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The Directors
Tencent Holdings Limited
Goldman Sachs (Asia) L.L.C.

7 June 2004

Dear Sirs

We set out below our report on the financial statements (the "Financial Statements") of Tencent Holdings Limited ("the Company") and the Group, as defined in note 1 of Section I in this Appendix, for each of the years ended 31 December 2001, 2002 and 2003 and the three months ended 31 March 2003 and 2004 (the "Relevant Periods") for inclusion in the prospectus of the Company dated 7 June 2004 (the "Prospectus") in connection with the initial listing of the shares of the Company on the Main Board of The Stock Exchange of Hong Kong Limited.

The Company was incorporated in the British Virgin Islands ("BVI") on 23 November 1999 under the name of Keyword Technology Limited and subsequently changed its name to OICQ.com Limited, Tencent (BVI) Limited and Tencent Holdings Limited on 29 December 1999, 7 June 2001 and 11 February 2004 respectively. On 27 February 2004, the Company's registration was transferred to the Cayman Islands as an exempted company with limited liability under the Companies Law of the Cayman Islands.

As explained in notes 1 and 3(a) of Section I in this Appendix and in the section headed "Our History and Structure" in the Prospectus, the operations of the Group were initially conducted through Shenzhen Tencent Computer Systems Company Limited ("Tencent Computer"), a limited liability company established in 1998 in the People's Republic of China ("the PRC") by certain shareholders of the Company who are citizens in the PRC ("the Registered Shareholders"). In order to enable certain foreign companies to make investments into the business of the Group, the Company and its first wholly owned subsidiary were established, which were substantially owned by the Registered Shareholders in similar proportions to their shareholding in Tencent Computer at the time of establishment. The non-PRC investors of the Company then subscribed to additional equity interests of the Company. The Financial Statements for the Relevant Periods include those of the Company, its wholly owned subsidiaries, Tencent Computer and Shenzhen Shiji Kaixuan Technology Company Limited ("Shiji Kaixuan Technology"). Tencent Computer and Shiji Kaixuan Technology are consolidated as subsidiaries because they are controlled by the Company through certain contractual arrangements between the Company, the Company's wholly owned subsidiaries, Tencent Computer, Shiji Kaixuan Technology and the Registered Shareholders, which transfer substantially all the economic risks and rewards of Tencent Computer and Shiji Kaixuan Technology to the Company.

Please refer to note 1 of Section I in this Appendix for details of subsidiaries in which the Company has direct and/or indirect interests, as well as companies in the PRC consolidated for accounting purposes as at the date of this report. All these subsidiaries and companies consolidated for accounting purposes have substantially the same characteristics as Hong Kong incorporated private companies.

All companies comprising the Group have adopted 31 December as their financial year end date. No audited financial statements have been prepared for the Company and its subsidiaries incorporated in the BVI since their dates of incorporation as there is no statutory audit requirement in their respective jurisdictions of incorporation/registration.

Details of the companies comprising the Group, which were incorporated in the PRC, and their auditors are set out in note 1 of Section I in this Appendix. The audited accounts of these companies were prepared in accordance with the relevant accounting principles and financial regulations applicable to PRC enterprises ("PRC GAAP").

For the purpose of this report, the directors of the Company have prepared the financial statements of the Company and consolidated financial statements of the Group in accordance with International Financial Reporting Standards ("IFRS") (the "IFRS Accounts") for the Relevant Periods for which the directors of the Company are solely responsible. We have carried out an independent audit of the IFRS Accounts for the Relevant Periods in accordance with the Statements of Auditing Standards issued by the Hong Kong Society of Accountants ("HKSA"). The financial information as set out in Section I of this Appendix (the "Financial Statements") has been prepared based on the IFRS Accounts and no adjustments are considered necessary. We have examined the IFRS Accounts and have carried out such additional procedures as are necessary in accordance with the Auditing Guideline "Prospectuses and the Reporting Accountant" issued by the HKSA.

The directors of the Company, at the Relevant Periods, are responsible for preparing the IFRS Accounts which give a true and fair view. In preparing the IFRS Accounts, it is fundamental that appropriate accounting policies are selected and applied consistently.

The directors of the Company are responsible for the Financial Statements. It is our responsibility to form an independent opinion, based on our examination, on the Financial Statements and to report our opinion thereon.

In our opinion, the Financial Statements, prepared based on IFRS, give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2001, 2002 and 2003 and 31 March 2004 and of the consolidated results and cash flows of the Group for the Relevant Periods.

(I) FINANCIAL STATEMENTS

CONSOLIDATED PROFIT AND LOSS ACCOUNTS

	Note	For the year ended 31 December			For the three months ended 31 March	
		2001	2002	2003	2003	2004
		RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenues						
Mobile and telecommunication value-added services		37,960	198,818	467,369	84,297	142,817
Internet value-added services		944	40,819	229,690	33,012	104,586
Online advertising		7,735	19,188	32,841	6,818	8,215
Others		2,437	4,282	5,057	866	1,935
	4	49,076	263,107	734,957	124,993	257,553
Cost of revenues	5	(18,044)	(71,674)	(229,548)	(36,339)	(87,368)
Gross profit	4	31,032	191,433	505,409	88,654	170,185
Other operating (expenses)/income, net		(82)	(242)	(1,226)	36	18
Selling and marketing expenses		(4,312)	(19,437)	(55,967)	(12,313)	(23,044)
General and administrative expenses		(16,297)	(28,860)	(112,011)	(16,652)	(34,074)
Profit from operations	6	10,341	142,894	336,205	59,725	113,085
Finance (expenses)/income, net	7	(125)	871	2,004	(257)	931
Profit before taxation		10,216	143,765	338,209	59,468	114,016
Taxation	12	—	(3,058)	(16,013)	(2,123)	(6,712)
Profit for the year/period	13	10,216	140,707	322,196	57,345	107,304
Earnings per share						
—basic (RMB)	15	0.009	0.104	0.244	0.042	0.085
—diluted (RMB)	15	0.008	0.104	0.244	0.042	0.085
Proposed dividends	14	—	10,334	28,935	N/A	N/A
Proposed dividends per share (RMB)	14	—	0.008	0.023	N/A	N/A

CONSOLIDATED BALANCE SHEETS—THE GROUP

	Note	As at 31 December 2001 RMB'000	As at 31 December 2002 RMB'000	As at 31 December 2003 RMB'000	As at 31 March 2004 RMB'000
Assets					
Non-current assets					
Fixed assets	16	16,868	38,851	80,139	87,961
Deposit in connection with the formation of Shiji Kaixuan Technology	27(f)	—	—	11,000	—
Current assets					
Accounts receivable	18	8,500	59,094	99,726	130,726
Amounts due from shareholders	27(e)	82	82	82	82
Prepayments, deposits and other receivables	19	369	2,945	35,872	46,174
Term deposits with initial term of over three months	20	—	67,440	23,311	48,141
Cash and cash equivalents	21	39,723	45,254	325,586	329,332
		48,674	174,815	484,577	554,455
Total assets		65,542	213,666	575,716	642,416
Equity and liabilities					
Current liabilities					
Other payables and accruals	22	5,273	3,615	59,301	56,571
Amounts due to shareholders	27(d)	8,919	—	—	—
Amounts due to related parties	27(c)	—	1,499	—	—
Dividends payable	14	—	—	—	1,963
Income taxes payable		—	—	7,115	13,465
Other taxes payable		3,026	7,021	32,679	16,957
Deferred revenue		—	523	3,676	1,783
		17,218	12,658	102,771	90,739
Non-current liabilities					
Deferred tax liabilities	23	—	3,058	988	1,351
Total liabilities		17,218	15,716	103,759	92,090
Shareholders' equity					
Share capital	24	146	149	138	138
Reserves	25	48,178	197,801	471,819	550,188
Total shareholders' equity		48,324	197,950	471,957	550,326
Total liabilities and shareholders' equity		65,542	213,666	575,716	642,416

BALANCE SHEETS—THE COMPANY

	Note	As at 31 December			As at 31 March
		2001	2002	2003	2004
		RMB'000	RMB'000	RMB'000	RMB'000
Assets					
Non-current assets					
Fixed assets	16	3,336	2,665	1,912	1,724
Interests in group companies	1, 17	16,534	16,534	16,534	—
		19,870	19,199	18,446	1,724
Current assets					
Amounts due from shareholders	27(e)	82	82	82	82
Amounts due from group companies	17	30,305	65,315	21,309	22,309
Prepayments, deposits and other receivables	19	—	45	150	1,207
Term deposits with initial term of over three months	20	—	4,134	—	24,830
Cash and cash equivalents	21	20,071	22,772	128,761	70,838
		50,458	92,348	150,302	119,266
Total assets		70,328	111,547	168,748	120,990
Equity and liabilities					
Current liabilities					
Other payables and accruals	22	213	—	6,146	5,057
Amounts due to shareholders	27(d)	8,919	—	—	—
Amounts due to related parties	27(c)	—	1,499	—	—
Dividends payable	14	—	—	—	1,963
Total liabilities		9,132	1,499	6,146	7,020
Shareholders' equity					
Share capital	24	146	149	138	138
Reserves	25	61,050	109,899	162,464	113,832
Total shareholders' equity		61,196	110,048	162,602	113,970
Total liabilities and shareholders' equity		70,328	111,547	168,748	120,990

Due to the fact that a subsidiary of the Company and Tencent Computer had accumulated losses carried forward from prior years and Tencent Computer also reported losses for the year ended 31 December 2001, as a result, the total shareholders' equity of the Company reported a larger amount than that of the Group as at 31 December 2001.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

a. For the years ended 31 December 2001, 2002 and 2003:

	Note	Share capital RMB'000	Share premium RMB'000	Capital reserve (Note i) RMB'000	Statutory reserves RMB'000	(Accumulated deficit)/ Retained earnings RMB'000	Total shareholders' equity RMB'000
Balance at 1 January 2001		137	18,132	1,000	—	(7,227)	12,042
Conversion of Convertible Notes into ordinary shares	24(c)	6	17,141	—	—	—	17,147
Shares issued during the year	24(d)	3	8,916	—	—	—	8,919
Profit for the year		—	—	—	—	10,216	10,216
Balance at 31 December 2001/1 January 2002		146	44,189	1,000	—	2,989	48,324
Shares issued during the year	24(e)	3	8,916	—	—	—	8,919
Profit for the year		—	—	—	—	140,707	140,707
Balance at 31 December 2002/1 January 2003		149	53,105	1,000	—	143,696	197,950
Profit appropriations to statutory reserves	25	—	—	—	3,653	(3,653)	—
Transfer to capital reserve (note i)		—	—	19,000	—	(19,000)	—
Dividends paid	14	—	—	—	—	(10,334)	(10,334)
Shares cancelled during the year	24(f)	(10)	(37,844)	—	—	—	(37,854)
Shares cancelled after share split during the year	24(h)	(1)	—	—	—	—	(1)
Profit for the year		—	—	—	—	322,196	322,196
Balance at 31 December 2003		138	15,261	20,000	3,653	432,905	471,957

b. For the three months ended 31 March 2003 and 2004:

	Note	Share capital RMB'000	Share premium RMB'000	Capital reserve (Note i) RMB'000	Statutory reserves RMB'000	(Accumulated deficit)/ Retained earnings RMB'000	Total shareholders' equity RMB'000
Balance at 31 December 2002/1 January 2003		149	53,105	1,000	—	143,696	197,950
Dividends paid	14	—	—	—	—	(10,334)	(10,334)
Profit for the period		—	—	—	—	57,345	57,345
Balance at 31 March 2003		149	53,105	1,000	—	190,707	244,961
Balance at 31 December 2003/1 January 2004		138	15,261	20,000	3,653	432,905	471,957
Dividends proposed/paid	14	—	—	—	—	(28,935)	(28,935)
Profit for the period		—	—	—	—	107,304	107,304
Balance at 31 March 2004		138	15,261	20,000	3,653	511,274	550,326

Note i: The capital reserve arises on elimination of the share capital of Tencent Computer (refer to note 1 on the accounting for the formation of the Group). The transfer to capital reserve in 2003 represents the increase in Tencent Computer's registered capital by way of capitalisation of reserves.

