sales introduced by the agent. The remaining of approximately RMB1.45 million commission were paid to companies which introduced customers to the Company based on oral agreement with no fixed commission rate and as a lump sum payment to the respective companies. During the five months ended 31 May 2003, sales to customers introduced by those companies amounted to approximately RMB4.3 million.

Administrative expenses increased by approximately 90.0% to approximately RMB7.6 million, comparing with the administrative expenses for the five months ended 31 May 2002 which amounted to approximately RMB4 million. It included Directors' remuneration and salaries and staff welfare of administrative staff of approximately RMB3 million. These payroll expenses increased in monthly average comparing with the year 2002 mainly because there was a general increase of approximately 10% in salary in early 2003 even though the number of administrative staff decreased from 45 to 36. The reasons for the decrease in the number of administrative staff for the five months ended 31 May 2003 were because they are classified as production staff or sales and marketing staff, instead of as administrative staff as before. The salary increment was made to maintain stability of staff. Salaries, staff welfare, education fund expenses and union fund of administrative staff increased by approximately RMB1.7 million. Director's emolument increased from approximately RMB 0.7 million for the five months ended 31 May 2002 to approximately RMB0.9 million for the five months ended 31 May 2003. The increase is due to the increase in the Directors' basic salary as a result of the general increase in salaries of approximately 10%, which was in line with the general salary increment of other staff in early 2003 while the number of Directors remains unchanged. The aggregate Directors' emolument contracted for the whole of year 2003 is expected to be approximately RMB1.8 million excluding bonuses. Such amount is approximately 13% higher than the actual amount for the year 2002. Travelling expenses increased by approximately RMB0.4 million as the management have to travel more to supervise the expanding sale network and to visit overseas customers and equipment providers. Motor vehicles expenses increased by approximately RMB0.1 million as the number of the Company's vehicles increased.

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For the five months ended 31 May 2003, other operating expenses increased by approximately 80% to approximately RMB7.2 million comparing with other operating expenses for the five months ended 31 May 2002 which amounted to approximately RMB4 million. The Directors consider that such increase is mainly due to the increase in product research and development expense of approximately RMB2.0 million. The main reasons for the increase in product research and development expenses are (i) increase of approximately RMB1.0 million in salaries and welfare for research and development staff in the early 2003 resulting from the increase in number of product research and development staff from 132 as at 31 May 2002 to 149 as at 31 May 2003; (ii) increase of approximately RMB0.5 million in depreciation of equipment for product research and development from new equipment; and (iii) increase of approximately RMB0.5 million in office expense for production research and development. It is the result of the Company's continued increase in the investment in developing new products and improving existing products.

For the five months ended 31 May 2003, finance expenses increased by approximately 71.4% to approximately RMB2.4 million comparing with the finance expenses for the five months ended 31 May 2002 which amounted to approximately RMB1.4 million. It was because the Company increased its bank borrowings (total balance of bank borrowings increased from approximately RMB70 million as at 31 May 2002 to approximately RMB97.1 million as at 31 May 2003) to finance the growing business even though the average rate of interest has not been changed significantly.

The increase in effective tax rate from 18.3% to 23.8% for the five months ended 31 May 2003 is mainly attributable to the increase in salaries and bonus payment. As such payment exceeded the maximum amount allowable for deduction, the non-deductible salary expenses increased. As a result, a higher effective tax rate was recorded.

TAXATION

Since the Company is based, and with all of its operations, in the PRC, the Company is only subject to the PRC corporate income taxes, for the two financial years ended 31 December 2002 and the five months ended 31 May 2003.

