

OVERVIEW

We are a leading provider of Internet services and mobile value-added services in China, with the largest IM community in China. The Internet services and mobile and telecommunications value-added services are provided by Tencent Computer and Shiji Kaixuan pursuant to contractual arrangements with the Company, Shidai Zhaoyang Technology and Tencent Technology. For more background on our corporate structure, see the section entitled “Our History and Structure”. Our IM platform allows users to communicate in real-time across the Internet, and mobile and fixed line telecommunications networks using various terminal devices. Our users are not only able to communicate via text messages, images, video, voice and email, but also have access to various Internet and mobile value-added services that are designed to enhance their community experience, including chat rooms, online and mobile games, dating, information downloads and entertainment services.

We believe that we have the largest IM community in China as measured by registered user accounts. As of March 31, 2004, we had 291.3 million registered IM user accounts. During the 16-day period ended March 31, 2004, the peak number of simultaneous online user accounts was 6.1 million, the average number of daily user hours was 64.7 million and the average number of messages sent daily was 848.8 million. We are also one of the leading mobile value-added service providers in China. For 2003, China Mobile recognized us as its “Best Performing Partner” for SMS services (短信業務合作伙伴最佳業績獎) on its Monternet platform. We believe that QQ, the brand name of our consumer IM service, is a widely recognized consumer brand in China. We have been able to leverage our large user community and the recognition of the QQ brand to attract Internet and mobile users to pay for our consumer-oriented value-added services and products. In addition, we have been able to leverage the significant traffic in our community to market online advertising services to our corporate clients.

We believe that we were one of the first providers of IM and mobile value-added services in China. Our basic online IM service was launched in February 1999. In May 2000, we commercially launched Mobile QQ, our mobile IM service, and have the leading position in mobile IM services in China. Since the introduction of our basic IM service, our services and products have evolved into a variety of value-added services for the QQ community, including email, various fee-based IM service packages, entertainment and information content services, chat rooms, dating services, casual games and massive multiple-player online games. Similarly, since the introduction of our mobile IM services, our mobile and telecommunications value-added services have expanded to include mobile chat, IVR services, ringback tones, mobile music and pictures, mobile news and information content services, mobile games and other telecommunications value-added services.

We also target the enterprise real-time communications market in China in which we believe there is a significant growth potential. We are making long-term investments in this market in order to develop real-time communications solutions to meet the needs of enterprises in China and capture market share at this early stage of market development. Our primary enterprise offering is known as Real Time Exchange (“RTX”), an IM solution that is capable of connecting enterprises internally and externally through a real-time communications network, interconnecting with our public QQ network across the Internet, and providing mobile value-added services. We launched the first commercial version of RTX in September 2003.

As a result of strong customer acceptance, we have been able to offer a growing number of our value-added services on a monthly subscription fee basis since May 2000. We achieved profitability in 2001 and have been able to grow our profit since then. For the year ended December 31, 2003, our revenues and profit for the year were RMB735.0 million and RMB322.2 million, respectively, representing an annual growth rate of 179.4% and 129.0% from 2002, respectively. Subscription based revenues accounted for over 75% of our revenues in 2003. For the three months ended March 31, 2004, our revenues and profit for the period were RMB257.6 million and RMB107.3 million, respectively.

OUR STRENGTHS

We believe that we are well positioned to take advantage of the growth in usage of Internet and mobile and fixed line telecommunications, as well as the growing demand for innovative Internet and telecommunications value-added services, in China. Our key strengths include the following:

Large and active user base. We have the largest IM registered user base in China with over 291.3 million registered user accounts as of March 31, 2004, of which 97.1 million were active user accounts in the 16-day period ended March 31, 2004. Our large and active user base is an important business driver as it provides a large community for our users to interact with one another via IM and other value-added services, which in turn enables us to retain our existing users and attract new users. In addition, our large user base provides us with the opportunity to market and deliver our value-added services and products. We believe that our large and active user base creates a high barrier to entry for competitors that would have difficulty in offering a similar critical mass of users in their IM services.

Distinctive community experience. We have created a community of active users who conduct person-to-person and multi-party real-time communications across the Internet and mobile and fixed line telecommunications networks using different communication terminal devices, including PCs and mobile phones. Via the QQ platform, our users establish their personalized identities and maintain connections and relationships with other users in an interactive and self-directed environment. Each of our users is identified with a QQ number, user name and a user profile. Once logged-on to our QQ network, our users can detect which other users in their own contact list are also online (i.e., “presence”) and can interact in real-time with such other users via a rich media of text, images, video, voice, sound and graphics. We believe that this sense of community and connectedness among our users is a distinctive offering for our users.

Compelling and creative value-added services. We continuously develop innovative value-added services to expand and enrich the experience of our users and enhance their loyalty to the “QQ” community. We believe our leading position in Internet services and mobile value-added services in China is based on our in-depth understanding of the needs of our users and trends in the market, as well as our strong research and development team. Our large, active and loyal user community also allows us to market our new value-added services to a significant customer base through advertising and word-of-mouth in our community. In addition to our basic IM services, our value-added services include Mobile QQ, mobile chat, QQ Dating, QQ Show, QQ Mail, and online games. Our services leverage the properties of our QQ client software, which allows us to bundle many enriched value-added service features with the QQ interface. By continuing the development of new value-added services

and content, particularly in the areas of information and entertainment, to meet the demands of a growing and increasingly sophisticated Internet and mobile consumer base in China, we expect that we will be able to generate new revenue streams.

Strong brand recognition. We believe our QQ brand () along with the QQ Penguin () is a widely recognized consumer brand in China. In addition, we believe that our Internet and mobile IM user base identifies the QQ brand with services and products that enhance their Internet and mobile experience. As an example of the strength of our brand, Guangzhou Donglihang Enterprise Development Company Limited (“DLH”) has licensed from us our QQ Penguin and our QQ brand. Pursuant to this license arrangement, DLH designs numerous QQ branded products such as apparel, and sells such products throughout a national chain of over 199 Q-Gen outlets, as of March 31, 2004, franchised or managed by DLH. By leveraging the QQ brand in our marketing initiatives, we have created an audience of consumers that is increasingly open to using our growing range of services and products.