CONSOLIDATED CASH FLOW STATEMENTS

	Note	For the year ended 31 December			For the three months ended 31 March	
		2001	2002	2003	2003	2004
		RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Cash flows from operating activities						
Profit for the year/period		10,216	140,707	322,196	57,345	107,304
Taxation		—	3,058	16,013	2,123	6,712
Depreciation on fixed assets		2,448	6,155	17,188	2,426	5,731
Loss on disposal of fixed assets		—	18	983	—	—
Interest income		(395)	(936)	(2,572)	(296)	(849)
Interest expenses		617	—	—	—	—
Changes in working capital						
Increase in accounts receivable		(8,500)	(50,594)	(40,632)	(20,612)	(31,000)
Decrease/(increase) in prepayments, deposits and other receivables		112	(2,089)	(32,797)	(1,446)	(10,265)
Increase/(decrease) in other payables and accruals, and other taxes payable		7,343	2,337	81,344	9,370	(18,452)
Increase/(decrease) in amounts due to shareholders	26(b)	8,919	(8,919)	—	—	—
Increase/(decrease) in amounts due to related parties		—	1,499	(1,499)	(1,499)	—
Increase/(decrease) in deferred revenue		—	523	3,153	296	(1,893)
Cash generated from operations		20,760	91,759	363,377	47,707	57,288
Interest paid		(4)	—	—	—	—
Taxation paid		—	—	(10,968)	—	—
Net cash generated from operating activities		20,756	91,759	352,409	47,707	57,288
Cash flows from investing activities						
Purchase of fixed assets		(11,456)	(28,156)	(59,459)	(8,338)	(13,553)
(Increase)/decrease in term deposits with initial term of over three months		—	(67,440)	44,129	4,133	(24,830)
Deposit in connection with the formation of Shiji Kaixuan Technology	27(f)	—	—	(11,000)	—	—
Capital contribution in Shiji Kaixuan Technology	27(f)	—	—	—	—	11,000
Interest income received		395	449	2,442	783	813
Net cash used in investing activities		(11,061)	(95,147)	(23,888)	(3,422)	(26,570)
Cash flows from financing activities	26(a)					
Repayment of short-term bank loans		(800)	—	—	—	—
Redemption of shares		—	—	(37,855)	—	—
Proceeds from issue of shares		8,919	8,919	—	—	—
Dividends paid		—	—	(10,334)	(10,334)	(26,972)
Net cash generated from/(used in) financing activities		8,119	8,919	(48,189)	(10,334)	(26,972)
Net increase in cash and cash equivalents		17,814	5,531	280,332	33,951	3,746
Cash and cash equivalents at beginning of year/period		21,909	39,723	45,254	45,254	325,586
Cash and cash equivalents at end of year/period		39,723	45,254	325,586	79,205	329,332

NOTES TO THE FINANCIAL STATEMENTS

1. Formation of the group and nature of operations

Tencent Holdings Limited ("the Company") was incorporated in the British Virgin Islands on 23 November 1999 under the name of Keyword Technology Limited and subsequently changed its name to OICQ.com Limited and Tencent (BVI) Limited on 29 December 1999 and 7 June 2001, respectively. On 11 February 2004, the Company was renamed to Tencent Holdings Limited. The Company was re-domiciled to the Cayman Islands on 27 February 2004. The Company, its subsidiaries and companies consolidated for accounting purposes (explained below), collectively referred to the "Group", is a provider of Internet and mobile value-added services to users in the People's Republic of China ("the PRC").

The operations of the Group were initially conducted through Shenzhen Tencent Computer Systems Company Limited ("Tencent Computer"), a limited liability company established in the PRC by certain shareholders of the Company on 11 November 1998. Tencent Computer is legally owned by the core founders of the Company who are PRC citizens ("the Registered Shareholders").

The PRC laws and regulations limit foreign ownership of companies providing value-added telecommunications services, which included activities and services operated by Tencent Computer. In order to enable certain foreign companies to make investments into the business of the Group, the Company's first subsidiary company, Tencent Technology (Shenzhen) Company Limited ("Tencent Technology"), which is a wholly foreign owned enterprise incorporated in the PRC, was established on 24 February 2000. The foreign investors of the Company then subscribed to additional equity interests of the Company.

Certain contractual arrangements have been made among the Company, Tencent Technology, Tencent Computer and the Registered Shareholders so that the decision-making rights and operating and financing activities of Tencent Computer are ultimately controlled by the Company. The Company and Tencent Technology are also entitled to substantially all of the operating profits and residual benefits generated by Tencent Computer under these arrangements. In particular, the Registered Shareholders are required under their contractual arrangements with the Group to transfer these interests in Tencent Computer to the Group or the Group's designee upon the Group's request at a pre-agreed nominal consideration.

Further, pursuant to the contractual arrangements between the Company and Tencent Computer, the Group owns the intellectual property developed by Tencent Computer and it collects revenue of Tencent Computer. It also receives the cash flow derived from the operations of Tencent Computer through the levying of service and consultancy fees and sales of software. The ownership interests in Tencent Computer have also been pledged by the Registered Shareholders to the Group.

On formation of the Group in 2000, all of the participating entities were under the control of the same shareholders in similar proportions. This was achieved via direct or indirect ownership as well as, in the case of the control over Tencent Computer, via contractual provisions. As a result, the formation of the Group was accounted for as a

NOTES TO THE FINANCIAL STATEMENTS

1. Formation of the group and nature of operations (continued)

business combination between entities under common control under a method similar to the uniting of interests method for recording all assets and liabilities at predecessor carrying amounts. The Relevant Periods are presented as if these three entities had always been combined. This approach was adopted because in management's belief it best reflects the substance of the formation.

The Registered Shareholders began to establish another company, Shenzhen Shiji Kaixuan Technology Company Limited ("Shiji Kaixuan Technology") in the PRC on behalf of the Group, and the Company also acquired two subsidiaries, Tencent Limited and Realtime Century Technology Limited, which were incorporated in the British Virgin Islands, towards the end of 2003. The required capital contribution of Shiji Kaixuan Technology of RMB11 million was advanced by Tencent Technology. The Shiji Kaixuan Technology was formally approved for incorporation on 13 January 2004 with similar contractual arrangements made with the Company and companies within the Group (see note 27(f) for details). On 8 February 2004, another subsidiary, Shidai Zhaoyang Technology (Shenzhen) Company Limited, was incorporated in the PRC.

At the date of this report, the Company has interests in the following companies:

Name	Place and date of incorporation and nature of legal entity	Principal activities and place of operation	Particulars of issued/ registered share capital	Effective/Deemed interest held	Name of statutory auditors
Shenzhen Tencent Computer Systems Company Limited	Incorporated on 11 November 1998 in the PRC, private limited liability company	Provision of internet instant message and value-added services and of internet advertisement service, Shenzhen	RMB20,000,000	100%	FNT Certified Public Accountants, the PRC
Tencent Technology (Shenzhen) Company Limited	Incorporated on 24 February 2000 in the PRC, wholly foreign owned enterprise	Development of computer software and provision of internet information service, Shenzhen	USD2,000,000	100%	FNT Certified Public Accountants, the PRC
Tencent Limited	Incorporated on 14 March 1997 in the BVI, private limited liability company	Investing holding	USD1	100%	N/A, no statutory audit requirements
Realtime Century Technology Limited	Incorporated on 14 March 1997 in the BVI, private limited liability company	Investing holding	USD1	100%	N/A, no statutory audit requirements

NOTES TO THE FINANCIAL STATEMENTS

1. Formation of the group and nature of operations (continued)

Name	Place and date of incorporation and nature of legal entity	Principal activities and place of operation	Particulars of issued/ registered share capital	Effective/ Deemed interest held	Name of statutory auditors
Shenzhen Shiji Kaixuan Technology Company Limited	Incorporated on 13 January 2004 in the PRC, private limited liability company	Provision of internet instant message and value-added services and of internet advertisement service, Shenzhen	RMB11,000,000	100%	No auditors appointed
Shidai Zhaoyang Technology (Shenzhen) Company Limited ("Shidai Zhaoyang Technology")	Incorporated on 8 February 2004 in the PRC, wholly foreign owned enterprise	Provision of technical and management consultancy services, Shenzhen	USD500,000	100%	No auditors appointed

2. Basis of preparation

The Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and have been prepared under the historical cost convention. There are no significant differences between IFRS and generally acceptable accounting principles in Hong Kong in those which are applicable to the preparation of the Financial Statements.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the Relevant Periods. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

The Group adopted International Accounting Standard ("IAS") 39 "Financial Instruments: Recognition and Measurement" in 2001. The financial effects of adopting this standard were not material. The Group did not early adopt the improvements project released by the International Accounting Standard Board which will be effective for periods starting on or after 1 January 2005.

3. Principal accounting policies

(a) Basis of consolidation

The consolidated financial statements consist of the financial statements of the Company, its subsidiaries, Tencent Computer and Shiji Kaixuan Technology (both companies consolidated for accounting purposes).

The Company has concluded that it is appropriate to include Tencent Computer and Shiji Kaixuan Technology in its consolidated financial statements, notwithstanding the lack of share ownership, because in substance the contractual arrangements described above give the Company control over Tencent Computer and Shiji Kaixuan Technology by way of controlling more than one half of the voting rights of Tencent Computer and Shiji Kaixuan

NOTES TO THE FINANCIAL STATEMENTS

3. Principal accounting policies (continued)

(a) Basis of consolidation (continued)

Technology, governing their financial and operating policies and appointing or removing the majority of the members of their controlling authorities, and casting the majority of votes at meetings of such authorities. In addition, such contractual arrangements also transfer the risks and rewards of Tencent Computer and Shiji Kaixuan Technology to the Company.

(b) Subsidiaries and companies consolidated for accounting purposes

Subsidiaries and companies consolidated for accounting purposes are entities in which the Group has an interest of more than one half of the voting rights or otherwise has power to exercise control over the operations. They are consolidated from the date on which control is transferred to the Group and are excluded from the date that control ceases. All intercompany transactions, balances and unrealised gains on transactions among companies comprising the Group are eliminated; unrealised losses, if any, are also eliminated unless cost cannot be recovered. Where necessary, accounting policies of these companies have been changed to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet, interests in subsidiaries and companies consolidated for accounting purposes are stated at cost less provision for impairment losses, if any. The results of these companies are accounted for by the Company on the basis of dividends received and receivable, if applicable.

(c) Foreign currency translation

The Company maintains its books and records in United States Dollars while all its subsidiaries and companies consolidated for accounting purposes maintain their books and records in Renminbi ("RMB"). Items included in the financial statements of each entity in the Group are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity ("the measurement currency"). Due to the fact that the core operations of the Group are conducted in the PRC by the subsidiaries, Tencent Computer and Shiji Kaixuan Technology, both of which have RMB as their measurement currency and reporting currency for their financial statements, management has adopted RMB as the reporting currency for both the financial statements of the Company and the consolidated financial statements of the Group presented in this appendix. Management considers that this adoption enhances the comparison to be made for financial information of the Company and the Group so disclosed.

Transactions in other currencies are translated into RMB using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in other currencies are translated into RMB at the exchange rates prevailing at the balance sheet date. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated profit and loss account.

NOTES TO THE FINANCIAL STATEMENTS

3. Principal accounting policies (continued)

(d) Fixed assets

Fixed assets are stated at historical cost less accumulated depreciation and accumulated impairment losses, if any. Cost includes the purchase price of the asset and any directly attributable costs of bringing the asset to its working condition and location for its intended use.

Depreciation is calculated on the straight-line basis to write off the cost less impairment losses of each asset over their estimated useful lives as follows:

Computer equipment	3 to 5 years
Furniture and office equipment	5 years
Motor vehicles	5 years
Leasehold improvements	the shorter of their useful lives or over the lease terms

Gains or losses on disposals are determined by comparing proceeds with carrying amount and are included in the consolidated profit and loss account.

Repairs and maintenance are charged to the profit and loss account during the financial period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits in excess of the originally assessed standard of performance of the existing asset will flow to the Group. Major renovations are depreciated over the remaining useful life of the related asset.

Fixed assets are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its recoverable amount which is the higher of an asset's net selling price and value in use. For the purpose of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows.