The Company is regarded by 西安市科學技術局 (Xi'an Municipal Bureau of Science and Technology) as a high-technology enterprise located in Xi'an National Hi-tech Industrial Development Zone. According to the 減免稅審批表 (Examination and approval form for tax reduction and exemption) in which the Company was granted EIT exemption for the period from 29 January 2000 to 29 January 2002 issued by 西安市雁塔區地方稅務局 (Local Taxation Bureau of Yanta District in Xi'an) dated 18 September 2000, 雁塔區地方稅務局關於對西安海天天線科技股份有限公司減免企業所得稅問題的批覆 (Written Reply of Local Taxation Bureau of Yanta District concerning questions of EIT reduction and exemption on Xi'an Haitian Antenna Technologies Co. Ltd.) issued by the 西安市雁塔區地方稅務局 (Local Taxation Bureau of Yanta District in Xi'an) dated 16 November 2001, 關於西安海天通訊設備有限公司享受稅收減免優惠政策說明函件 (Explanatory statement concerning preferential treatment policy of tax reduction and exemption for Xi'an Haitian Communications) issued by 西安高新技術產業開發區管理委員會 (Management committee of Xi'an National Hi-tech Industrial Development Zone) dated 22 August 2002 and as confirmed by the legal opinion issued by Jingtian & Gongcheng, due to the Company's status as a recognised high-technology enterprise according to 《財政部、國家稅務總局關於企業所得稅若干優惠政策的通知》 ("Notice of Ministry of Finance and State Taxation Administration Concerning Certain Preferential Policies for EIT"), the Company is exempted from income tax for the first two years of production followed by an income tax rate of 15% from the third year. Therefore, the Company was exempted from income tax for the two years ended 31 December 2001 and is subject to an income tax payable of 15% thereafter. According to 企業所得稅匯算清繳檢查報告表 (the inspection report on the payment of enterprise income tax), income tax rate and the income tax for the two financial years ended 31 December 2002 had been approved.

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According to Jingtian & Gongcheng and as confirmed by the relevant tax authorities, during the Track Record Period, the Company has complied with the requirements of national and local tax laws and regulations and paid various tax in accordance with the relevant PRC laws. The Company has not violated any relevant laws and regulations in relation to taxation and has not been punished in relation thereto. The relevant tax authorities have confirmed on 18 November 2001, 6 March 2003, 21 July 2003 and 3 September 2003 that there are no tax disputes involving the Company during the Track Record Period and up to August 2003. Jingtian & Gongcheng confirmed that Xi'an Haitian Communications, the predecessor of the Company, also complied with the requirements of national and local tax laws and regulations and no tax liabilities were outstanding since the establishment of Xi'an Haitian Communications on 13 October 1999 to the transformation to the Company on 11 October 2000 according to 變更主管稅務機關申請審批 (The Approval of Application in respect of the Alteration of Governing Tax Authority) issued by 西安市雁塔區地方稅務局 (Local Taxation Bureau of Yanta District in Xin).

According to 企業技術開發費稅前扣除管理辦法 (國稅發[1999] 49號) (Methods for administration on deduction of research and development costs from taxable profit of corporations) a national policy promulgated by the State General Bureau of Taxation (國家稅務總局) that a deduction of taxable profit equivalent to 50% of the total of research and development expenses for the taxation year is granted if a company's research and development expenses increased by 10% comparing with that of last taxable year. The Company is eligible to have the above mentioned benefit as long as the relevant national policy and tax rules and laws remain valid.

According to 技術改造國產設備投資抵免企業所得稅暫行辦法 (財稅字[1999] 290號) (Provisional methods for deduction of corporation income tax for investment in domestic plant and equipment for technologically advancement), a national policy promulgated by the Ministry of Finance and the State General Bureau of Taxation that a deduction of income tax payable equivalent to 40% of the total amount of equipment manufactured in the PRC and purchased for the purpose of technology advancement of the Company is granted. The Company is eligible to have the above mentioned benefit as long as the relevant national policy and tax rules and laws remain valid.

VALUE-ADDED TAX AND BUSINESS TAX

The Company's provision of products to its customers is subject to a value-added tax of 17% while its provision of services (such as performing independent tests on antennas and related products not produced by the Company and inspecting the networks operated by the Company's customers) is subject to a business tax at rate between 3% to 5%.