Strong strategic relationships with telecommunications operators and terminal device manufacturers in China. We have built strategic relationships with a range of third parties, including mobile and fixed line operators and terminal device manufacturers. We have strong relationships with telecommunications operators because QQ provides a platform to the operators for end-users to enjoy value-added communication services, driving traffic on their networks and increasing their revenues. As mobile data and broadband are two significant focus areas for telecommunications operators in China, we expect that our strong strategic relationships with these operators will continue in the future. Currently, our relationships with telecommunications operators include utilizing their billing and service platform and co-marketing. We also have strong relationships with terminal device manufacturers in China. We currently have relationships with 13 mobile phone manufacturers, including, among others, Motorola, Nokia and TCL. We work with these manufacturers to pre-load our QQ client software on the advanced mobile phones and we frequently conduct joint marketing activities and cooperate to customize the QQ client software for their various mobile handset environments. PDA manufacturers such as Lenovo and Samsung, PC peripheral device manufacturers such as Logitech, and PC manufacturers such as Start also pre-loaded our client software or conducted joint marketing activities with us.

OUR STRATEGIES

Our goal is to be the leading Internet and telecommunications value-added service provider in China. We have developed our IM platform into a comprehensive service platform that provides a portfolio of IM, value-added services and online entertainment to our large and growing community. To grow our business and maximize shareholder value, we will seek to:

Continue to expand our user base. We seek to continue to expand our user base, as we believe the size of our user base is an important competitive advantage. We believe that by being the largest IM community in China, our user base will grow in tandem with the increase in Internet and mobile phone users in China. In addition, we target the youth segment in China, which we believe is a main source for the growth of Internet usage in China. To reinforce this leading position, we will continue to increase our customer satisfaction through

continuously upgrading the user experience, functionality, and services provided as part of our free IM service. In addition, we intend to further differentiate and cater to different needs of our various customer segments. For example, we have launched Tencent Messenger to cater to professional users and we are providing different services targeting different demographic groups within our user base. We also seek to maximize the reach of our services by integrating our services with the service offerings of telecommunications operators and bundling our client software with various terminal devices.

Deliver new services and products to enrich the QQ community experience. We intend to continue to develop and deliver new value-added communications, community, entertainment and information-based services and products to enrich the experience of our users and generate new sources of revenues. We intend to integrate and distribute online content such as music, video and other forms of multimedia content through our IM platform and to further expand the service offerings in our online dating, avatars and online game services. We intend to develop these new value-added services and products through a combination of internal efforts and cooperation with third-party content providers. See “Regulation—Applications by Tencent Computer”.

Continue to strengthen our strategic relationships with telecommunications operators, device manufacturers and content providers. We intend to strengthen our relationships with telecommunications operators in China through joint marketing, co-branding and joint development initiatives. We believe we can develop value-added services to help telecommunications operators in China attract new subscribers to their data service platforms and increase data traffic on their networks. In return, we can utilize their billing and network infrastructure to attract users for our value-added services. We also intend to strengthen existing, and build new, relationships with handset, PC, PDA, game console and other device manufacturers to pre-install our value-added software applications on the devices they manufacture. By doing so, we can increase demands for their devices that are capable of supporting our applications, while increasing the reach of our services. In the past, we relied primarily on internal efforts in developing our new services. Going forward, we will seek to expand our relationships with existing content partners and establish new relationships with additional content providers and technology partners to speed up the development of innovative service and product offerings for our users.

Develop real-time communications solutions for enterprises in China. We believe that the enterprise IM market in China presents a significant opportunity and can provide us with a large potential user base and revenue source over the long-run. We intend to become a leading provider of real-time communications solutions for enterprises in China by building upon our successes in delivering consumer IM services. To this end, we have launched our business enterprise solution, branded RTX, that is tailored to the specific needs of enterprises in China. The solution offers enhanced security features, is interoperable with our public QQ network and provides integration with our mobile value-added services. We have built a distribution channel for RTX in China which consists of a growing number of national, regional and local distributors and resellers. We have also entered into strategic relationships with various enterprise software providers in China in which we co-market, bundle or distribute our enterprise IM solutions with their products, including IBM, UFSOFT, Kingsoft and Kingdee. We intend to continue to build partnerships to position RTX as the market standard for enterprise IM in China.

SERVICES AND PRODUCTS

We operate the largest IM community in China, as measured by the number of registered user accounts. Through our IM platform, we offer a diversified portfolio of value-added Internet and telecommunications services. Leveraging our strategic relationships with telecommunications operators, device manufacturers and content providers, we are continuously expanding our services and products as well as the channels to deliver them to our users throughout China.

The following table sets forth certain operating statistics relating to our IM community as of the dates and for the periods presented:

	For the 16-day period ended December 31,			For 16-day period ended March 31, 2003	For 15-day period ended June 30, 2003	For 15-day period ended September 30, 2003	For 16-day period ended December 31, 2003	For 16-day period ended March 31, 2004
	2001	2002	2003					
	(in millions)							
Registered IM user accounts (at end of period)	93.2	151.3	256.1	165.8	181.1	214.5	256.1	291.3
Active user accounts	43.8	54.4	81.5	56.1	53.0	65.6	81.5	97.1
Peak simultaneous online user accounts	1.9	2.9	4.8	3.4	2.9	3.9	4.8	6.1
Average daily user hours	18.3	28.6	51.4	33.6	35.7	39.0	51.4	64.7
Average daily messages ⁽¹⁾	413.9 ⁽²⁾	386.4	681.8	448.1	581.6	554.4	681.8	848.8

Notes:

- (1) Average daily messages include messages exchanged between PCs only and exclude messages exchanged with mobile handsets.
- (2) Average daily messages for the 16-day period ended December 31, 2001 include messages derived from our online advertising. In subsequent periods, average daily messages exclude those advertising messages.

Internet Value-Added Services

Internet value-added services provide the main platform on which our user community is built and generates a considerable portion of our revenues. In 2003 and for the three months ended March 31, 2004, approximately 31.3% and 40.6%, respectively, of our revenues were derived from Internet value-added services. As of December 31, 2003, there were 6.9 million registered subscriptions for our fee-based Internet value-added services, and such registered subscriptions grew to 7.3 million as of March 31, 2004.