(e) Operating leases

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the consolidated profit and loss account on a straight-line basis over the period of the lease.

(f) Accounts receivable

Accounts receivable are carried at original invoice amounts less provision made for impairment of these receivables. Such provision for impairment of accounts receivable is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the market rate of interest for similar borrowers.

NOTES TO THE FINANCIAL STATEMENTS

3. Principal accounting policies (continued)

(g) Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand and deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less.

(h) Share Capital

Ordinary shares and non-redeemable preference shares with discretionary dividends are classified as equity.

(i) Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Currently enacted tax rates are used in the determination of deferred income tax.

Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on interests in group companies, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

(j) Employee benefits

(i) Employee leave entitlements

Employee entitlements to annual leave are recognized when they accrue to employees. A provision is made for the estimated liability for annual leave as a result of services rendered by employees up to the balance sheet date. Employee entitlements to sick and maternity leave are not recognized until the time of leave.

(ii) Pension obligations

The Group contributes on a monthly basis to various defined contribution benefit plans organised by the relevant governmental authorities. The Group's liability in respect of these funds is limited to the contributions payable in each period. Contributions to these plans are expensed as incurred.

(iii) Equity compensation benefits

Share options are granted to employees. Options are granted at exercise price determined by the Board of Directors of the Company. Options are exercisable during the period from the date of commencement of the options' vesting period or

NOTES TO THE FINANCIAL STATEMENTS

3. Principal accounting policies (continued)

(j) Employee benefits (continued)

(iii) Equity compensation benefits (continued)

the date of the initial public offering of the shares of the Company in a stock exchange, whichever is later, to 31 December 2011. When the options are exercised, the proceeds received, net of any related transaction costs, are credited to share capital (at nominal value) and share premium. The Group does not make any charge to staff costs in connection with the share options grants.

(k) Government grants

Grants from government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions. Under these circumstances, the grants are recognized as income or matched with the associated costs which the grant is intended to compensate.

(l) Provision

Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain.

(m) Revenue recognition

The Group principally derives revenues from provision of mobile and telecommunications value-added services, Internet value-added services and online advertising. The Group recognises its revenues (see details for each category below) net of applicable business taxes and other related taxes.

(i) Mobile and telecommunications value-added services

Mobile and telecommunication value-added services revenues are derived principally from providing users with mobile instant messaging services, mobile chat services, and other mobile value-added services such as mobile interactive voice response services, ringback tones services, music and image/picture downloads, mobile news and information content services and mobile games services.

These services are substantially billed on a monthly subscription basis with certain portions billed on a per message basis ("Mobile and Telecom Service Fees"). These services are predominantly delivered through the platforms of various subsidiaries of China Mobile Communications Corporation ("China Mobile") and China United Communications Corporation ("China Unicom") and they also collect the Mobile and Telecom Service Fees on behalf of the Group.

NOTES TO THE FINANCIAL STATEMENTS

3. Principal accounting policies (continued)

(m) Revenue recognition (continued)

(i) Mobile and telecommunications value-added services (continued)

Revenue derived from the mobile and telecommunication value-added services are recognized based on the Mobile and Telecom Services Fees, net of any applicable business taxes and other related taxes and amount of uncollectibles.

In order to derive the Mobile and Telecom Service Fees, China Mobile and China Unicom are entitled to a fixed commission, which is calculated based on agreed percentages of the Mobile and Telecom Service Fees received/receivable by these mobile operators, plus, in certain cases, a fixed per-message adjustment for the excess of messages sent over messages received between the platforms of the Group and these two mobile operators (collectively defined as "Mobile and Telecom Charges"). The Mobile and Telecom Charges are withheld and deducted from the gross Mobile and Telecom Service Fees collected by the two operators from the users, with the net amounts remitted to the Group.

The Mobile and Telecom Service Fees and the Mobile and Telecom Charges, or the net amount of the two, are confirmed and advised by subsidiaries of China Mobile and China Unicom to the Group on a monthly basis. For revenue of which the amounts are not confirmed/advised by the two mobile operators at the time of reporting the financial results of the Group, management of the Group estimates the amount receivable based on historical data and management estimates, which reflect developing trends in customer payment delinquencies. Historical data used in estimating revenues include the most recent three-month history of the Mobile and Telecom Service Fees actually derived from the operations, the number of subscriptions and the volume of data transmitted between the network gateways of the Group, China Mobile and China Unicom. Adjustments are made in subsequent periods in case the actual revenue amounts are different from the original estimates.

(ii) Internet value-added services

Revenue from Internet value-added services ("Internet Service Fees") are derived from subscriptions received/receivable from the provision of a comprehensive customer service platform that utilises instant messaging and online entertainment services to create a virtual community over the internet. Similar to (i) above, these services are substantially delivered to the Group's customers through the platforms of various subsidiaries of China Mobile and China Unicom with monthly subscriptions paid/payable by the users. The two operators also collect the subscriptions on behalf of the Group, with an agreed portion retained by them as revenue sharing, the net amounts are remitted to the Group. In addition, a small portion of the Internet Service Fees are prepaid by the customers to the Group such as in the form of prepaid point card.

For services delivered through the mobile operators, the related revenue is recognized on the same basis as mentioned in (i) above. For revenues derived from

NOTES TO THE FINANCIAL STATEMENTS

3. Principal accounting policies (continued)

(m) Revenue recognition (continued)

(ii) Internet value-added services (continued)

the sale of prepaid point cards, the related revenues are deferred and recorded as "deferred revenue" in the consolidated balance sheets of the Group as at 31 December 2001 to 2003 and 31 March 2004, where appropriate. The amounts are amortised into income over the estimated consumption period on a straight-line basis.

(iii) Online advertising

Online advertising revenues are derived from fees for selling advertising space on the Group's websites and instant messaging windows in the forms of banners, links and logos, and delivery of advertisements by various means throughout the community created by the Group.

All the advertising contracts are based on the actual time period that the advertisements appear on the Group's web sites or instant messaging windows and the revenues are recognized ratably over the period in which the advertisements are displayed.

(n) Research and development expenses

Research expenditure is recognized as an expense as incurred. Costs incurred on development projects relating to the design and testing of new or improved products are recognized as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility, and only if the cost can be measured reliably. Other development expenditures are recognized as an expense as incurred. Development costs previously recognized as an expense are not recognized as an asset in subsequent periods. Development costs capitalised are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit, not exceeding five years.

(o) Contingent liabilities and contingent assets

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognized because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognized but is disclosed in the notes to the financial statements. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognized as a provision.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain events not wholly within the control of the Group.

NOTES TO THE FINANCIAL STATEMENTS

3. Principal accounting policies (continued)

(o) Contingent liabilities and contingent assets (continued)

Contingent assets are not recognized but are disclosed in the notes to the financial statements when an inflow of economics benefits is probable. When inflow is virtually certain, an asset is recognized.

(p) Financial instruments

Financial instruments carried on the consolidated balance sheet include cash and bank balances, deposits in approved financial institutions, accounts receivable, prepayments, deposits and other receivables, other payables and accruals and deferred revenue. The accounting policies on recognition and measurement of these items are disclosed in the respective accounting policies.

Disclosure about financial instruments of Group are provided in note 30 to the Financial Statements.

(q) Segment reporting

Segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services with a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Unallocated costs represent corporate expenses. Segment assets consist primarily of operating fixed assets and operating receivables and mainly exclude operating cash and deferred tax assets. Segment liabilities comprise items such as operating liabilities and mainly exclude current and deferred tax liabilities. Capital expenditures mainly comprise additions to fixed assets.

Operating expenses of a functional unit are allocated to the relevant segment which is the predominant user of the services provided by the unit. Operating expenses of other shared services which cannot be allocated to a specific segment and corporate expenses are included as unallocated costs.

(r) Related parties

Related parties are those parties which have the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence.

(s) Profit appropriations and distributions

Profit appropriations and distributions proposed or declared after the balance sheet date are disclosed as a post balance sheet date event and are not recognized as a liability at the balance sheet date. This has been applied throughout the Relevant Periods.

NOTES TO THE FINANCIAL STATEMENTS

4. Segment information

As all the Group's activities are conducted in the PRC, no analysis by geographical segment is presented.

The business segment information of the Group during the Relevant Periods is presented as below:

	As at and for the three months ended 31 March 2004				
	Mobile and telecommunication value-added services	Internet value-added services	Online advertising	Others	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenues	142,817	104,586	8,215	1,935	257,553
Gross profit/(loss)	94,552	71,899	4,358	(624)	170,185
Other operating income					18
Selling and marketing expenses					(23,044)
General and administrative expenses					(34,074)
Profit from operations					113,085
Finance income, net					931
Profit before taxation					114,016
Taxation					(6,712)
Profit for the period					107,304
Segment assets	93,129	89,721	4,345	4,018	191,213
Unallocated assets					451,203
Total assets					642,416
Segment liabilities	2,187	2,219	210	281	4,897
Unallocated liabilities					87,193
Total liabilities					92,090
Other segment items					
Capital expenditure	1,795	6,592	4	229	8,620
Unallocated capital expenditure					4,933
Total capital expenditure					13,553
Depreciation	731	2,868	141	162	3,902
Unallocated depreciation					1,829
Total depreciation					5,731

NOTES TO THE FINANCIAL STATEMENTS

4. Segment information (continued)

	As at and for the three months ended 31 March 2003				
	Mobile and telecommunication value-added services	Internet value-added services	Online advertising	Others	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenues	84,297	33,012	6,818	866	124,993
Gross profit	63,066	20,076	4,669	843	88,654
Other operating income					36
Selling and marketing expenses					(12,313)
General and administrative expenses					(16,652)
Profit from operations					59,725
Finance expense, net					(257)
Profit before taxation					59,468
Taxation					(2,123)
Profit for the period					57,345
Segment assets	55,831	47,692	2,914	664	107,101
Unallocated assets					163,866
Total assets					270,967
Segment liabilities	281	252	83	—	616
Unallocated liabilities					25,390
Total liabilities					26,006
Other segment items					
Capital expenditure	425	4,388	378	65	5,256
Unallocated capital expenditure					3,082
Total capital expenditure					8,338
Depreciation	283	1,104	57	23	1,467
Unallocated depreciation					959
Total depreciation					2,426

NOTES TO THE FINANCIAL STATEMENTS

4. Segment information (continued)

	As at and for the year ended 31 December 2003				
	Mobile and telecommunication value-added services	Internet value-added services	Online advertising	Others	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenues	467,369	229,690	32,841	5,057	734,957
Gross profit	325,453	154,201	22,342	3,413	505,409
Other operating expenses					(1,226)
Selling and marketing expenses					(55,967)
General and administrative expenses					(112,011)
Profit from operations					336,205
Finance income, net					2,004
Profit before taxation					338,209
Taxation					(16,013)
Profit for the year					322,196
Segment assets	75,250	73,985	3,515	1,148	153,898
Unallocated assets					421,818
Total assets					575,716
Segment liabilities	3,527	3,052	405	447	7,431
Unallocated liabilities					96,328
Total liabilities					103,759
Other segment items					
Capital expenditure	8,769	25,725	676	937	36,107
Unallocated capital expenditure					23,352
Total capital expenditure					59,459
Depreciation	1,512	5,899	306	122	7,839
Unallocated depreciation					9,349
Total depreciation					17,188

NOTES TO THE FINANCIAL STATEMENTS

4. Segment information (continued)

	As at and for the year ended 31 December 2002				
	Mobile and telecommunication value-added services	Internet value-added services	Online advertising	Others	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenues	198,818	40,819	19,188	4,282	263,107
Gross profit	148,962	25,971	12,218	4,282	191,433
Other operating expenses					(242)
Selling and marketing expenses					(19,437)
General and administrative expenses					(28,860)
Profit from operations					142,894
Finance income, net					871
Profit before taxation					143,765
Taxation					(3,058)
Profit for the year					140,707
Segment assets	53,562	27,567	1,565	—	82,694
Unallocated assets					130,972
Total assets					213,666
Segment liabilities	78	49	48	—	175
Unallocated liabilities					15,541
Total liabilities					15,716
Other segment items					
Capital expenditure	2,271	13,239	933	—	16,443
Unallocated capital expenditure					11,713
Total capital expenditure					28,156
Depreciation	552	2,591	253	—	3,396
Unallocated depreciation					2,759
Total depreciation					6,155

NOTES TO THE FINANCIAL STATEMENTS

4. Segment information (continued)

	As at and for the year ended 31 December 2001				
	Mobile and telecommunication value-added services	Internet value-added services	Online advertising	Others	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Revenues	37,960	944	7,735	2,437	49,076
Gross profit/(loss)	27,159	(3,279)	4,715	2,437	31,032
Other operating expenses					(82)
Selling and marketing expenses					(4,312)
General and administrative expenses					(16,297)
Profit from operations					10,341
Finance expenses, net					(125)
Profit before taxation					10,216
Taxation					—
Profit for the year					10,216
Segment assets	9,570	6,444	903	—	16,917
Unallocated assets					48,625
Total assets					65,542
Segment liabilities	79	61	44	—	184
Unallocated liabilities					17,034
Total liabilities					17,218
Other segment items					
Capital expenditure	918	4,479	712	—	6,109
Unallocated capital expenditure					5,386
Total capital expenditure					11,495
Depreciation	137	904	197	—	1,238
Unallocated depreciation					1,210
Total depreciation					2,448

5. Cost of revenues

Cost of revenues of the Relevant Periods mainly comprise the Mobile and Telecom Charges (mentioned in note 3(m)(i)) and other direct expenses incurred in deriving the revenues.