PROPERTY INTERESTS

Properties owned and occupied by the Company in the PRC

The Company owns and occupies a parcel of industrial land located in No. 36 Gao Xin Liu Road, Xi'an National Hi-tech Industrial Development Zone, Xi'an, Shaanxi Province, the PRC and the buildings erected thereon. The property comprises a parcel of land with a site area of approximately 32,001.98 sq. m., ("the Land") and six buildings with a total gross floor area of approximately 14,813.91 sq.m. ("the Buildings") and were completed in or about 2001. The land use rights have been granted to the Company for a term of 50 years from 4 August 2000 to 4 August 2050 for industrial purpose.

According to the PRC legal opinion dated 24 October 2003 issued by Jingtian & Gongcheng, the PRC legal advisers to the Company:

1. The Company is the lawful and sole owner of the Land and the Buildings, namely Plant Nos. 1 and 2, a power station, a guard room, a test centre and Building No. 2 all located at No. 36 Gao Xin Liu Road, Xi'an National Hi-tech Industrial Development

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Zone. The Company is entitled to occupy, use, transfer, lease or charge the Land and the Buildings.

2. The Land and the Buildings are subject to a mortgage of RMB30,000,000 in favour of Agricultural Bank of China, for a term from 29 March 2002 to 28 March 2006 and another mortgage to secure a facility amount to the maximum of RMB40,000,000 in favour of the China Everbright Bank, for a term from 28 April 2003 to 28 April 2006.
3. The Company has obtained the building ownership certificate in respect of five of the Buildings. According to a document issued by Real Estate Administration Bureau of Xi'an National Hi-tech Industrial Development Zone on 15 July 2002 entitled "An Explanation of the Consent Granted to Xi'an Haitian Antenna Technologies Co., Ltd. to Apply for Building Ownership Certificate in respect of Building No. 2", the Company was granted an approval from Planning and Environmental Protection Bureau of Xi'an National Hi-tech Industrial Development Zone on 18 December 2000 with respect to an overall planning of its new factory complex ("Old Planning"). In October 2001, the Company made a new planning of its new factory complex, and obtained an approval from Planning and Environmental Protection Bureau of Xi'an National Hi-tech Industrial Development Zone on 21 January 2002. The Real Estate Administration Bureau was of the opinion that the Company shall apply for the building ownership certificate of the completed buildings under the Old Planning, including Building No. 2 in conjunction with those under the new planning to be completed thereafter.

According to Vigers Hong Kong Ltd., as at 31 August 2003, the value of the building of which the Company has not yet obtained the building ownership certificate, namely Building No. 2, amounted to RMB2 million. In addition, the net book value of such building amounted to approximately RMB1.92 million and RMB1.9 million as at 31 May 2003 and 31 August 2003 respectively.

Properties rented and occupied by the Company in the PRC

As at the Latest Practicable Date, the Company had 10 leased properties (for details of the properties, please refer to the properties referred to in Group II of the property valuation report in appendix II to this prospectus) being office, staff quarters or warehouses in the PRC which covered the regions of Beijing, Hangzhou of Zhejiang, Nanjing of Jiangsu, Wuhan of Hubei, Fuzhou of Fujian and Xi'an of Shaanxi.

It is the Company's policy that for those lease agreements which will be renewed or signed after May 2003, (i) lease agreements will not be signed unless relevant property right and/or use right documents are obtained and the landlords agree to undertake all registration procedures and (ii) the Company will only sign the standard lease agreements drafted by Jingtian & Gongcheng, which will require the landlords to provide complete ownership record and to undertake the registration procedures in relation to the subject properties.

As at the Latest Practicable Date, the Company has not set up any branches in the PRC nor any sales office overseas.

Property valuation

Vigers Hong Kong Ltd., an independent valuer, has undertaken an assessment for the Company with regard to the valuation of its property interests in the PRC as at 31 August 2003. The full text of the letter, summary of values and valuation certificate with regard to such property interests are set out in appendix II of this prospectus.