The following table sets forth our registered subscriptions for our fee-based Internet value-added services as of the dates presented:

	As of December 31,			As of March 31, 2003	As of June 30, 2003	As of September 30, 2003	As of December 31, 2003	As of March 31, 2004
	2001	2002	2003					
	(in millions)							
Registered subscriptions	—	1.5	6.9	3.5	5.4	7.2	6.9	7.3

IM and Mail Services

IM is at the core of our Internet value-added service platform. QQ is a comprehensive service platform that utilizes IM and other value-added services to create an online

community. We are one of the early developers of IM services in China as demonstrated by the launch of our basic IM service in February 1999. QQ is now widely recognized as the most popular IM community in China. We will continue to leverage the popularity of our QQ service to deliver value-added community and entertainment services to our expanding QQ user base. For a detailed discussion on IM generally, see “Industry Overview—Instant Messaging”.

We have three main categories of IM services that we provide to our consumer users. These categories are as follows:

- Basic QQ
- Premium QQ
- Tencent Messenger

Basic QQ. Basic QQ is our free IM service that allows users to send and receive instant messages and participate in the QQ community. In addition, via the QQ IM software client, our Basic QQ users are offered access to QQ chat rooms, QQ Mail, the Tencent Traveler browser, audio and video conferencing, and file transfer capability. To sign up for Basic QQ, users simply go to our website or many other software download websites to download our client software. Once registered, users can enjoy the Basic QQ service through the QQ software client. We seek to grow our Basic QQ user base and migrate them into paying subscribers of our premium QQ services, community services and online entertainment services.

Premium QQ. QQ Membership, launched in November 2000, enables users to enjoy a variety of additional benefits over the Basic QQ service for a monthly fee of RMB10.00. Membership benefits include the ability of users to choose their own QQ numbers, the ability to store message logs on QQ servers, 100 megabytes storage space, free credits to use various QQ value-added services (including online entertainment services), special indicators throughout the QQ network to allow others to recognize them as QQ Members, and exclusive access to additional chat rooms. We intend to continue to expand these premium membership benefits to grow the number of QQ Members.

QQ Xing, launched in September 2002, is our entry-level Premium QQ service package, for which users currently pay a monthly fee of RMB2.00. Current benefits for QQ Xing users include, among others, enhanced account security features, the ability to store message logs on QQ servers, and 20 megabytes storage space. We are continuing to expand the value-added services available to QQ Xing users.

Tencent Messenger. Tencent Messenger (“TM”), launched in December 2003, is our new IM service targeted to meet the evolving needs of professionals in China. While TM uses the same server infrastructure as QQ, it provides a differentiated user experience via the TM software client. TM offers an increasing number of value-added services intended to increase the productivity of its users and assist users in maintaining relationships with people in a professional environment. Some of these value-added services include a virtual “business card” that forms part of the TM user’s profile and can be exchanged with contacts inside the TM contact list. Other features include the ability to search for users not only based on

demographics such as region and age, but also by industry and profession. We intend to continue to expand the value-added services available to TM users.

QQ Mail. QQ Mail, launched in May 2003, is currently available via the QQ software client. QQ Mail is an email service closely integrated with the QQ IM platform. QQ Mail allows users' emails to be accessed directly from an email client that is bundled into the QQ software client. Users are notified instantly via the QQ software client whenever an email is received. QQ Mail provides a convenient way for QQ users to send email messages within the QQ community, and to email accounts outside the QQ community.

Community Services

QQ.com Portal. We operate an Internet portal under the domain name www.qq.com. This portal is a platform through which we enrich our users' experience and reinforce the QQ community. Our QQ.com portal, relaunched in December 2003, is designed to provide users with information, community resources and introductions to our growing number of value-added services. The main portal channels currently include news, entertainment sports, automobiles, games, jokes, fashion and horoscopes. The portal also features extensive community services such as BBS and chat, and various other Tencent value-added services such as our QQ Show and QQ game portal services. In particular, the BBS and chat services offered through the portal serve as important mediums for enhancing the sense of community among our users as the content is user-generated and interactive. See "Regulation—Applications by Tencent Computer". As of April 23, 2004, we had 1,254 chat rooms and as of March 31, 2004, the peak simultaneous online user accounts in our chat rooms was 57,974. The QQ.com portal is now one of the most visited Internet portals in China. According to Alexa.com, an Internet traffic monitoring website, as of March 31, 2004, we were one of the top 20 most visited websites in the world. We plan to expand our portal to offer more diversified content and services, focusing on entertaining content and the leisure experience.

QQ Dating. As QQ.com portal is a popular meeting place for our users, it is a natural medium for online dating. QQ Dating service was launched in November 2002 and is a dating service designed around our IM platform. The QQ Dating service allows all QQ users to register their own profiles and search the profiles of other registered users in the QQ Dating database for free. However, only paying QQ Dating users are provided with the ability to contact other QQ Dating registered users. We offer tools to facilitate user contact via IM, mobile SMS and picture messaging. The monthly subscription fee for QQ Dating service is currently RMB10.00. We regularly upgrade the functionality of the QQ Dating service to ensure that it maintains its value to our customers as an effective online dating service.

QQ Alumni Club. QQ Alumni Club, launched in January 2004, aims to create more specialized communities in the QQ community targeted at different school-based alumni groups. QQ users can create groups of fellow alumni and contact other alumni through a variety of web-based and QQ software client-based tools. We intend to grow the QQ Alumni Club into a fee-based service by promoting the service as a vital medium for users to maintain connections with their fellow alumni.

QQ E-card. QQ E-card, launched in August 2003, is a service that adds a rich messaging experience to the QQ platform. Our users can select from a growing number of

E-cards and send them to their QQ contacts. Upon the target recipient receiving an E-card, the sender is notified with a QQ message confirming successful transmission. A QQ E-card may also be sent to a user's email account. QQ E-card is sold on both a subscription and per E-card basis. A monthly subscription to the QQ E-card service is priced at RMB5.00 per month. On a per item basis, a QQ E-card costs between RMB1.00 and RMB3.00.

Entertainment Services

Casual Games. The QQ casual game service was launched in August 2003 and provides board games, card games and other games of skill. See "Regulation—Applications by Tencent Computer". The number of users of this service is growing rapidly. During the 16-day period ended March 31, 2004, the number of peak simultaneous online users was 219,199, and this number has continued to grow since this date. We currently offer over 15 different casual games through the QQ game portal. The QQ casual game service allows multiple users to play games together in a highly interactive game environment. Our casual game service features a special game software client that is bundled with the QQ software client. We currently allow users to play our QQ games for free. However, for a fee, users can enter into competitions and purchase "items" that can be used to enhance game play experience. We expect to offer an increasing number of client-based and web-based casual games.