NOTES TO THE FINANCIAL STATEMENTS

6. Profit from operations

Profit from operations is stated after charging the following:

	For the year ended 31 December			For the three months ended 31 March	
	2001	2002	2003	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Staff costs (including directors' emoluments) (note 8)	13,088	22,490	81,921	9,961	32,278
Value-added tax paid upon transfer of software within the Group (see note 12(b))	—	—	5,550	—	2,102
Depreciation on fixed assets	2,448	6,155	17,188	2,426	5,731
Loss on disposal of fixed assets	—	18	983	—	—
Operating lease rentals in respect of land and buildings	1,135	3,035	8,211	1,766	2,897
Research and development expenses (including staff costs and depreciation of approximately RMB 5,610,000, RMB 7,783,000, RMB 21,933,000, RMB 3,080,000 and RMB 6,185,000 for the three years ended 2001, 2002 and 2003 and for the three months ended 31 March 2003 and 2004) (note a)	5,610	7,783	26,010	3,837	12,639
Auditors' remuneration	28	195	869	570	90

Note a: The Group had not capitalised any of research and development expenses during the Relevant Periods.

7. Finance (expenses)/income, net

	For the year ended 31 December			For the three months ended 31 March	
	2001	2002	2003	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Interest income	395	936	2,572	296	849
Interest expenses (note a)	(617)	—	—	—	—
Exchange gains/(losses), net	113	(31)	(414)	(514)	126
Bank charges	(16)	(34)	(154)	(39)	(44)
	(125)	871	2,004	(257)	931

Note a: Interest expenses in 2001 were mainly incurred on convertible notes (see note 24(c)). The effective interest rate of the notes was 8% per annum.

NOTES TO THE FINANCIAL STATEMENTS

8. Staff costs (including directors' emoluments)

All employees of the subsidiaries in the PRC and Tencent Computer who are PRC citizens participate in employee social security plans enacted in the PRC, including pension, medical, housing and other welfare benefits, which are organized and administered by the governmental authorities. Except for the welfare benefits provided by these social security plans, the Group has no other material commitments to employees. According to the relevant regulations, the portion of premium and welfare benefit contributions that should be borne by these companies within the Group as required by the above social security plans, are calculated based on percentages of the total salary of employees (or on other basis), subject to a certain ceiling, and are paid to the labor and social welfare authorities. Contributions to the plans are expensed as incurred. The applicable percentages used to provide for insurance premium and welfare benefit funds are listed below:

	Percentages
Pension insurance	9%
Medical insurance	7%
Unemployment insurance	1.5%

Analysis of staff costs for the Relevant Periods are as follows:

	For the year ended 31 December			For the three months ended 31 March	
	2001	2002	2003	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Wages, salaries and bonuses	12,390	19,224	70,625	8,661	27,969
Welfare, medical and other expenses	334	1,185	6,128	386	1,752
Labour insurance	165	1,020	2,546	449	705
Contributions to pension plans	119	236	1,439	180	682
Training expenses	80	825	1,183	285	1,170
	13,088	22,490	81,921	9,961	32,278

The average number of employees in 2001, 2002 and 2003 and for the three months ended 31 March 2003 and 2004 were 73, 167, 422, 283 and 682, respectively, of which none of them worked on a part-time basis for these years/periods.

9. Directors' emoluments

Details of emoluments paid and payable to the directors of the Company by the Group in respect of their services rendered for managing the business of the Group during the Relevant Periods are as follows:

	For the year ended 31 December			For the three months ended 31 March	
	2001	2002	2003	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Fees	—	—	—	—	—
Basic salaries, bonuses, housing allowances, other allowances and benefits in kind	919	921	1,670	218	869
Contributions to pension plans	7	5	16	1	6
	926	926	1,686	219	875
Number of directors	3	2	2	2	2

NOTES TO THE FINANCIAL STATEMENTS

9. Directors' emoluments (continued)

For the years ended 31 December 2001, 2002 and 2003 and the three months ended 31 March 2003 and 2004, no emoluments were paid to any non-executive directors by the Group.

The following table sets forth the numbers of directors whose remuneration fell within the band set out below as of the periods indicated:

	For the year ended 31 December			For the three months ended 31 March	
	2001	2002	2003	2003	2004
Nil-HK$1,000,000	3	2	2	2	2

During the years ended 31 December 2001, 2002 and 2003 and the three months ended 31 March 2003 and 2004, no emoluments were paid by the Group to the directors as an inducement to join or upon joining the Group or as compensation for loss of office, and there has been no arrangement under which a director has waived or agreed to waive any emoluments.

The above represents historical amounts incurred by the Group during the Relevant Periods. Emoluments of directors of the Company may change after the listing of the Company.

10. Five highest paid individuals of the Group

The five individuals whose emoluments were the highest in the Group for the years ended 31 December 2001, 2002 and 2003 and the three months ended 31 March 2003 and 2004 include 3 directors, 2 directors, 2 directors, 2 directors and 2 directors, respectively, whose emoluments are reflected in the analysis presented above (note 9). The emoluments payable to the remaining 2 individuals, 3 individuals, 3 individuals, 3 individuals and 3 individuals for the years ended 31 December 2001, 2002 and 2003 and the three months ended 31 March 2003 and 2004, respectively, are as follows:

	For the year ended 31 December			For the three months ended 31 March	
	2001	2002	2003	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Basic salaries, housing allowances, other allowances and benefits in kind	620	1,281	2,274	521	1,171
Contributions to pension schemes	4	7	24	3	9
	624	1,288	2,298	524	1,180

The following table sets forth the numbers of individual whose remuneration fell within the band set out below as of the periods indicated:

	For the year ended 31 December			For the three months ended 31 March	
	2001	2002	2003	2003	2004
Nil-HK$1,000,000	2	3	3	3	3

NOTES TO THE FINANCIAL STATEMENTS

11. Profit Appropriations

In accordance with the Companies Laws of the PRC and the articles of association of Tencent Computer and Shiji Kaixuan Technology, appropriations of net profit, after offsetting accumulated losses from prior years, should be made by Tencent Computer and Shiji Kaixuan Technology to their respective Statutory Surplus Reserve Funds, the Statutory Public Welfare Funds and the Discretionary Reserve Funds before distributions are made to the investors. The percentages of appropriation to Statutory Surplus Reserve Fund and Statutory Public Welfare Fund are 10% and 5—10%, respectively. The amount to be transferred to the Discretionary Reserve Fund is determined by the shareholders' meetings of Tencent Computer and Shiji Kaixuan Technology. When the balance of the Statutory Surplus Reserve Fund reaches 50% of the paid up/registered capital, such transfer needs not be made. Both of the Statutory Surplus Reserve Fund and Discretionary Reserves Fund can be capitalised as capital of an enterprise, provided that the remaining statutory Surplus Reserve Fund shall not be less than 25% of the registered capital. However, the Statutory Public Welfare Fund is only available to provide staff collective welfare benefits.

In addition, in accordance with the Law of the PRC on Enterprises with Foreign Investments and the articles of association of Tencent Technology and Shidai Zhaoyang Technology, appropriations from net profit, after offsetting accumulated losses brought forward from prior years, should be made by the Tencent Technology and Shidai Zhaoyang Technology to their respective Reserve Funds and the Staff Bonus and Welfare Funds before distributions are made to the owners. The percentage of net profit to be appropriated to the Reserve Fund is not less than 10% of the net profit. The percentage to be appropriated to the Staff Bonus and Welfare Fund is determined by the Boards of Directors of the Tencent Technology and Shidai Zhaoyang Technology. When the balance of the Reserve Fund reaches 50% of the paid up share capital, such transfer needs not be made.

For Tencent Technology and Shidai Zhaoyang Technology, the Staff Bonus and Welfare Fund is available to fund payments of special bonuses to staff and for collective welfare benefits. Upon approval from their respective Boards of Directors, the Reserve Fund can be used to offset accumulated deficit or to increase capital.

For the year ended 31 December 2001, no profit appropriations were made as both Tencent Technology and Tencent Computer reported losses. For the year ended 31 December 2002, Tencent Technology still reported a loss and no profit appropriations were required to be made. Despite the fact that Tencent Computer reported a profit in 2002 after offsetting losses brought forward, no profit appropriations were made in its 2002 financial statements because the shareholders' meeting only approved the percentages of appropriations in 2003. Management of the Company has obtained a legal opinion from its legal counsel that such appropriation policy is in accordance with the conditions of Articles 177 and 179 of the PRC Company Law and the provisions of the articles of association of Tencent Computer. Up to the date of this report, the directors had not proposed the 2003 appropriations of Tencent Computer and Tencent Technology. In addition, no appropriations had been made by both Shiji Kaixuan Technology and Shidai Zhaoyang Technology since they had not commenced commercial operations up to the end of the Relevant Periods.

NOTES TO THE FINANCIAL STATEMENTS

12. Taxation

(a) Profits tax

(i) Cayman Islands Profits Tax

The Group is not subject to any taxation under this jurisdiction during the Relevant Periods.

(ii) British Virgin Islands Profits Tax

No British Virgin Islands ("BVI") profits tax has been provided as BVI does not charge income taxes, therefore, the Group is not subject to any taxation in this jurisdiction during the Relevant Periods.

(iii) Hong Kong Profits Tax

No Hong Kong profits tax has been provided as the Group has no assessable profit arising in Hong Kong during the Relevant Periods.

(iv) PRC Enterprise Income Tax

PRC Enterprise Income Tax ("EIT") is provided on the assessable income of the Company and the Group during the Relevant Periods, calculated in accordance with the relevant regulations of the PRC after considering at the available tax benefits from refunds and allowances.

Both Tencent Computer and Tencent Technology were established in the Shenzhen Special Economic Zone of the PRC where they conduct their operations. Accordingly, they are subject to EIT at a rate of 15%.

According to the provisions stipulated in the tax circular, Shendishuierhan [2002] No. 128, Tencent Computer is exempt from EIT for the first year starting from the first year of profitable operations after offsetting prior year tax losses, followed by a 50% reduction for the next two years ("the Tencent Computer Tax Holiday"). The first profitable year of Tencent Computer was in 2002 with the Tencent Computer Tax Holiday commenced in that year. No EIT was paid or payable by Tencent Computer in 2001 and 2002 while EIT was levied at 7.5% on its assessable profits for the year ended 31 December 2003 and the three months ended 31 March 2003 and 2004.