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DIVIDEND POLICY

Holders of the H Shares and Domestic Shares will share proportionately, on a per Share basis, all dividends and other distributions declared by the Board and approved by the Shareholders. Under the Articles, unless otherwise approved by an ordinary resolution of the general meeting of Shareholders, the Company may only distribute final dividends once a year. Shareholders may, by an ordinary resolution passed at annual general meeting, authorise the Board to declare and pay an interim dividend after it has considered the financial position of the Company and subject to compliance with all relevant laws and administrative regulations. The Board will declare dividend, if any, in Renminbi, with respect to the H Shares on a per H Share basis and such dividend will be paid in Hong Kong dollars. The declaration of dividend is subject to the approval of the Shareholders at annual general meetings. According to the PRC laws and as provided in the Articles, the Company may only distribute dividend after it has made allowance for: (1) recovery of losses (if any); (2) allocation to the statutory common reserve fund; (3) allocation to the statutory common welfare fund; and (4) allocation to a discretionary common reserve fund if approved by its Shareholders. Under PRC laws, the Company's distributable profits will be equal to the sum of (i) its net profit determined in accordance with PRC accounting standards and regulations or that in accordance with Hong Kong generally accepted accounting principles, whichever is lower; and (ii) the distributable profits as at the beginning of the relevant year less allowance for losses and allocation to the statutory and discretionary funds.

During the year ended 31 December 2002, the Company declared dividends of RMB15 million out of the distributable reserves as at 31 December 2001. The Directors presently do not intend to recommend the payment of any dividend by the Company in respect of the year ending 31 December 2003. The declaration, payment and amount of future dividends will be at the discretion of the Board and will depend upon, among other things, the Company's business and operating results, operations capital requirements and surplus, cashflow, general financial condition, contractual restrictions and such factors as the Board may deem relevant. The Directors would draw investors' attention that the dividend declared during the Track Record Period is not and will not be considered as a binding precedent on the dividend policy of the Company in the future.

The Directors confirm that all of the dividends payable as at 31 May 2003 was paid in September 2003 from the internal resources of the Company.

DISTRIBUTABLE RESERVES

Upon the listing of the H Shares on the GEM and the adoption of the Articles, the distributable reserve will be determined in accordance with the Mandatory Provisions as incorporated in the Articles which are governed by the PRC laws. In accordance with the the PRC laws, the reserve available for distribution is the lower of (i) the net profit determined in accordance with accounting principles generally accepted in the PRC and (ii) the net profit determined in accordance with Hong Kong Statement of Standard Accounting Practices.

As at 31 May 2003, the Company's distributable reserves amounted to approximately RMB41,310,358.

STATUTORY SURPLUS RESERVE

The Articles requires the appropriation of 10% of its profit after taxation each year to the statutory surplus reserve until the balance reaches 50% of the registered share capital. According to the provision of the Articles, in normal circumstances, the statutory surplus reserve shall only be used for making up losses, capitalisation into share capital and expansion of the Company's production and operation.

As at 31 May 2003, the Company's statutory surplus reserve amounted to approximately RMB5,831,000.

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STATUTORY PUBLIC WELFARE FUND

Pursuant to the Company Law, the Company shall make allocation from its profit after taxation at the rate of 5% to 10% to the statutory public welfare fund. The statutory public welfare fund can only be utilised on capital items for employees collective welfare. Individual employees only have the right to use these facilities, the titles to which will remain with the Company. The statutory public welfare fund forms part of the shareholder's equity but is non-distributable other than in liquidation.

As at 31 May 2003, the Company's statutory public welfare fund amounted to approximately RMB3,339,000.

WORKING CAPITAL

The Directors are of the opinion that, taking into account the internally generated resources of the Company, bank financing available to the Company and the estimated net proceeds from the issue of H Shares (excluding the Over-allocation Shares) under the Placing and in the absence of unforeseeable circumstances, the Company has sufficient working capital for its present requirements.