QQ Show ("Avatars"). An "avatar" is a virtual character that enhances a QQ user's online identity, presence and personality in the community. QQ avatars can be seen throughout the QQ software client, in various community sections of the QQ.com portal and in the QQ game portal. Launched commercially in March 2003, QQ Show allows users to individualize their "avatars" with fashionable virtual clothing and other items by shopping in our online shopping malls. During the period from January 24, 2004 to March 31, 2004, over 29 million of our users obtained QQ Show items. To promote the service, we offer particular QQ Show items for free, although other QQ Show items are priced typically between RMB0.50 and RMB3.00. We plan to regularly introduce new features to improve the QQ Show user experience.

Massive Multiple-Player Online Game ("MMOG"). We believe the QQ platform is well-suited for launching and promoting MMOGs because of their community orientation. Our expertise in operating China's largest IM community also provides us with the experience and technology to offer compelling MMOG user experiences. In December 2003, we began operating our first MMOG, "Sephiroth", on a commercial basis. See "Regulation—Applications by Tencent Computer". "Sephiroth" is a three-dimensional MMOG that we license from Imazic of Korea. As of March 31, 2004, users were billed at RMB0.40 per hour to play the Sephiroth game or could purchase unlimited access to the Sephiroth game by paying a monthly subscription fee of RMB45.00. We are reviewing additional MMOGs from leading game developers for potential licensing and operation in China. We have also established an in-house MMOG development team that is focused on developing our own MMOGs.

Mobile and Telecommunications Value-Added Services

Mobile and telecommunications value-added services are an important segment of our business. We pioneered mobile IM services in China with the launch of Mobile QQ in June 2000. We have been introducing and promoting value-added services by leveraging our strategic relationships with telecommunications operators in China. In addition, we promote

these services via both the QQ software client and the QQ.com portal, where users can directly purchase various content subscription packages and items. The majority of mobile data traffic in China now occurs via SMS and we expect new services such as MMS, WAP and Java downloads to grow over time. In 2003 and for the three months ended March 31, 2004, approximately 63.6% and 55.5%, respectively, of our revenues were derived from our mobile and telecommunications value-added services. As of December 31, 2003, there were approximately 13.1 million registered subscriptions for fee-based mobile and telecommunication value-added services provided directly by us or through mobile operators, but such registered subscriptions decreased to 12.8 million as of March 31, 2004 as mobile operators have been cleaning up many inactive customer accounts in recent months.

The following table sets forth our registered subscriptions for our fee-based mobile and telecommunications value-added services provided directly by us or through mobile operators as of the dates presented:

	As of December 31,			As of	As of	As of	As of	As of
	2001	2002	2003	March 31,	June 30,	September 30,	December 31,	March 31,
				2003	2003	2003	2003	2004
					(in millions)			
Registered subscriptions	1.4	5.6	13.1	7.9	10.3	12.9	13.1	12.8

Mobile QQ. Mobile QQ is a mobile phone-based extension of our QQ service, that allows its users to access the QQ network via their mobile phones and communicate in real-time with other QQ users. We offer Mobile QQ on the mobile networks operated by China Mobile and China Unicom. We have also begun to offer Mobile QQ on the PHS networks of China Telecom and China Netcom. Mobile QQ currently offers some of the following functionalities:

- the ability to check the “presence” status of other QQ contacts to verify if they have logged on and are available for communication;
- the ability to send and receive instant messages between mobile phones and PC-based QQ users; and
- the ability to have profile information on other QQ users delivered to mobile phones.

The majority of our Mobile QQ users are now SMS-based and pay a monthly subscription fee of RMB4.50 to RMB5.00. Mobile QQ service is also offered over 2.5G networks in China, and can be accessed through a WAP browser or installable client software based on standards such as K-Java, Smartphone, BREW and native code.

We have arrangements with a number of subsidiaries and branch operators of China Mobile and China Unicom to pre-load Mobile QQ SMS command sets onto these mobile operators’ SIM cards. Mobile QQ client software is available for download from China Mobile’s WAP portal as well as from our and other WAP websites. We also work with a substantial number of handset manufacturers in China to pre-load the Mobile QQ and other client software directly into mobile handsets.

Mobile QQ was named the most popular mobile application in China during 2002 and 2003 according to a market research released by Shanghai iResearch Co., Ltd.

Mobile Chat. Mobile chat is a service that allows mobile phone users to communicate with each other through SMS using their mobile chat identification numbers instead of their mobile phone numbers. We launched our mobile chat service, “Feichang QQ Nannu”, in September 2001. We currently charge a monthly fee of RMB4.00 for this service. In addition, we provide technical support to China Mobile in their offering of a similar service called 161 Mobile Chat. The monthly user fee for 161 Mobile Chat is currently set at RMB5.00, a portion of which we share with China Mobile under a co-branding arrangement.

IVR. IVR is a technology for delivering various types of audio content over a telephony voice channel. Our IVR services are currently offered on China Mobile’s “Monternet” platform. One of our IVR services is a voice chat service in which QQ users can make telephone calls to other QQ users via their QQ number preceded by a short code. This provides our QQ users with the ability to mask their identity while they utilize the QQ service to develop relationships with other QQ users. In addition to voice chat, we offer an increasing range of audio content services, including information, music, jokes and games. We currently charge our IVR users a usage fee ranging from RMB0.20 to RMB1.50 per minute.

Ringback Tones. Ringback tones service allows users to stream music or other content pre-selected by the call receiver to the dialer while the latter waits for the call to be answered. We provide content for ringback tones services provided by telecommunications operators and participate in joint efforts to market these services. Users of the service pay a monthly subscription fee to the telecommunications operators. In addition, users are typically charged a fee ranging between RMB1.00 and RMB3.00 for each selected ringback tone, for which we are entitled to a share of such revenues. Telecommunications operators typically hold competitive bids to select a limited number of content providers to be ringback tones service partners in each province. We license music and other content from third parties and share a portion of our revenues with them.

Mobile Music, Image and Picture Download Services. We distribute ringtones, music-related products, images and picture content via mobile channels in formats adapted for mobile devices. We license content from various third parties that we market and distribute to our users. We offer a variety of packages and options for users to purchase our content. Individual download items generally cost between RMB0.50 and RMB2.00, and monthly packages are generally offered at RMB5.00 to RMB10.00. We plan to deliver richer multimedia content as more mobile devices supporting these features are developed and distributed in China.