In addition, Tencent Technology had applied to the relevant tax authorities and has been approved to be recognized as a foreign invested enterprise with productive sales income ("Productive Sales Income") under the provisions stipulated in the tax circular, Shendishuiwaihan [2003] No. 413. Tencent Technology is exempt from EIT for two years starting from the first year of profitable operations after offsetting prior year tax losses, followed by a 50% reduction for the next three years if its annual productive sales income exceeds 50% of it reported total sales income ("the WFOE Tax Holiday"). 2003 is the first profitable year of Tencent Technology after offsetting all tax losses brought forward from prior years. Accordingly, no provision for EIT was made in the financial statements as at and for

NOTES TO THE FINANCIAL STATEMENTS

12. Taxation (continued)

(a) Profits tax (continued)

the year ended 31 December 2003 and the three months ended 31 March 2003 and 2004. For 2001 and 2002, no EIT provision was required because all assessable profits, if any, were offset by losses carried forward.

An analysis of the profits tax charges of the Relevant Periods is as follows:

	For the year ended 31 December			For the three months ended 31 March	
	2001	2002	2003	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Current tax					
—Hong Kong	—	—	—	—	—
—The PRC (Note 12 (a) (iv))	—	—	18,083	2,123	6,349
Deferred tax (Note 23)	—	3,058	(2,070)	—	363
	—	3,058	16,013	2,123	6,712

(b) Value-added tax and related taxes

According to the PRC value-added tax temporary regulations ("VAT Regulations"), both Tencent Technology and Tencent Computer incorporated in the PRC are subject to output value-added tax ("output VAT") which is generally calculated at 17% of the sales of goods including self-generated software. The Group pays VAT on its purchases ("input VAT") which is deducted against output VAT in arriving at the net VAT amount payable to the PRC Government. In addition, the Group accrues and pays city construction tax ("CCT") and educational surcharge ("ES") based on 1% and 3% of net VAT amount payable, respectively. These two charges are recorded as a reduction against gross revenue.

During the year ended 31 December 2003 and the three months ended 31 March 2004, Tencent Technology sold two sets and 1 set of its self-generated software ("Software Sales") at considerations of approximately RMB185,000,00 and RMB70,085,000 (collectively "Sales Considerations") to Tencent Computer, respectively. VAT was levied at 17% on the Sales Considerations amounting to approximately RMB31,450,000 and RMB11,914,000, respectively. According to a notice of the relevant government authorities in the PRC, Caishui [2000] Document No 25, the portion of VAT paid in excess of 3% on the sales consideration of the software products developed and sold by an ordinary VAT payer would be immediately refunded by the tax bureau ("the Tax Rebate") in the form of a government grant. Accordingly, Tencent Technology lodged applications with the relevant tax bureaus for the refund of the Tax Rebate, amounting to approximately RMB25,900,000 and RMB9,812,000 for the transactions. The respective VAT paid/payable, net of the amounts of the government grants receivable, in the amount of approximately RMB5,550,000 for the year ended 31 December 2003 and approximately RMB2,102,000 for the three months ended 31 March 2004, were recorded as part of the general and administrative expense of the Group for the year/period then ended. The Company has obtained the necessary documentation from the tax bureaus in order to support the receipt of the Tax Rebate.

NOTES TO THE FINANCIAL STATEMENTS

12. Taxation (continued)

(b) Value-added tax and related taxes (continued)

In March and April, 2004, the full amount of the Tax Rebate of RMB25,900,000 in relation to the Software Sales transacted in 2003 was paid by the tax bureau to the Company. The Directors are confident that there is no recoverability problem associated with the unsettled balance of the Tax Rebate of approximately RMB9,812,000 relating to the Software Sales undertaken in the three months ended 31 March 2004 which remained outstanding as at the date of this report.

(c) Business tax and related taxes

Both Tencent Technology and Tencent Computer incorporated in the PRC are subject to Business Tax ("BT") and related taxes which are calculated at 5% of the service fee income received and receivable, as well as income arising from transfer of technology and licensing arrangements enacted within the Group. In addition, the Group accrues and pays city construction tax ("CCT") and educational surcharge ("ES") based on 1% and 3% of BT amount payable, respectively. These three charges are also recorded as a reduction against gross revenue.

The tax on the Group's profit before taxation differs from the theoretical amount that would arise using the tax rate of 15%, the tax rate enacted at the place where principal activities of the Group are conducted, as follows:

	For the year ended 31 December			For the three months ended 31 March	
	2001	2002	2003	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Profit before taxation	10,216	143,765	338,209	59,468	114,016
Tax calculated at a tax rate of 15%	1,532	21,565	50,731	8,920	17,102
Effects on different tax rate available to different companies of the Group	(2,665)	(5,990)	(15,111)	(6,375)	—
Effects on tax holiday available to different companies of the Group	—	(12,231)	(56,003)	(1,930)	(21,346)
Income not subject to tax	—	—	(129)	—	—
Expenses not deductible for tax purposes	—	—	34	—	353
Deferred tax assets not recognized (see note 23)	—	—	36,491	—	10,128
Unrecognized tax losses sustained by companies of the Group	1,133	150	—	1,508	475
Utilisation of previously unrecognized tax losses	—	(436)	—	—	—
Tax charge	—	3,058	16,013	2,123	6,712

NOTES TO THE FINANCIAL STATEMENTS

13. Profit for the year/period and attributable to shareholders

The profit attributable to shareholders for the years ended 31 December 2001, 2002 and 2003 and for the three months ended 31 March 2003 are dealt with in the financial statements of the Company to the extent of RMB17,768,000, RMB39,933,000, RMB100,743,000, RMB42,497,000, respectively. For the three months ended 31 March 2004, there was a loss of RMB3,163,000.

14. Dividends

At a meeting of the board of directors of the Company held on 15 January 2003, a dividend in respect of 2002 of RMB0.008 (post share splits, see notes 24(g) and 24(i) per ordinary share amounting to US$1,250,000 (equivalent to approximately RMB10,334,000) in total was proposed, and paid in January 2003. The amount was accounted for in shareholders' equity as an appropriation of retained earnings for the three months ended 31 March 2003 as well as for the year ended 31 December 2003.

Pursuant to a resolution passed by the Board of Directors on 20 January 2004, final dividend of 2003 was proposed at RMB0.023 per ordinary share (after taking into account the two share splits) with an aggregate amount of US$3,500,000 (equivalent to approximately RMB28,935,000), of which approximately US$3,263,000 (equivalent to approximately RMB26,972,000) had been paid up to 31 March 2004. The remaining balance of US$237,000 (equivalent to approximately RMB1,963,000) was recorded as dividends payable in the balance sheet as at 31 March 2004. This proposed dividend was not reflected as a dividend payable in 2003, but was reflected as an appropriation of retained earnings for the three months ended 31 March 2004.

15. Earnings per share

Basic earnings per share is calculated by dividing the net profit for the year/period by the weighted average number of ordinary shares in issue during the year.

	For the year ended 31 December			For the three months ended 31 March	
	2001	2002	2003	2003	2004
Profit for the year/period (RMB'000)	10,216	140,707	322,196	57,345	107,304
Weighted average number of ordinary shares in issue (in thousand) (note a)	1,086,362	1,357,883	1,321,151	1,359,808	1,260,481
Basic earnings per share (RMB) (note a)	0.009	0.104	0.244	0.042	0.085

The diluted earnings per share is calculated based on the adjusted weighted average number of ordinary shares outstanding, assuming the conversion of all dilutive potential ordinary shares, namely convertible preference shares and convertible notes (mentioned in notes 24(a), 24(b), and 24(c)). Convertible preference shares and convertible notes are assumed to have been converted into ordinary shares and the net profit is adjusted to eliminate the respective interest expenses, if any.

In 2001, the diluted earnings per share of RMB0.008 is based on approximately 1,323,246,000 shares, which is the weighted average number of ordinary shares in issue

NOTES TO THE FINANCIAL STATEMENTS

15. Earnings per share (continued)

during the year plus the weighted average of approximately 236,884,000 ordinary shares deemed to be issued, and the net profit of the year (after eliminating the associated interest and other expenses) of approximately RMB10,920,000. Upon the conversion of the convertible preference shares and convertible notes in 2001, there were no other potentially dilutive instruments in 2002 and 2003 and for the three months ended 31 March 2003 and 2004 and the diluted earnings per share is equal to the basic earnings per share.

Note a: All per share information has been adjusted retroactively as if the aggregate effect of the two share splits mentioned in notes 24(g) and 24(i) had taken place at the beginning of the Relevant Periods.

NOTES TO THE FINANCIAL STATEMENTS

16. Fixed assets

Group

	Computer equipment	Furniture and office equipment	Motor vehicles	Leasehold improvements	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Cost					
As at 1 January 2001	8,236	398	—	—	8,634
Additions	10,665	404	426	—	11,495
As at 31 December 2001	18,901	802	426	—	20,129
Accumulated depreciation					
As at 1st January 2001	(694)	(119)	—	—	(813)
Charge for the year	(2,360)	(81)	(7)	—	(2,448)
As at 31 December 2001	(3,054)	(200)	(7)	—	(3,261)
Net book value					
As at 31 December 2001	15,847	602	419	—	16,868
Cost					
As at 1 January 2002	18,901	802	426	—	20,129
Additions	23,860	745	204	3,347	28,156
Disposals	(59)	—	—	—	(59)
As at 31 December 2002	42,702	1,547	630	3,347	48,226
Accumulated depreciation					
As at 1 January 2002	(3,054)	(200)	(7)	—	(3,261)
Charge for the year	(4,961)	(156)	(89)	(949)	(6,155)
Disposals	41	—	—	—	41
As at 31 December 2002	(7,974)	(356)	(96)	(949)	(9,375)
Net book value					
As at 31 December 2002	34,728	1,191	534	2,398	38,851
Cost					
As at 1 January 2003	42,702	1,547	630	3,347	48,226
Additions	50,842	4,052	1,184	3,381	59,459
Disposals	(2,190)	(165)	(13)	—	(2,368)
As at 31 December 2003	91,354	5,434	1,801	6,728	105,317
Accumulated depreciation					
As at 1 January 2003	(7,974)	(356)	(96)	(949)	(9,375)
Charge for the year	(10,589)	(679)	(141)	(5,779)	(17,188)
Disposals	1,187	198	—	—	1,385
As at 31 December 2003	(17,376)	(837)	(237)	(6,728)	(25,178)
Net book value					
As at 31 December 2003	73,978	4,597	1,564	—	80,139
Cost					
As at 1 January 2004	91,354	5,434	1,801	6,728	105,317
Additions	13,315	238	—	—	13,553
As at 31 March 2004	104,669	5,672	1,801	6,728	118,870

NOTES TO THE FINANCIAL STATEMENTS

16. Fixed assets (continued)

	Computer equipment	Furniture and office equipment	Motor vehicles	Leasehold improvements	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Accumulated depreciation					
As at 1 January 2004	(17,376)	(837)	(237)	(6,728)	(25,178)
Charge for the period	(5,350)	(291)	(90)	—	(5,731)
As at 31 March 2004	(22,726)	(1,128)	(327)	(6,728)	(30,909)
Net book value					
As at 31 March 2004	81,943	4,544	1,474	—	87,961

NOTES TO THE FINANCIAL STATEMENTS

16. Fixed assets (continued)

Company

	Computer equipment RMB'000
Cost	
As at 1 January 2001	—
Additions	3,728
As at 31 December 2001	3,728
Accumulated depreciation	
As at 1st January 2001	—
Charge for the year	(392)
As at 31 December 2001	(392)
Net book value	
As at 31 December 2001	3,336
Cost	
As at 1 January 2002 and 31 December 2002	3,728
Accumulated depreciation	
As at 1 January 2002	(392)
Charge for the year	(671)
As at 31 December 2002	(1,063)
Net book value	
As at 31 December 2002	2,665
Cost	
As at 1 January 2003	3,728
Additions	66
Disposals	(278)
As at 31 December 2003	3,516
Accumulated depreciation	
As at 1 January 2003	(1,063)
Charge for the year	(648)
Disposals	107
As at 31 December 2003	(1,604)
Net book value	
As at 31 December 2003	1,912
Cost	
As at 1 January 2004	3,516
Additions	—
Disposals	—
As at 31 March 2004	3,516
Accumulated depreciation	
As at 1 January 2004	(1,604)
Charge for the period	(188)
Disposals	—
As at 31 March 2004	(1,792)
Net book value	
As at 31 March 2004	1,724

NOTES TO THE FINANCIAL STATEMENTS

17. Interests in group companies

(a) Interests in group companies

The amount represents the investment in the equity interests in subsidiaries of the Company. Details are as follows:

Company

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Investment in equity interests of subsidiaries, unlisted and at cost (note)	16,534	16,534	16,534	—

In 2004, the Company transferred all its equity investment (the "Transfer") in its wholly owned subsidiary, Tencent Technology, to a newly acquired wholly owned subsidiary at a consideration of US$1 (equivalent to approximately RMB8). Since it is a reorganization under common control of the same shareholder, the difference between the original cost of investment in Tencent Technology and the consideration received by the Company for the Transfer in the amount of RMB16,534,000 was recorded as a debit to the capital reserve of the Company and no gain or loss had been recognized by the Company in the transaction.