ADJUSTED NET TANGIBLE ASSETS

The following pro forma statement of adjusted net tangible assets of the Company is based on the audited net assets of the Company as at 31 May 2003 as shown in the accountants' report set out in appendix I to this prospectus, adjusted as described below:

	<i>RMB'000</i>
Audited net assets of the Company as at 31 May 2003	100,479
Less: intangible assets	
Land use right	(12,284)
Technological know-how	(7,250)
	<hr/>
Audited net tangible assets of the Company as at 31 May 2003	80,945
Unaudited net profit of the Company for the three months ended 31 August 2003	9,762
Estimated net proceeds of the Placing (<i>Note 1</i>)	65,720
	<hr/>
Adjusted net tangible assets	<u>156,427</u>
	<hr/>
Adjusted net tangible asset value per Share (<i>Note 2</i>)	<u>RMB0.24</u>

Notes:

- (1) The estimated net proceeds from the Placing, after deducting related expenses and the amount payable to the Vendors, are based on the Placing Price of HK\$0.55 per H share (being the lowest point of the Placing Price range stated in this prospectus) and take no account of any H Shares which may be issued pursuant to the exercise of the Over-allocation Option.
- (2) The adjusted net tangible asset value per share is arrived at based on 647,058,824 Shares in issue immediately after the Placing and take no account of any H Shares to the issued pursuant to the Over-allocation Option.

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- (3) The surplus of approximately RMB0.7 million and RMB0.6 million arose from the revaluation of the Company's leasehold buildings and land use right, representing approximately 0.39% and 0.32% of the adjusted net tangible assets of the Company, would not be incorporated in the financial statements of the Company for the year ending 31 December 2003. If the revaluation surplus was incorporated into the Company's financial statements for the year ending 31 December 2003, the depreciation and amortisation charge of the Company would be increased by approximately RMB22,000 and RMB12,000. The valuation was performed on an open market value basis by Vigers Hong Kong Ltd., an independent valuer, the details of which are set out in appendix II.

In accordance with the accounting policy adopted by the Company, land use right and leasehold buildings are stated in the balance sheet at cost less accumulated depreciation and amortisation and accumulated impairment losses. Accordingly, the net surplus arising from revaluation of leasehold buildings and land use right are not recognised in the financial statements of the Company.

CAPITALISATION OF PRODUCT RESEARCH AND DEVELOPMENT EXPENSES

To maintain the Company's potential for future development, the Company invests significantly in product research and development, for the two years ended 31 December 2002 and the five months ended 31 May 2003, total of product research and development costs amounted to approximately RMB5.3 million, RMB9.1 million and RMB5.1 million respectively. As these costs mainly represent salary and staff welfare of research and development staff, and depreciation of equipment which are daily operating costs and cannot be directly related to specific products. In accordance with the Hong Kong Statement of Standard Accounting Practice 29, the costs do not fulfill the criteria for capitalisation. Therefore, up to the Latest Practicable Date, no product research and development costs have been capitalised in the Company's balance sheet.

During the Track Record Period, the Company has commenced research and development of antenna and related products for the 3G mobile communication and incurred expenses directly related to research and development which amounted to approximately RMB0.6 million. In accordance with the Hong Kong Statement of Standard Accounting Practice 29, the expenditure does not fulfill the criteria for capitalisation. Therefore, up to the Latest Practicable Date, no expenditure of research and development of antenna and related products for the 3G mobile communication has been capitalised in the Company's balance sheet.

DISCLOSURE UNDER CHAPTER 17 OF THE GEM LISTING RULES

As at 31 May 2003, trade receivables due from members of China Unicom Group (in aggregate), UTStarcom, members of China Mobile Group (in aggregate) and other trade customers (in aggregate) amounted to approximately RMB50.6 million, approximately RMB18.8 million, approximately RMB12.7 million and approximately RMB17.0 million respectively. Such trade receivables in an aggregate amount of RMB99,087,709 owed by a total of 42 debtors which are trade customers and Independent Third Parties.

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Details of trade receivables outstanding from three of the Company's major customers are disclosed below. As at 31 May 2003, the ageing analysis of the Company's trade receivables from China Unicom Group (in aggregate), UTStarcom and China Mobile Group (in aggregate) was as follows:

	China Unicom Group RMB	UTStarcom RMB	China Mobile Group RMB
0 – 60 days	12,959,391	18,779,393	5,799,673
61 – 120 days	3,686,460	–	191,747
121 – 180 days	6,533,452	–	1,060,903
181 – 240 days	8,380,473	–	1,770,526
241 – 365 days	16,726,311	–	2,315,856
Over 365 days	2,264,539	–	1,569,865
	<u>50,550,626</u>	<u>18,779,393</u>	<u>12,708,570</u>
<i>Less:</i> Allowance for doubtful debts	<u>(2,364,718)</u>	<u>–</u>	<u>(1,143,847)</u>
	<u><u>48,185,908</u></u>	<u><u>18,779,393</u></u>	<u><u>11,564,723</u></u>

In addition, as at 31 August 2003, the ageing analysis of the Company's trade receivables from China Unicom Group (in aggregate), UTStarcom and China Mobile Group (in aggregate) was as follows:

	China Unicom Group RMB	UTStarcom RMB	China Mobile Group RMB
0 – 60 days	22,222,570	13,596,764	10,992,075
61 – 120 days	7,574,281	17,877,559	7,933,519
121 – 180 days	5,043,105	1,401,700	1,383,155
181 – 240 days	4,638,570	–	67,500
241 – 365 days	11,669,957	–	2,606,074
Over 365 days	11,301,499	–	1,839,787
	<u>62,449,982</u>	<u>32,876,023</u>	<u>24,822,110</u>
<i>Less:</i> Allowance for doubtful debts	<u>(2,364,718)</u>	<u>–</u>	<u>(1,143,847)</u>
	<u><u>60,085,264</u></u>	<u><u>32,876,023</u></u>	<u><u>23,678,263</u></u>

All of the above trade receivables are unsecured and repayable in accordance with terms specified in the contracts governing the relevant transactions. No collateral is required to be made by the three customers and no interest is charged on such balances. Despite the balances from China Unicom Group (in aggregate), UTStarcom and China Mobile Group (in aggregate) represented approximately 62.5%, 23.2% and 15.7% respectively of the Company's net tangible assets as at 31 May 2003, such balances from these three customers as at 31 August 2003 represented approximately 69.0%, 36.3% and 27.4% respectively, which was more than 25%, of the Company's net tangible assets as at 31 August 2003. This constitutes a disclosure obligation on the part of the Company pursuant to Rule 17.15 of the GEM Listing Rules as the relevant advance to an entity from the Company exceeds 25% of the Company's net tangible assets. Taken into account the net proceeds from the Placing, the adjusted net tangible assets of the Company as stated in the subsection

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headed “Adjusted Net Tangible Assets” under the section headed “Financial information” to this prospectus, would be approximately RMB156.4 million (“Adjusted Net Tangible Assets”). Accordingly, the trade receivables from China Unicom Group, UTStarcom and China Mobile Group as at 31 August 2003 represented approximately 39.9%, 21% and 15.9% of the Adjusted Net Tangible Assets. Each of China Mobile Group, China Unicom Group and UTStarcom is independent from each other. Save for the aforesaid, 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 Rule 17.15 of the GEM Listing Rules. According to the Directors, the terms of such advance are on normal commercial terms and in the ordinary course of business.

According to the Directors, the Company has not encountered any negative impact to its operations or business despite the Company’s significant exposure to China Unicom Group, UTStarcom and China Mobile Group. In addition, the Directors believe that with the strong backing of these customers, the Company is able to further expand its business as one of the leading providers of the base station antennas and related products in the PRC. Since there are only two mobile telecommunication operators in the PRC for GSM/CDMA networks as at the Latest Practicable Date, namely China Unicom Group and China Mobile Group, and UTStarcom as a major supplier to China Telecom for PHS/WLL base station antennas, reliance on these customers becomes industry norm and practice for the Company’s nature of business.

As confirmed by the Directors, for the purpose of disclosure according to Rule 17.15 of the GEM Listing Rules, trade receivables pledged or factored to banks as securities for bank borrowings are included as part of outstanding advances to customers. Save for the above the Directors confirmed that there is no other disclosure obligation under Rule 17.15 to Rule 17.21 of the GEM Listing Rules.

NO MATERIAL ADVERSE CHANGE

The Directors confirm that since 31 May 2003 (being the date to which the latest audited financial information of the Company was made up), there has been no material adverse change in the financial or trading position or prospects of the Company.