Mobile News and Information Content Services. We offer a variety of mobile news and information content for distribution over mobile networks. Our mobile content services currently cover popular content areas such as news, stock and financial updates, sports, jokes, proverbs and horoscopes. These services are provided on a monthly subscription basis with monthly user fees ranging from RMB5.00 to RMB30.00.

Mobile Games. We offer a range of mobile games for use on a broad range of mobile handsets sold in China. We have licensed a variety of single player and multiplayer games based on SMS, WAP, K-Java or BREW applications from mobile game developers, and we also maintain an in-house mobile games development team. We are also building a mobile

version of our online casual game service to allow mobile phone users to play our casual games with other PC and mobile phone users.

Online Advertising

We sell advertising space on our QQ software client and websites that generate significant impressions daily. We believe that our advertising services are attractive for our advertising customers because it enables advertisers to reach our large user base that spends time in the QQ community. The QQ software client enables targeted advertisements such as “log-in flashes” and “system messages” to deliver high resolution images to the end-user’s PC screen. “Log-in flashes” are displayed for several seconds after a user has logged on to the QQ network and “system messages” are advertisements that users can view selectively. We also offer special services and activities on our websites to promote our advertising customers’ services and products. In addition, we have a revenue sharing agreement with Baidu for search service distribution on the Tencent Traveler browser and the QQ.com portal. We intend to further grow our online advertising business through leveraging our QQ.com portal. Online advertising accounted for approximately 4.5% of our revenues in 2003. As of December 31, 2003, over 450 advertising customers have placed advertisements on our websites.

Enterprise IM

As the Chinese economy continues to grow, we believe that China’s enterprises will demand more sophisticated tools for organizing their business processes, managing communication both internally and externally, and satisfying the needs of their customers. Accordingly, we expect significant growth and demand for enterprise IM solutions in China. We have an enterprise services business unit that focuses on developing IM solutions and promoting the use of these solutions to enterprises in China. We believe that we are well-positioned to enter this market as we are able to leverage our significant technical expertise in developing and operating our large scale QQ IM network.

At the core of our enterprise business is our RTX software package, an IM solution tailored to the specific needs of Chinese enterprises. RTX is a client-server IM service package that allows an enterprise to operate and manage its own internal IM network on its local area or wide area network and enables its internal RTX network to interoperate with other RTX networks, our QQ network, and mobile networks through our gateways. We sell RTX throughout China via a network of national, regional and local distributors and resellers. We price RTX competitively to maximize our market share in this early stage of market development. We also have strategic relationships with IBM, UFSOFT, Kingsoft and Kingdee in which we market, bundle or distribute RTX with their products in China. Currently, our RTX clients include China Mobile, China Telecom, TCL Corporation and PRC subsidiaries of The Coca Cola Company. As of March 31, 2004, there were over 14,900 active RTX servers connected to Tencent Computer’s public IM network.

Licensing

We license our trademarks from time to time to increase our brand recognition and further penetrate the consumer market in China. We leverage off-line arrangements such as licensing and co-branding to strengthen our brand by building an increasingly stronger

relationship with our QQ users, integrating QQ into our users' daily lives, and attracting new users to the QQ community. Our trademark licensing consists of two key elements:

Q-Gen products and retail shops. We have licensed our popular QQ Penguin and QQ brands to DLH, whereby DLH designs and oversees manufacturing and distribution of numerous QQ branded products such as apparel, watches and other fashionable consumer goods. These licensed products are then sold throughout the national chain of over 190 Q-Gen outlets, as of December 31, 2003, franchised or managed by DLH.

Co-branded QQ products. We have also from time to time licensed our QQ brand directly to manufacturers of various products, including electronic and consumer goods products such as PCs, PC peripherals such as web cameras and storage devices, mobile phones, and beverages. Our trademarks have also appeared along with trademarks of other corporate entities for joint marketing and co-branding initiatives.

SALES AND MARKETING

We believe that the large number of active QQ users in our community in itself is a key driver of our user growth as many Internet users in China seek to join an established and vibrant online community. Our users also form a large potential customer base for our value-added services. We market our value-added services to them primarily via our QQ platform and QQ.com portal. In the QQ community, "word of mouth" is an important driver for the adoption of value-added services as positive feedback from users can be quickly communicated via IM, chat rooms and BBS postings. In addition, we also conduct offline marketing and promotion activities.

We also promote our value-added services through joint marketing with telecommunication operators and device manufacturers. Our large user base is attractive to the network operators and device manufacturers with whom we cooperate. We believe that by working closely with these operators and manufacturers, we can stimulate demand for our own services as well as drive higher network traffic and demand for more sophisticated devices.

We sell and market our services and products throughout China. Our sales and marketing efforts are supported by a network of regional offices. Through these offices, we maintain day-to-day contact with telecommunications operators, provide on-the-ground support to these operators, and execute joint-marketing initiatives for the local market. As of March 31, 2004, we had a total of 60 employees in our regional sales and marketing offices.

We market our online advertising services from our head office in Shenzhen (for Southern China) and our offices in Beijing and Shanghai (for Northern China and Eastern China, respectively). We work closely with advertising agencies and other distribution partners to sell advertising and provide marketing solutions to our customers. We market RTX via a network of national, regional and local distributors and resellers as well as through our dedicated website, rtx.tencent.com.

BILLING AND REVENUE COLLECTION

We bill and collect revenues for our value-added services principally through four channels: mobile operators, fixed line operators, pre-paid cards and our e-Sales system.

Mobile Operators

Due to the relatively low penetration rate of credit cards in China, a significant number of our Internet and mobile value-added users pay for our services through their mobile operators. Accordingly, we work closely with both China Mobile and China Unicom to develop value-added services to attract new subscribers to their platforms and to increase data traffic on their networks, and in return we utilize their billing and collection platforms to collect fees. Substantially all of the fees for our mobile value-added services and a majority of the fees for our Internet value-added services are separately settled and collected for us by the 29 affiliates of China Mobile and 15 affiliates or branches of China Unicom.