(b) Amounts due from group companies

The amounts represent the current account balances maintained with Tencent Technology and Tencent Computer consolidated for accounting purposes (mentioned in note 1). Details are as follows:

Company

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Amounts due from group companies	30,305	65,315	21,309	22,309

The amounts are unsecured, non-interest bearing and have no fixed repayment terms.

18. Accounts receivable

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
0 - 30 days	7,722	25,796	45,694	109,163
31 days - 60 days	595	20,981	31,573	14,048
61 days - 90 days	179	5,146	17,635	4,427
Over 90 days but less than a year	4	7,171	4,824	3,088
	8,500	59,094	99,726	130,726

No specific credit period is granted by the Group to its customers but customers are usually required to settle the outstanding balance within 30 to 90 days from the billing date. Substantially all the receivable balances as at the end of each of the Relevant Periods were due from China Unicom and China Mobile.

NOTES TO THE FINANCIAL STATEMENTS

19. Prepayments, deposits and other receivables

Group

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
VAT refund receivable (mentioned in note 12(b))	—	—	25,900	23,814
Rental deposits	243	835	2,293	3,219
Travelling advance to employees	83	777	1,989	2,225
Interest receivable	—	487	617	654
Rental prepayments	—	—	1,671	875
Other prepayments	43	846	3,402	15,387
	369	2,945	35,872	46,174

Company

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Travelling advance to employees of the Group	—	45	84	95
Interest receivable	—	—	66	6
Rental deposit	—	—	—	102
Other prepayments	—	—	—	1,004
	—	45	150	1,207

20. Term deposits with initial term of over three months

(a) The effective interest rates of the term deposits with initial term of over three months for the two years ended 31 December 2002 and 2003 are 1.84% and 1.77%, respectively. The effective interest rates for the three months ended 31 March 2003 and 2004 are 1.91% and 1.37%, respectively.

(b) As at 31 December 2002 and 2003 and 31 March 2004, approximately RMB7,440,000, RMB3,311,000 and RMB28,141,000 respectively, of the Group's term deposits with initial term of over three months were denominated in the United States Dollars. There was no deposit denominated in the United States Dollars in 2001.

(c) As at 31 December 2002 and 2003 and 31 March 2004, approximately RMB60,000,000, RMB20,000,000 and RMB20,000,000 respectively, of the Group's term deposits of initial term of over three months were denominated in RMB and deposited with banks in the PRC. The conversion of these RMB denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC government.

(d) As at 31 December 2002 and 31 March 2004, all of the Company's term deposits with initial term of over three months were denominated in the United States Dollars. There was no deposit denominated in the United States Dollars as at 31 December 2001 and 2003.

NOTES TO THE FINANCIAL STATEMENTS

21. Cash and cash equivalents

Group

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Cash at bank and in hand	21,475	32,656	208,454	265,805
Short-term bank deposits	18,248	12,598	117,132	63,527
	39,723	45,254	325,586	329,332

Company

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Cash at bank and in hand	20,071	22,772	128,761	70,838

(a) The effective interest rates of the short-term bank deposits for the Relevant Periods for the years ended 31 December 2001 to 2003 and the three months ended 31 March 2003 and 2004 are 1.73%, 1.20%, 1.14% 0.88% and 1.29% respectively and these deposits have maturities not more than 90 days.

(b) As at 31 December 2001, 2002 and 2003 and 31 March 2004, approximately RMB15,449,000, RMB22,338,000, RMB196,669,000 and RMB253,369,000, respectively of the amounts of cash and cash equivalents of the Group were denominated in RMB and deposited with banks in the PRC. The conversion of these RMB denominated balances into foreign currencies is subject to the rules and regulations of foreign exchange control promulgated by the PRC governments.

(c) As at 31 December 2001, 2002 and 2003 and 31 March 2004, approximately RMB24,274,000, RMB22,916,000, RMB128,917,000 and RMB75,963,000, respectively were denominated in United States Dollars and Hong Kong Dollars.

(d) As at 31 March 2004, the Company had approximately RMB6,000 cash at bank and in hand denominated in RMB. As at 31 December 2001, 2002 and 2003, the Company had no RMB denominated cash at bank and in hand.

22. Other payables and accruals

Group

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Staff costs and welfare accruals	2,222	735	21,661	15,390
Prepayments received from customers	2,832	350	18,836	20,291
Professional fees accruals	—	—	6,625	6,062
Others	219	2,530	12,179	14,828
Total	5,273	3,615	59,301	56,571

NOTES TO THE FINANCIAL STATEMENTS

22. Other payables and accruals (continued)

Company

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Professional fee accruals	—	—	6,146	5,057
Others	213	—	—	—
Total	213	—	6,146	5,057

23. Deferred income taxes

Deferred income taxes are calculated in respect of temporary differences under the liability method using the tax rates which are expected to apply at the time of reversal of the temporary differences.

The movements of deferred taxation of the Group are as follows:

Group

Deferred tax liabilities:

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
At beginning of year	—	—	3,058	988
Increase during the year/period	—	3,058	988	1,351
Reversal during the year/period	—	—	(3,058)	(988)
At end of year	—	3,058	988	1,351

The deferred tax liabilities were provided in respect of

Taxes applicable to the transfer of profits derived from Tencent Computer to the Company	—	3,058	988	1,351

The ending deferred taxation balances of the Group are as follows:

Group

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Deferred tax assets	—	—	—	—
Deferred tax liabilities	—	(3,058)	(988)	(1,351)
	—	(3,058)	(988)	(1,351)

All the above deferred tax liabilities will be settled in the next 12 months.

NOTES TO THE FINANCIAL STATEMENTS

23. Deferred income taxes (continued)

There were no material unprovided deferred tax assets of the Group as at 31 December 2001 and 2002. As mentioned in note 12(b) to the financial statements, certain intragroup Software Sales were transacted during the year ended 31 December 2003 and the three months ended 31 March 2004. The costs of the software, upon obtaining an approval from the local tax bureau in the PRC, might be amortised as expenses over their contracted useful lives (the "Amortisation") for income tax deduction claims in ascertaining the assessable profits of Tencent Computer. These have given rise to a potential temporary difference between the accounting base (in the consolidated financial statements of the Group) and the tax base (in the company financial statements of Tencent Computer) in such intragroup transactions. The related potential deferred tax assets, estimated to be in the amount RMB36,491,000 and RMB46,619,000, respectively, had not been recognized in the consolidated financial statements as at 31 December 2003 and 31 March 2004 because there is no reasonable certainty that Tencent Computer would obtain the approval from the local tax bureau in claiming the Amortisation as tax deductible expenses of Tencent Computer, and the accounting base of such temporary difference as at the end of the two reporting periods is assessed to be zero.

The Company did not have other unprovided deferred taxation as at 31 December 2001, 2002 and 2003 and 31 March 2004.

24. Share Capital

Both the authorised share capital of the Company as at 31 December 2001 and 2002 were 5,000,000 shares at US$0.01 (equivalent to RMB0.083) each. Pursuant to a resolution passed on 26 September 2003, the Company undertook a share split whereby each then issued ordinary share was split into 10.788 shares. The authorised share capital then increased from 5,000,000 shares to 53,941,626 shares and the par value of each share was also altered from US$0.01 (equivalent to RMB0.083) each to no par value.

On 24 March 2004, the Company undertook a second share split whereby each then issued ordinary share was split into 70 shares. The board of directors also resolved to increase the authorised share capital to 10,000,000,000 ordinary shares and a par value of HK$0.0001 was assigned to each share.

NOTES TO THE FINANCIAL STATEMENTS

24. Share Capital (continued)

Movements in issued share capital during the Relevant Periods are as follows:

	Ordinary shares		Convertible Preference Shares (Classes A & B) (Note a)		Total
	Number of shares	Amount RMB'000	Number of shares	Amount RMB'000	RMB'000
As at 1 January 2001	1,000,000	82	666,666	55	137
Conversion of preference shares into ordinary shares (note (b))	666,666	55	(666,666)	(55)	—
Conversion of Convertible Notes into ordinary shares (note (c))	72,016	6	—	—	6
Shares issued during the year (note (d))	31,003	3	—	—	3
As at 31 December 2001/1 January 2002	1,769,685	146	—	—	146
Shares issued during the year (note (e))	31,003	3	—	—	3
As at 31 December 2002/1 January 2003	1,800,688	149	—	—	149
Shares cancelled during the year (note (f))	(131,580)	(10)	—	—	(10)
Shares issued upon share split (note (g))	16,337,772	—	—	—	—
Shares cancelled after share split during the year (note (h))	(12)	(1)	—	—	(1)
As at 31 December 2003	18,006,868	138	—	—	138
Shares issued upon share split (note i)	1,242,473,892	—	—	—	—
As at 31 March 2004	1,260,480,760	138	—	—	138

(a) In accordance with the articles of association of the Company, holders of the Class A and Class B preference shares ("Preference Shares") were entitled to substantially the same dividend entitlement and voting rights as those entitled by the ordinary shareholders. The holders of Preference Shares were also entitled to convert the whole or part of their shareholding ordinary shares at a par value of US$0.01 each on a one-to-one basis. The shareholders had all the rights and restrictions attached to, and the shares ranked pari passu in all respects with, the ordinary shares outstanding.

(b) On 5 June 2001, all Preference Shares were converted into 666,666 ordinary shares in aggregate at US$3.30 per share (equivalent to RMB27.28). These shares ranked pari passu in all respects with the then ordinary shares outstanding.

(c) On 5 December 2000, the Company issued convertible notes ("Convertible Notes") valued at US$ 2 million (equivalent to approximately RMB 17 million) to two former shareholders. The Convertible Notes bore interests at 8% per annum and were convertible into ordinary shares of the Company. The number of shares for conversion had to be determined based on the outstanding principal amount of the notes and the related accrued interest, divided by a conversion price based on either the lower of (i) US$28.8 per share or (ii) the lowest price per share paid, or payable, by any person for subscription of any ordinary share of the Company. On 5 June 2001, the holders of Convertible Notes converted the notes together with the interest accrued at the same

NOTES TO THE FINANCIAL STATEMENTS

24. Share Capital (continued)

date in full for 72,016 ordinary shares at US$28.8 (equivalent to RMB238.09) each, total of approximately RMB17,147,000, with a share premium of RMB17,141,000 being recognized.

(d) On 25 July 2001, the Company issued 31,003 ordinary shares on a pro-rata basis to its then existing shareholders at a consideration of US$34.8 (equivalent to RMB287.69) each, total of approximately RMB8,919,000. A share premium of RMB8,916,000 was recognized.

(e) On 31 January 2002, the Company issued 31,003 ordinary shares on a pro-rata basis to its then existing shareholders at a consideration of US$34.80 (equivalent to RMB287.69) each, total of approximately RMB8,919,000. Pursuant to the issuance, a share premium of RMB8,916,000 was recognized.

(f) On 11 August 2003, the Company undertook a redemption of 131,580 of its ordinary shares in issue from certain then shareholders at a consideration of US$34.80 (equivalent to RMB287.69) each. All these redeemed shares were then cancelled.

(g) On 26 September 2003, the Company undertook a share split ("the First Share Split") whereby 1 then issued ordinary share was split into 10.788 shares. Accordingly, the number of shares issued increased from 1,669,108 shares to 18,006,880 shares with the relative percentage of shareholding among the shareholders remains unchanged. The nominal value of the ordinary shares was also decreased from US$0.01 to no par value.

(h) On 30 September 2003, the Company undertook to redeem a total of 12 ordinary shares from all the then existing shareholders at a consideration of US$3.23 (equivalent to RMB26.66) each. All these redeemed shares were then cancelled.