China Mobile and China Unicom collect the fees for our services from their customers and pass such fees to us after withholding their portion of the fees and, other than for co-branded services, an “imbalance fee” that results from the number of SMS or MMS messages sent from the Internet to mobile phones exceeding the number of SMS or MMS messages sent from mobile phones to the Internet. We generally share with China Mobile and China Unicom 12% to 15% of the fees collected from customers. China Mobile and China Unicom generally charge between RMB0.04 and RMB0.08 per SMS message and between RMB0.20 and RMB0.25 per MMS message for the imbalance fee.

The following table sets forth the typical terms of revenue sharing arrangements with China Mobile and China Unicom as of March 31, 2004.

	<u>Portion of fees shared with operator</u>	<u>Imbalance fee per message</u>
China Mobile ⁽¹⁾ :		
SMS	15%	RMB 0.05-RMB 0.08
MMS	15%	RMB 0.20-RMB 0.25
China Unicom ⁽²⁾	12%	RMB 0.04-RMB 0.08

Notes:

- (1) Other than the fees relating to co-branded services, the amount of fees that we share with China Mobile range from 9% to 15%. However, we have generally shared with China Mobile 15% of the fees, before the adjustments for imbalance transmission fees.
- (2) The amount of fees that we share with China Unicom generally range from 12% to 20%. However, in a majority of our contracts, we have shared with China Unicom 12% of the fees, before the adjustments for imbalance transmission fees.

On a periodic basis, we confirm with each mobile operator the subscription information and the data transmission volume between our network gateway and the operator’s network gateway. Each subsidiary or branch operator of China Mobile and China Unicom will also provide us with a summary on a monthly basis as to the net fees payable to us by the subsidiary or branch operator, as the case may be. The level of detail and timing of summaries vary among the subsidiaries and branch operators. We also receive information on customer payment status and coordinate with the mobile operators for final billing and collection of revenues.

See “Risk Factors — Risks Related to Our Business — Our revenues will be adversely impacted if mobile or other telecommunications operators refuse to pay, or delay payment of, fees to Tencent Computer and Shiji Kaixuan”.

Fixed Line Telecommunications Network Operators

We also bill for our services via the broadband and IVR platforms of the fixed line telecommunications network operators, China Telecom and China Netcom. China Telecom has developed, and China Netcom is developing, its own data service billing platform for its respective broadband services. We anticipate that these platforms will provide us with effective channels to bill users of our services and products, particularly given the growth in broadband users in China. According to CNNIC, there were 17 million broadband users in China as of December 31, 2003, an increase of 77.6% from December 31, 2002.

We also work with the IVR departments of both China Telecom and China Netcom to sell QQ Coins that are used within our QQ platform to purchase our various online value-added services. Fixed line users can call special phone numbers and agree to add credits, in the form of QQ Coins, to their QQ user accounts. These QQ Coins can be used to purchase a wide range of our value-added services. These users are billed for these QQ Coins on their monthly telephone statements.

China Telecom and China Netcom have also begun to build out their data services over their PHS networks. We have begun to provide value-added services over their PHS networks and will continue to as they are introduced and expanded to deliver our value-added services. For example, we have already begun to provide Mobile QQ services over a number of these PHS networks and will expand our presence as the infrastructure is enabled by the operators.

See “Risk Factors — Risks Related to Our Business - Our revenues will be adversely impacted if mobile or other telecommunications operators refuse to pay, or delay payment of, fees to Tencent Computer and Shiji Kaixuan”.

Prepaid Cards

We also collect revenues through the sale of prepaid cards. These prepaid cards are sold at retail outlets and are used to purchase our fee-based services. These prepaid cards provide users with credit that can be used to purchase our value-added services. We also have entered into contractual arrangements with Junnet for the distribution of prepaid cards for time usage on our “Sephiroth” MMOG service.

e-Sales Systems via Banking Networks

We have arrangements with Internet cafes and other retailers across China to sell QQ Coins and usage credit for our “Sephiroth” MMOG service through an e-Sales platform. Under the e-Sales platform, Internet cafes and other retailers purchase QQ Coins and usage credit in bulk at a wholesale rate from us via bank transfers, and then re-sell them to users at the local retail outlet. We do not offer any refunds after the QQ Coins and usage credit are sold to retailers. The e-Sales platform is an efficient way to sell our services to our customers because they can access our services immediately at the retailer’s premises, and no physical distribution of prepaid cards is required.

STRATEGIC RELATIONSHIPS

We are focused on enriching our value-added services and expanding the networks over which we deliver these services. We maintain strategic relationships with telecommunications operators and device manufacturers in the telecommunications industry in China. In addition, while we develop a significant number of our services and products through in-house development teams, we also license content from an increasing number of third parties.

Relationships with Telecommunications Operators

We have strategic and complementary relationships with the telecommunications operators in China as our large user base and innovative applications create new demand for, and increase traffic on, telecommunications networks. We believe that this is particularly relevant in the case of China's emerging broadband and mobile networks. We currently have strategic relationships with China Mobile, China Unicom, China Telecom and China Netcom. See “—Our Strengths” and “—Billing Systems and Revenue Collection”. These relationships are important to us and we expect to maintain and further develop them.

Relationships with Device Manufacturers

We endeavor to work with major manufacturers of network connected terminal devices. We believe that cooperation with device manufacturers is mutually important and beneficial. Device manufacturers assist in the distribution of our services by making our client software and applications readily available on the devices they manufacture. At the same time, our applications create market demand for more sophisticated devices capable of supporting and interfacing with our applications. We currently have relationships with 13 mobile phone manufacturers, including, among others, Motorola, Nokia and TCL. We work with these manufacturers to pre-load our QQ client software on the advanced mobile phones, and we frequently conduct joint marketing activities and cooperate to customize the QQ client software with their various wireless handset environments. PDA manufacturers such as Lenovo and Samsung, PC peripheral device manufacturers such as Logitech, and PC manufacturers such as Start also pre-loaded our client software or conducted joint marketing activities with us.

Relationships with Content Providers

Our relationships with content providers are important to us as we strive to expand our value-added services. The goal of our content partnerships is to provide our users with a broad offering of attractive content and applications available. We have relationships with a number of content providers including mobile and portal content providers, music content providers and game and application providers, and we expect to further grow these relationships.

Strategic Acquisitions

To date, we have grown our business organically without making any acquisitions. Going forward, we intend to explore strategic acquisitions of companies, assets, and

technologies that are complementary to our existing business and can be integrated into our service platforms. Our primary objective in engaging in mergers or acquisitions in the future would be to expand and broaden our services for our large and growing customer base.