(i) On 24 March 2004, the Company undertook another share split ("the Second Share Split") whereby 1 then issued ordinary share was split into 70 shares, while the relative rights of each shareholder remain unchanged. In addition, the board of directors also passed a resolution to increase the authorised share capital to 10,000,000,000 ordinary shares and a par value of HK$0.0001 was assigned to each share.

NOTES TO THE FINANCIAL STATEMENTS

25. Reserves

Group

	Share premium	Capital Reserve	Statutory reserves (note i)	(Accumulated deficit)/ Retained earnings	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
As at 1 January 2001	18,132	1,000	—	(7,227)	11,905
Conversion of Convertible Notes into ordinary shares (note 24(c))	17,141	—	—	—	17,141
Issuance of shares (note 24(d))	8,916	—	—	—	8,916
Profit for the year	—	—	—	10,216	10,216
As at 31 December 2001	44,189	1,000	—	2,989	48,178
As at 1 January 2002	44,189	1,000	—	2,989	48,178
Issuance of shares (note 24(e))	8,916	—	—	—	8,916
Profit for the year	—	—	—	140,707	140,707
As at 31 December 2002	53,105	1,000	—	143,696	197,801
As at 1 January 2003	53,105	1,000	—	143,696	197,801
Profit appropriations to statutory reserves (note i)	—	—	3,653	(3,653)	—
Transfer to capital reserve	—	19,000	—	(19,000)	—
Dividends paid (note 14)	—	—	—	(10,334)	(10,334)
Shares cancelled during the year (notes 24(f) &(h))	(37,844)	—	—	—	(37,844)
Profit for the year	—	—	—	322,196	322,196
As at 31 December 2003	15,261	20,000	3,653	432,905	471,819
As at 1 January 2004	15,261	20,000	3,653	432,905	471,819
Dividends proposed/paid (note 14)	—	—	—	(28,935)	(28,935)
Profit for the period	—	—	—	107,304	107,304
As at 31 March 2004	15,261	20,000	3,653	511,274	550,188
As at 1 January 2003	53,105	1,000	—	143,696	197,801
Profit appropriations to statutory reserves (note i)	—	—	3,653	(3,653)	—
Transfer to capital reserve	—	19,000	—	(19,000)	—
Dividends proposed/paid (note 14)	—	—	—	(10,334)	(10,334)
Profit for the period	—	—	—	57,345	57,345
As at 31 March 2003	53,105	20,000	3,653	168,054	244,812

Note i: The appropriations of profits of 2002 to statutory reserves amounting to approximately RMB3,653,000 were recorded in the Group's financial statements for the year ended 31 December 2003 in accordance with the relevant Companies Law in the PRC and the articles of association of Tencent Computer (note 11).

NOTES TO THE FINANCIAL STATEMENTS

25. Reserves (continued)

Company

	Share premium	Capital reserve	(Accumulated deficit)/ Retained earnings	Total
	RMB'000	RMB'000	RMB'000	RMB'000
As at 1 January 2001	18,132	—	(907)	17,225
Issuance of shares (note 24(c))	17,141	—	—	17,141
Issuance of shares (note 24(d))	8,916	—	—	8,916
Profit for the year (note 13)	—	—	17,768	17,768
As at 31 December 2001	44,189	—	16,861	61,050
As at 1 January 2002	44,189	—	16,861	61,050
Issuance of shares (note 24(e))	8,916	—	—	8,916
Profit for the year (note 13)	—	—	39,933	39,933
As at 31 December 2002	53,105	—	56,794	109,899
As at 1 January 2003	53,105	—	56,794	109,899
Dividends paid (note 14)	—	—	(10,334)	(10,334)
Shares cancelled during the year (note 24(f) &(h))	(37,844)	—	—	(37,844)
Profit for the year (note 13)	—	—	100,743	100,743
As at 31 December 2003	15,261	—	147,203	162,464
As at 1 January 2004	15,261	—	147,203	162,464
Dividends proposed (note 14)	—	—	(28,935)	(28,935)
Capital reserve arising from group reorganisation (note i)	—	(16,534)	—	(16,534)
Loss for the period (note 13)	—	—	(3,163)	(3,163)
As at 31 March 2004	15,261	(16,534)	115,105	113,832
As at 1 January 2003	53,105	—	56,794	109,899
Dividends paid (note 14)	—	—	(10,334)	(10,334)
Profit for the period			42,497	42,497
As at 31 March 2003	53,105	—	88,957	142,062

Note i: As described in Note 17(a), the debit balance of the capital reserve of the Company arose as a result of the intragroup transfer of equity interests in a subsidiary which is under common control of the same shareholder.

The Company's reserves available for distribution comprise the share premium, capital reserve and retained earnings. Under the Companies Law of the Cayman Islands and the relevant laws in the BVI, the share premium account is distributable to the shareholders of the Company provided that immediately following the date on which the dividend is proposed to be distributed the Company will be in a position to pay off its debts as they fall due in the ordinary course of business.

As at 31 December 2001, 2002 and 2003 and 31 March 2003 and 2004, the reserves of the Company available for distribution to shareholders amounted to approximately RMB61,050,000, RMB109,899,000, RMB162,464,000, RMB142,062,000 and RMB113,832,000, respectively.

NOTES TO THE FINANCIAL STATEMENTS

26. Consolidated cash flow statements

(a) Analysis of changes in financing during the Relevant Periods is as follows:

	Share capital including premium	Short-term bank loan and long-term notes payable	Dividends payable	Convertible Notes interest payable	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2001	18,187	17,334	—	—	35,521
Proceeds from issue of shares	8,919	—	—	—	8,919
Interests on Convertible Notes' interest (note b)	—	—	—	613	613
Convertible Notes converted into ordinary shares (note b)	17,147	(16,534)	—	(613)	—
Repayment of short-term bank loans	—	(800)	—	—	(800)
At 31 December 2001/1 January 2002	44,253	—	—	—	44,253
Proceeds from issue of shares	8,919	—	—	—	8,919
At 31 December 2002/1 January 2003	53,172	—	—	—	53,172
Redemption of shares	(37,855)	—	—	—	(37,855)
Proposed dividends	—	—	10,334	—	10,334
Payment of dividends	—	—	(10,334)	—	(10,334)
At 31 December 2003/1 January 2004	15,317	—	—	—	15,317
Proposed dividends	—	—	28,935	—	28,935
Payment of dividends	—	—	(26,972)	—	(26,972)
As at 31 March 2004	15,317	—	1,963	—	17,280
As at 1 January 2003	53,172	—	—	—	53,172
Proposed dividends	—	—	10,334	—	10,334
Payment of dividends	—	—	(10,334)	—	(10,334)
As at 31 March 2003	53,172	—	—	—	53,172

(b) Major non-cash transactions

The major non-cash transactions during the Relevant Periods are as below:

(i) On 5 June 2001, Convertible Notes amounting to US$2 million (equivalent to approximately RMB17 million) and the related accrued interests amounting to approximately RMB613,000 were converted into 72,016 ordinary shares (mentioned in note 24(c)).

(ii) On 5 June 2001, all the preference shares were converted into ordinary shares at their then existing carrying value with no changes in the overall equity balance of the Company.

(iii) On 31 January 2002, the prepaid share subscription of approximately RMB8,919,000 was settled upon issuance of 31,003 ordinary shares to the then shareholders (see also note 27(d)).

(iv) The two share splits mentioned in note 24(g) and (i).

27. Related party transactions

Except as disclosed in note 9 (Directors' emoluments) and note 29 (Share option plans) to the Financial Statements, the Group also undertook the following transactions with related

NOTES TO THE FINANCIAL STATEMENTS

27. Related parties transactions (continued)

parties. In the opinion of the Directors, these transactions were conducted in the ordinary and usual course of business and the pricing of these transactions was determined based on mutual negotiation and agreement between the Company and the related parties.

(a) Continuing related parties transactions beyond 31 March 2004:

(i) Intellectual Property and Know-how licensing agreement and supplementary agreements with a shareholder and its affiliate

On 27 June 2002, the Company granted a sole and exclusive license to a shareholder ("the Shareholder") and its affiliates (collectively the "Operators"), to use certain proprietary intellectual property and know-how of the Company for a license fee computed at 40% of gross revenue derived by the Operators by using these proprietary information in certain countries. The agreement is for a term of 15 years expiring in 2017.

Pursuant to two supplementary agreements dated 18 January and 18 June 2003 respectively, an affiliate of the Shareholder is granted the right to use any licensed mobile downloaded images developed by the Group and both the Shareholder and the Operators are granted a sole and exclusive license to use certain trademarks and other intellectual property belonged to the Company.

During the Relevant Periods, no license fees were received/receivable by the Company as the Shareholder had not generated any revenue from provision of the services.

(ii) Cooperation agreement between Tencent Technology and a subsidiary of a shareholder

On 1 January 2003, Tencent Technology entered in a cooperation agreement with a subsidiary of the Shareholder in Shanghai, the PRC to develop a co-branded SMS channel. Tencent Technology is entitled to 40% of the revenue so generated while the counter contract party is entitled to the remaining 60%. This contract will expire on 31 December 2004. During the Relevant Periods, sharing of revenues of approximately RMB587,000, RMB213,000 and RMB36,000 were paid/payable by the Group under such arrangements in 2003 and for the three months ended 31 March 2003 and 2004.

(b) Discontinuing related parties transactions beyond 31 March 2004:

Consultancy agreements with related parties

(i) A consultancy agreement dated 1 September 2002 was entered into between the Company and Fat Yue Holdings Limited ("Fat Yue"), a company controlled by one of the shareholders who is also an employee of the Company pursuant to which Fat Yue agreed to provide certain consultancy services to the Company for a monthly service fee. The agreement was terminated on 20 July 2003. The Company had paid Fat Yue approximately RMB470,000 and RMB659,000 for the

NOTES TO THE FINANCIAL STATEMENTS

27. Related parties transactions (continued)

years ended 31 December 2002 and 2003. For the three months ended 31 March 2003 approximately RMB282,000 was paid/payable. No amount was paid/payable for the three months ended 31 March 2004.

(ii) A consultancy agreement dated 20 July 2003 was entered into between the Company and Surge Ahead Limited ("Surge Ahead"), a company controlled by five shareholders of the Company, two of them are directors of the Company. Pursuant to which, Surge Ahead agreed to provide certain consultancy services to the Company for a monthly service fee. The agreement was terminated on 31 December 2003 and the Company had paid Surge Ahead approximately RMB1,604,000 in 2003. No amount was paid/payable for the three months ended 31 March 2004.

(iii) During the years ended 31 December 2002 and 2003, the Company agreed to pay to 5 companies, two owned by two directors of the Company and three owned by three shareholders of the Company, for consultancy services provided by them, in the aggregate, of US$235,000 (equivalent to approximately RMB1,943,000) for consultancy services rendered in 2002 and US$705,000 (equivalent to approximately RMB5,828,000) for consultancy services rendered in 2003. The amount paid/payable for the three months ended 31 March 2003 was approximately RMB1,457,000 while there was no amount paid/payable for the three months ended 31 March 2004.

(c) The amounts due to related parties represent consultancy fees payable to related parties (see note b(iii) above). The amounts are unsecured, non-interest bearing and have no fixed repayment terms.

(d) The amounts due to shareholders represent the amounts prepaid by certain shareholders for share subscription. On 31 January 2002, the amounts were settled upon the issuance of 31,003 ordinary shares of the Company to these shareholders (mentioned in note 24(e)).

(e) Amounts due from shareholders

Group

	As at and for the year ended 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Maximum amount outstanding during the year/period	82	82	82	82
Amount outstanding, end of year/period	82	82	82	82

The amounts due from shareholders are unsecured, non-interest bearing and have no fixed repayment terms.

NOTES TO THE FINANCIAL STATEMENTS

27. Related parties transactions (continued)

(f) Deposit in connection with the formation of Shiji Kaixuan Technology

Pursuant to an agreement entered into among the Registered Shareholders and Tencent Technology on 16 December 2003, a sum of RMB11,000,000 was advanced by Tencent Technology to the Registered Shareholders for making capital contribution into Shiji Kaixuan Technology. The Registered Shareholders have granted an irrevocable and exclusive right to Tencent Technology, and through another person, to purchase all or part of the equity interests and assets of Shiji Kaixuan Technology at a nominal consideration. Shiji Kaixuan Technology was formally approved to be incorporated on 13 January 2004 by the relevant PRC authorities.