COMPETITION

The market for Internet and telecommunications value-added services in China is highly competitive and competition is expected to increase continuously. Accordingly, we expect to face competition from a number of fronts. As the industry is relatively new and is rapidly evolving, the basis of competition may frequently shift, offering opportunities for new competitors to enter our markets. We also believe that as we continue to expand our business scope, we will encounter new competitors and competitive environments in which we have less operating experience. In addition, as China opens its telecommunications value-added services market to foreign investors, we may face increased competition from international competitors that may establish joint venture companies with local companies to provide services based on the foreign investors' technology and experience developed in overseas markets. Many of our existing competitors, as well as a number of new potential competitors, have significantly greater financial, technical and marketing resources than us.

Our main competitors in the overall Internet and telecommunications value-added services market in China are local Internet portals such as Sina.com, Sohu.com, Netease.com and Tom.com. We compete directly with these portals to provide comprehensive Internet and telecommunications value-added services to Chinese consumers. In addition to these horizontal portals, other competitors in the China IM market include Microsoft, Yahoo and AOL. These IM competitors have substantial brand recognition and large user bases outside China, and may leverage such strengths to increase their market position in the China market. Some of the telecommunications operators may also bundle their own IM services with the basic telecommunications services they offer, further increasing the level of competition in the market. In the area of mobile and telecommunications value-added services, we also face competition from a large number of competitors that provide an expanding range of value-added services. We believe that the key areas of competition in mobile value-added services and products are currently mobile content and mobile games, and that our primary competitors in these areas will continue to be the local Internet portals. In the online entertainment market, we also have a number of specialized competitors. In the online casual games market, we compete with Ourgames.net, Chinagames.net and Bian Feng, among others. We also compete with Shanda, The9 and Guangtong, among others, in the MMOG market. The enterprise IM market in China is in an early stage of development. Microsoft, AOL and Yahoo may enter the enterprise market in China, as they have launched enterprise IM products in the United States. Alibaba.com has recently begun to market a public IM service to its business customers via its portal. Enterprise software companies in China may also provide IM functionality in their products in the future.

We believe the principal competitive factors in our business include size of user base, community cohesiveness and interactivity, brand recognition, technology, understanding of and tailoring to user needs, and pricing. We aim to compete by strengthening our leadership in the China IM and value-added services market through continuous innovation of our

technologies and services and focusing on delivering services of value to our target customers in China. With our large user community, our ability to deliver innovative services and products to our user base, our strong brand recognition within China and our operating experience in dealing with Chinese consumers specifically, we believe we are well positioned to compete. In the enterprise IM market, we believe that we are one of the first players in China with a commercialized enterprise IM solution that can be hosted, maintained and operated by enterprises on their own internal data networks. Our experience in operating China's largest scale IM network and the ability for our enterprise solutions to integrate with our public QQ IM network provide us with unique advantages for competing in the enterprise IM space.

See the section entitled "Risk Factors - Risks Related to Our Business - We operate in a very competitive market".

INTELLECTUAL PROPERTY AND LICENSES

Our Intellectual Property

We regard our copyrights, trademarks and other intellectual property as critical to our success. We rely primarily on a combination of trademark, copyright, trade secret and other intellectual property-related laws and contractual restrictions to establish and protect our intellectual property rights. We require our employees to enter into agreements requiring them to keep confidential all proprietary and other confidential information relating to our customers, methods, technology, business practices and trade secrets during their employment with us and for three years after the termination of their employment. Our employees are required to acknowledge and recognize that all inventions, trade secrets, works of authorship, developments and other processes, whether or not patentable or copyrightable, made by them during their employment are our property.

Despite our precautions, it may be possible for third parties to obtain and use our intellectual property without our authorization. Furthermore, the validity, enforceability and scope of protection of intellectual property rights in the Internet and telecommunications-related industries are uncertain and still evolving. Infringement and misappropriation of our intellectual property could materially harm our business. The Group was not involved in any material litigation to enforce its intellectual property rights during the years 2001, 2002 and 2003. The Group was, however, involved as an applicant or opposing party in several administrative actions involving trademark disputes. For a further discussion of these administrative actions, see the section entitled "—Legal Proceedings".

We have registered the domain names "www.qq.com" and "www.tencent.com" with Internet Corporation for Assigned Names and Numbers and the domain names "www.tencent.com.cn" and "www.rtx.com.cn" with CNNIC, a domain name registration organization in the PRC. In addition to these domain names, we have registered over 110 domain names with various domain name registration services.

Our "QQ (stylized)" mark and the "penguin" device and many associated marks have been registered as trademarks in various classes in the PRC. We have also registered our "QQ (stylized)" mark and the "penguin" device in various classes in Hong Kong, Taiwan and

Japan. We have also registered “Q-GEN” as a trademark in the PRC. In addition, a series of “QQ” marks and the “penguin” device have also been registered as copyrighted artworks in the PRC. We have also filed trademark applications for “QQ (stylized)” and the “penguin” device in Singapore, Thailand, the United States, Indonesia, South Korea, and South Africa and in additional classes in Taiwan and Japan. These trademark applications are currently being processed in the relevant jurisdictions.

We have filed over 30 patent applications for a number of Internet, mobile and IM-related technologies in the PRC and the United States. These patent applications are currently being processed.

We have independently developed the key software used in our business and have registered a number of these software copyrights.

Our Licensing Arrangements

We have licensed the Q-GEN brand to DLH and the QQ brand to manufacturers of various electronic products. See “—Services and Products – Licensing”.

We have also entered into licensing arrangements whereby we receive licenses from numerous content and applications providers.

RESEARCH AND DEVELOPMENT

We believe that our ability to develop IM technology, Internet, mobile and online entertainment applications has been a key factor in the success of our business. To maintain and enhance our leadership position, we will need to continue to invest in research and development in order to enhance our services and products.

As of March 31, 2004, our research and development team consisted of over 220 development and technical staff members focused in the areas of IM, enterprise IM, mobile applications and Internet value-added service applications.

Our self-developed technologies include IM technology, mobile IM technology, enterprise IM technology and other interactive technologies. We also license some services and technology from third parties such as database technology and audio/video codec technology. We will continue to develop our core technologies in-house and when required, license technology from third parties.

NETWORK INFRASTRUCTURE

Our network infrastructure is built to satisfy the requirements of our operations and to support the growth of our business. Our network infrastructure is administered by our network operations group, which includes more than 20 full-time engineers who handle system and hardware operation and maintenance. As of March 31, 2004, our online services were accessible through more than 1,800 network servers located in Shenzhen, Shanghai and Beijing, the majority of which were located in Shenzhen. Our systems are designed for scalability and reliability to support growth in our user base. We lease over eight Gigabits of

bandwidth from China Netcom and China Telecom to connect to the national Internet backbone, and also lease dedicated lines from various mobile operators to connect to their networks. Our hardware platform includes Compaq (HP) DL380, Compaq (HP) DL580 servers, PowerLeader PT2300 servers and PowerLeader PT2300 G2 servers. We use commonly used third-party operating systems and software for our services, web server support and database server support. We believe that our current network facilities and broadband capacity provide us with sufficient capacity to carry out our current operations. We believe that we can expand our network facilities and broadband capacity to meet the Group's currently planned expansion during 2004. While we believe that the Group's network infrastructure and maintenance will likely prevent network interruption resulting from computer viruses, there remains a possibility that computer viruses could result in delays or interruptions on our network. For a further discussion, see the section entitled "Risk Factors—Unexpected network interruption caused by system failures or computer viruses may reduce visitor traffic, reduce revenues and harm our reputation". The Group's network infrastructure did not experience any material network interruption, as a result of computer viruses or other reasons, during the years 2001, 2002 and 2003.

CUSTOMER SERVICE AND TECHNOLOGY SUPPORT

We place a high priority on providing our customers with a consistently high quality of service and support. Our call centers, located in Shenzhen, provide customer service 24 hours a day, seven days a week. Our call centers handle general product and service inquiries, billing questions and technical support issues. We also have customer service representatives performing other tasks such as loading new customer information into our databases.

As of March 31, 2004, we employed as well as sourced from temporary employment agencies more than 190 customer service representatives.

SUPPLIERS AND CUSTOMERS

Our largest supplier for each of the three years ended December 31, 2003 accounted for approximately 30%, 24% and 15% of our purchases during those periods, respectively. Our five largest suppliers for each of the three years ended December 31, 2003 accounted for approximately 85%, 64% and 59% of our purchases during those periods, respectively. Purchases mainly include bandwidth leasing and server custody arrangements, content licensing and fixed asset purchases. See "Risk Factors—Risks Related to our Business—The failure of telecommunications network operators to provide us with bandwidth and server custody and of our suppliers to provide content as expected could hurt our business."

The credit terms provided by our suppliers generally range from payment upon delivery to 60 days credit. We typically settle our outstanding vendor invoices within 30 days from the date of the invoices in order to maintain good relationship with our vendors. As a result, we did not have any trade payable balances at the end of each of the three years ended December 31, 2003.

Our largest customer for each of the three years ended December 31, 2003 accounted for approximately 17%, 15% and 12% of our revenues during these periods, respectively. Our five largest customers for each of the years ended December 31, 2003, accounted for

approximately 44%, 46% and 39% of our revenues during those periods. See “Risk Factors—Risks Related to our Business—Deterioration in our relationships with, or financial difficulties encountered by, major operators may hurt our business.”

As of March 31, 2004, none of the Directors, their associates or any shareholders of the Company (who or which to the knowledge of the Directors owned more than 5% of the Company’s issued share capital) had any interest in any of our five largest customers or five largest suppliers.

EMPLOYEES

As of March 31, 2004, the Group had 700 full-time employees, of whom 36.9% work in the business operations department, 37.6% work in the technology research and development department, 12.1% work in the functional support department, 10.3% work in the information department and 3.1% work in the customer service department. As of March 31, 2004, we had 176 individuals working in our call centers that were sourced from temporary employment agencies. We consider our relationships with our employees to be good. As of March 31, 2004, of the Group’s 700 full-time employees, 570 were based full-time in Shenzhen, 77 in Beijing, 52 in Shanghai, and one in Santa Clara, California.

The following table sets out the number of our full-time staff by business area as of the dates indicated:

	As of December 31			As of
	2001	2002	2003	March 31
				2004
Technology, research and development	26	89	217	263
Business operations	39	106	235	258
Information	11	18	67	72
Customer service	5	18	21	22
Functional support	17	35	74	85
Total	98	266	614	700

We anticipate that our headcount will reach 1,100 by the end of 2004 as we expect our business to continue to grow.

All of our management and key executives, and substantially all of our other employees, have entered into confidentiality and non-competition agreements with the Group. In addition, all of our management and key executives, and all of our other employees, have entered into employment agreements with the Group.

PROPERTIES AND FACILITIES

Our executive offices and our major operational facilities are located in Shenzhen, PRC and occupies more than 8,000 square meters under current leases, a number of which will expire in 2004. We also maintain offices in Beijing and Shanghai. We have recently signed a lease agreement with respect to the leasing of more than 20,000 square meters in Shenzhen, PRC and have relocated our principal executive offices to these new premises.

We believe that we will be able to obtain adequate facilities, principally through the leasing of appropriate properties, to accommodate our future expansion plans. We also maintain an office in Hong Kong and a representative office in Santa Clara, California, United States. Our representative office in the United States is used to facilitate the development of business and technology relationships between the Company and companies based in the United States. We have no other foreign offices.

We have obtained an independent valuation which values our property interests at no commercial value. See Appendix IV to this Prospectus for further details.

INSURANCE

We maintain property insurance to cover us against damage to our equipment, including our servers. We provide insurance for our employees as required by applicable law and policy in the PRC. We have not made any claims on our insurance policies as of March 31, 2004. The Directors believe that the insurance coverage of the Group is adequate to cover material property damage.

LEGAL PROCEEDINGS

We are involved as an applicant or opposing party in several administrative actions involving trademark disputes. These administrative actions only involve the right to use certain trademarks and do not involve any monetary claims for trademark infringement. The Company does not consider the trademarks that are the subject of these administrative actions as material trademarks to the Company's business. Accordingly, neither the Company nor the Directors believe that any of these disputes will result in material liabilities to the Company or substantively impair our ability to operate our business. Other than these disputes, we are not currently a party to any material litigation or administrative proceedings and are not aware of any pending or threatened litigation or administrative proceedings. In addition, during the past three years, we have not been subject to any material unresolved claim in relation to the content on our websites or in relation to infringements of third parties' proprietary rights, including trademark and copyright ownership rights.