28. Commitments

(a) Capital commitments

The Group had the following capital commitments being contracted but not provided for at the respective balance sheet dates during the Relevant Periods:

Group

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Acquisition of fixed assets:				
—Contracted but not provided for	—	5,408	7,043	17,747

(b) Operating lease commitments

The Group had future aggregate minimum lease payments under non-cancelable operating leases in respect of buildings as follows during the Relevant Periods:

Group

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Not later than one year	48	1,081	13,533	15,398
Later than one year and not later than five years	—	235	28,740	31,649
	48	1,316	42,273	47,047

(c) Other commitments

Group

	As at 31 December			As at 31 March
	2001	2002	2003	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Bandwidth leasing	—	—	66,111	52,139

The Company had no capital/operating lease commitments nor other commitments during the Relevant Periods.

NOTES TO THE FINANCIAL STATEMENTS

29. Share option plans

On 27 July 2001, the Company adopted a share option scheme (the "Pre-IPO Option Scheme") for the purpose of providing incentives to its directors and eligible employees. Under the scheme, the Board of Directors of the Company may grant options to eligible employees, including executive directors of the Company to subscribe for shares in the Company. The Pre-IPO Option Scheme will expire on 31 December 2011.

The total number of shares in respect of which options may be granted under the Pre-IPO Option Scheme is not permitted to exceed 5% of the ordinary shares of the Company in issue as at the date of adoption of the Pre-IPO Option Scheme. The number of ordinary shares in respect of which options may be granted to any individual is not permitted to exceed 10% of the number of ordinary shares issued and issuable under the scheme. Options granted must be taken up within 15 days of the date of grant, upon payment of RMB1 per grant.

The options will vest in four equal tranches after the expiration of a 12 months, 24 months, 36 months and 48 months' period beginning on the date of the grant, respectively. All the options are exercisable in installments from the commencement of the relevant vesting period until 31 December 2011, but on the condition that the Company has been listed in a sizeable securities market. In each grant of the options, the Board of Directors may at their discretion determine the specific vetting and exercise periods, as well as the exercise price.

In the event of any alterations made to the capital structure of the Company whilst any options granted remains exercisable, whether by way of capitalisation of profits or reserves, rights issue, consolidation, sub-division, or reduction of the share capital of the Company or otherwise howsoever in accordance with legal requirements or in any event of any distribution of the Company's capital assets to its shareholders on a pro rata basis (whether in cash or in specie) other than dividends paid out of the net profits attributable to its shareholders for each financial year of the Company, such corresponding alterations shall be made to (i) the number or nominal amount of shares subject to the options of the scheme so far unexercised; (ii) the subscription price; or (iii) the method of exercise of the option.

On 14 December 2001, pursuant to the resolution, the Pre-IPO Option Scheme was amended so as to increase the maximum number of shares in respect of which options may be granted from 5% to 7.5% of the shares in issue on the date the offer of the grant of an option is made. Up to 31 December 2001, 55,578,600 options (post share spilts, see below) were granted by the Company to its employees under the Pre-IPO Option Scheme (see details below).

As mentioned in notes 24(g) and 24(i) on 26 September 2003 and 24 March 2004, the Company undertook the First and the Second Share Splits. In the First Split, each outstanding option granted and remained un-exercised as at that date was split at a ratio of one to ten. The subscription price to be paid by each grantee in respect of each option was revised from US$34.80 to US$3.48; and the cash bonus to be paid to each cash bonus grantee was revised from an amount of US$17.40 for each option to an amount of US$1.74. In the Second Split, each outstanding option granted and remained un-exercised as at that date (after taking into effect of the First Split) was split at a ratio of one to seventy. The respective subscription

NOTES TO THE FINANCIAL STATEMENTS

29. Share option plans (continued)

prices to be paid by each grantee were also adjusted to reflect the effect of the Second Split. The subscription prices, after adjustments made, are US$0.0497, US$0.1967, and US$0.4396, respectively.

For presentation in this report, all share option data has been presented as if the share option was also split according to the two events at the beginning of the Relevant Periods.

NOTES TO THE FINANCIAL STATEMENTS

29. Share option plans (continued)

During 2001, 2002, 2003 and the three months ended 31 March 2004, no options were granted to directors. The movements and details of the number of share options granted to employees in 2001, 2002, 2003 and up to 31 March 2004 under the 2001 Scheme are shown as follows:

Date granted	Exercisable period	Exercise price USD (Note 1)	Number of share options: Balance at 1 January (Note 1)	Granted during the year /period (Note 1)	Cancelled during the year /period (Note 1)	Balance at 31 December (Note 1)
Year ended 2001						
10 August 2001 (Note 2)	later of the date of commencement of vesting period ('Commencement Date') or date of initial public offering of the Company ("IPO Date") to 31 December 2011	0.0497	—	47,845,000	—	47,845,000
From 10 September 2001 to 14 December 2001 (Note 3)	later of Commencement Date or IPO Date to 31 December 2011	0.0497	—	7,733,600	—	7,733,600
			—	55,578,600	—	55,578,600
Year ended 2002						
10 August 2001 (Note 2)	later of Commencement Date or IPO Date to 31 December 2011	0.0497	47,845,000	—	—	47,845,000
From 10 September 2001 to 14 December 2001 (Note 3)	later of Commencement Date or IPO Date to 31 December 2011	0.0497	7,733,600	—	—	7,733,600
From 10 March 2002 to 10 June 2002 (Note 4)	later of Commencement Date or IPO Date to 31 December 2011	0.0497	—	6,982,500	—	6,982,500
			55,578,600	6,982,500	—	62,561,100
Year ended 2003						
10 August 2001 (Note 2)	later of Commencement Date and IPO Date to 31 December 2011	0.0497	47,845,000	—	—	47,845,000
From 10 September 2001 to 14 December 2001 (Notes 2 & 3)	later of Commencement Date and IPO Date to 31 December 2011	0.0497	7,733,600	—	(472,500)	7,261,100
From 10 March 2002 to 10 June 2002 (Note 4)	later of Commencement Date and IPO Date to 31 December 2011	0.0497	6,982,500	—	—	6,982,500
			62,561,100	—	(472,500)	62,088,600
Three months ended 31 March 2004						
10 August 2001 (Note 2)	later of Commencement Date or IPO Date to 31 December 2011	0.0497	47,845,000	—	—	47,845,000
From 10 September 2001 to 14 December 2001 (Note 3)	later of Commencement Date or IPO Date to 31 December 2011	0.0497	7,261,100	—	—	7,261,100
From 10 March 2002 to 10 June 2002 (Note 4)	later of Commencement Date or IPO Date to 31 December 2011	0.0497	6,982,500	—	—	6,982,500
From 10 February 2004 to 24 March 2004 (Note 5)	later of Commencement Date or IPO Date to 31 December 2011	0.1967/ 0.4396	—	10,464,230	(61,180)	10,403,050
			62,088,600	10,464,230	(61,180)	72,491,650
Three months ended 31 March 2003						
10 August 2001 (Note 2)	later of Commencement Date and IPO Date to 31 December 2011	0.0497	47,845,000	—	—	47,845,000
From 10 September 2001 to 14 December 2001 (Note 3)	later of Commencement Date and IPO Date to 31 December 2011	0.0497	7,733,600	—	—	7,733,600
From 10 March 2002 to 10 June 2002 (Note 4)	later of Commencement Date and IPO Date to 31 December 2011	0.0497	6,982,500	—	—	6,982,500
			62,561,100	—	—	62,561,100

Note 1: The exercise price and the number of share options granted as at 31 December 2001, 2002, 2003 and 31 March 2004 have been adjusted retroactively as a result of

NOTES TO THE FINANCIAL STATEMENTS

29. Share option plans (continued)

the combined effect of the two option splits effectuated on 26 September 2003 and 24 March 2004 as if the splits had taken place on 10 August 2001.

Note 2: Pursuant to the Pre-IPO Option Scheme, the Company granted 47,845,000 options at a subscription price of US$0.0497 each, out of which a cash bonus will be paid by the Company to grantees holding in aggregate 17,745,000 of the options. The bonus will be determined according to half of the amount of the subscription price payable by such grantee upon the options are exercised. On 17 September 2003, 472,500 options lapsed as a grantee ceased to be an employee of the Company by resignation.

Note 3: Pursuant to the Pre-IPO Option Scheme, the Company granted a total of 7,733,600 options at a subscription price of US$0.0497 each.

Note 4: During the period from 10 March 2002 to 10 June 2002, the Company further granted a total of 6,982,500 options.

Note 5: On 10 February and 24 March 2004 the Company granted 10,403,050 additional options, net of amounts cancelled, to certain employees under the Pre-IPO Option Scheme. The subscription prices are US$0.1967 per share and US$0.4396 per share, respectively.

Subsequent to 31 March 2004 and up to the date of this report, 105,280 options granted in 2004 were cancelled and the number of outstanding options became 72,386,370.

30. Financial risk management

(a) Financial risk factors

The Group activities expose it to a variety of financial risks, including the effects of: changes in debt and equity market prices, foreign currency exchange rates and interest rates.

(i) Foreign exchange risk

The Group has no significant concentrations of a foreign exchange risk.

The Group mainly operates in the PRC with most of the transactions settled in RMB. RMB is not freely convertible into other foreign currencies. The Group also had United States Dollar denominated term deposits with initial term of over three months with several banks of approximately RMB7,440,000 and RMB3,311,000 and RMB28,141,000 as at 31 December 2002, 2003 and 31 March 2004, respectively. In addition, the Group had United States Dollar denominated cash in bank and short-term deposits of approximately RMB24,156,000, RMB22,899,000, RMB128,901,000 and RMB75,651,000 as at 31 December 2001, 2002 and 2003 and 31 March 2004, respectively.

The Group has not used any forward contracts, currency borrowings or other means to hedge its exposure as foreign currency risk is considered minimal.

NOTES TO THE FINANCIAL STATEMENTS

30. Financial risk management (continued)

(ii) Interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates and the Group has no significant interest-bearing borrowings. The Group's exposure to changes in interest rates is mainly attributable to its term deposits with initial term of over three months and short-term deposits, details of which have been disclosed in notes 20 and 21 to the Financial Statements. The Group has not used any interest rate swaps to hedge its exposure as interest rate risk is considered minimal.

(iii) Credit risk

As mentioned in note 3(m)(i), the Mobile and Telecom Fees and revenue from Internet value-added services of the Group are substantially derived from co-operative arrangements with China Mobile and China Unicom (the "mobile telecommunication operators"). If the strategic relationship with either mobile telecommunication operator is terminated or scaled-back, or if the mobile telecommunication operators alter the co-operative arrangements, the Group's Mobile and Telecommunications and Internet value-added services might be adversely affected.

However, the credit risk related to the end customers of these two services was shared by the mobile telecommunication operators and the Group.

(b) Fair value estimation

The carrying amounts of the Group's financial assets including cash and cash equivalents, accounts receivables, deposits, prepayment and other receivables; and financial liabilities including accounts payables, other payables and accruals, approximate their fair values due to their short maturities.

In assessing the fair value of non-trading financial instruments, the Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Quoted market prices or dealer quotes for the specific or similar instruments are used for long-term debt. Other techniques, such as estimated discounted value of future cash flows, are used to determine fair value for the remaining financial instruments.

The face values less any estimated credit adjustments for financial assets and liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

The Group adopted IAS 39 "Financial Instruments: Recognition and Measurement" in the year ended 31 December 2001 and there was no material impact on the Group's opening shareholders' equity as at 1 January 2001.

NOTES TO THE FINANCIAL STATEMENTS

31. Subsequent events

There were no significant subsequent events after 31 March, 2004.

(II) SUBSEQUENT ACCOUNTS

No audited financial statements for any of the companies comprising the Group have been prepared in respect of any period subsequent to 31 March 2004.

Yours faithfully,

PricewaterhouseCoopers
Certified Public Accountants
Hong Kong