

Tencent

騰訊

TENCENT HOLDINGS LIMITED

騰訊控股有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 700)

Announcement of Half-year Results for 2004

Following the initial listing of the shares in Tencent Holdings Limited (the “Company”) on the Main Board of The Stock Exchange of Hong Kong Limited (the “Stock Exchange”) on 16 June 2004, the Board of Directors of the Company is pleased to announce the unaudited consolidated results of the Company, its subsidiaries and companies consolidated for accounting purposes (collectively, the “Group”) for the three and six months ended 30 June 2004, respectively. These interim results have been reviewed by PricewaterhouseCoopers, the auditors of the Company (the “Auditors”) and the Audit Committee of the Company, comprising a majority of independent non-executive directors.

CONDENSED CONSOLIDATED PROFIT AND LOSS ACCOUNTS  
FOR THE THREE AND SIX MONTHS ENDED 30 JUNE 2004

	<i>Note</i>	Unaudited Three months ended 30 June 2004		Unaudited Six months ended 30 June 2004	
		RMB'000	RMB'000	RMB'000	2003 RMB'000
Revenues					
Mobile and telecommunications value-added services		156,054	115,086	298,871	199,383
Internet value-added services		99,913	47,898	204,499	80,910
Online advertising		12,847	8,529	21,062	15,347
Others		1,699	646	3,634	1,512
		270,513	172,159	528,066	297,152
		(100,159)	(51,437)	(187,527)	(87,776)
Cost of revenues		170,354	120,722	340,539	209,376
Gross profit					
Other operating income/(expense), net		—	(1,182)	18	(1,146)
Selling and marketing expenses		(26,465)	(10,970)	(49,509)	(23,283)
General and administrative expenses		(28,310)	(22,502)	(62,384)	(39,154)
Profit from operations	3	115,579	86,068	228,664	145,793
Finance income, net		1,003	494	1,934	237
Profit before taxation		116,582	86,562	230,598	146,030
Taxation	4	(3,293)	(4,342)	(10,005)	(6,465)
Profit for the period		113,289	82,220	220,593	139,565
Earnings per share					
— basic (RMB)	6	0.085	0.060	0.170	0.103
— diluted (RMB)	6	0.085	0.060	0.170	0.103
Proposed dividends	5	N/A	N/A	N/A	N/A

CONDENSED CONSOLIDATED BALANCE SHEETS  
AS AT 30 JUNE 2004 AND 31 DECEMBER 2003

	Unaudited 30 June 2004 RMB'000	Audited 31 December 2003 RMB'000
Assets		
Non-current assets		
Fixed assets	113,298	80,139
Deposit in connection with the formation of an operating company, Shiji Kaixuan Technology	—	11,000
Current assets		
Accounts receivable	141,856	99,726
Amounts due from shareholders	—	82
Prepayments, deposits and other receivables	42,572	35,872
Term deposits with initial term of over three months	62,971	23,311
Cash and cash equivalents	1,950,665	325,586
	2,198,064	484,577
Total assets	2,311,362	575,716
Equity and liabilities		
Current liabilities		
Trade payables	3,864	—
Other payables and accruals	86,129	59,301
Dividends payable	145	—
Income taxes payable	4,644	7,115
Other taxes payable	23,656	32,679
Deferred revenue	12,839	3,676
	131,277	102,771
Non-current liabilities		
Deferred tax liabilities	—	988
Total liabilities	131,277	103,759
Shareholders' equity		
Share capital	183	138
Reserves	2,179,902	471,819
Total shareholders' equity	2,180,085	471,957
Total liabilities and shareholders' equity	2,311,362	575,716

1 Basis of preparation and presentation

These unaudited consolidated condensed accounts of the Group are prepared in accordance with International Accounting Standard (“IAS”) 34, “Interim Financial Reporting” issued by the International Accounting Standards Board.

These condensed accounts should be read in conjunction with the Accountants' Report and audited financial statements of the Group for the three years ended 31 December 2003 and the three months ended 31 March 2004 (collectively, the “IPO Financial Statements”) for inclusion in the prospectus of the Company dated 7 June 2004 (the “Prospectus”) in connection with the initial listing of the shares on the Main Board of the Stock Exchange.

The accounting policies and methods of computation used in the preparation of these condensed accounts are consistent with those used in the IPO Financial Statements.

2 Segment information

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

The business segment information of the Group for the three and six months ended 30 June 2003 and 2004, respectively, is presented as follows:

	Unaudited Three months ended 30 June 2004				
	Mobile and telecommunications value-added services RMB'000	Internet value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
Revenues	156,054	99,913	12,847	1,699	270,513
Gross profit/(loss)	96,218	65,864	9,511	(1,239)	170,354
Selling and marketing expenses					(26,465)
General and administrative expenses					(28,310)
Profit from operations					115,579
Finance income, net					1,003
Profit before taxation					116,582
Taxation					(3,293)
Profit for the period					113,289

	Unaudited Three months ended 30 June 2003				
	Mobile and telecommunications value-added services RMB'000	Internet value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
Revenues	115,086	47,898	8,529	646	172,159
Gross profit	82,554	31,123	6,644	401	120,722
Other operating expenses, net					(1,182)
Selling and marketing expenses					(10,970)
General and administrative expenses					(22,502)
Profit from operations					86,068
Finance income, net					494
Profit before taxation					86,562
Taxation					(4,342)
Profit for the period					82,220

	Unaudited Six months ended 30 June 2004				
	Mobile and telecommunications value-added services RMB'000	Internet value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
Revenues	298,871	204,499	21,062	3,634	528,066
Gross profit/(loss)	190,770	137,763	13,869	(1,863)	340,539
Other operating income, net					18
Selling and marketing expenses					(49,509)
General and administrative expenses					(62,384)
Profit from operations					228,664
Finance income, net					1,934
Profit before taxation					230,598
Taxation					(10,005)
Profit for the period					220,593

	Unaudited Six months ended 30 June 2003				
	Mobile and telecommunications value-added services RMB'000	Internet value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
Revenues	199,383	80,910	15,347	1,512	297,152
Gross profit	145,620	51,199	11,313	1,244	209,376
Other operating expenses, net					(1,146)
Selling and marketing expenses					(23,283)
General and administrative expenses					(39,154)
Profit from operations					145,793
Finance income, net					237
Profit before taxation					146,030
Taxation					(6,465)
Profit for the period					139,565

	Unaudited Six months ended 30 June 2003				
	Mobile and telecommunications value-added services RMB'000	Internet value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
Revenues	199,383	80,910	15,347	1,512	297,152
Gross profit	145,620	51,199	11,313	1,244	209,376
Other operating expenses, net					(1,146)
Selling and marketing expenses					(23,283)
General and administrative expenses					(39,154)
Profit from operations					145,793
Finance income, net					237
Profit before taxation					146,030
Taxation					(6,465)
Profit for the period					139,565

3 Profit from operations

Profit from operations is stated after charging the following:

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Staff costs	32,686	17,751	64,964	27,712
Value-added tax paid upon transfer of software within the Group	3,300	—	5,402	—
Depreciation on fixed assets	6,454	2,112	12,185	4,538
Operating lease rentals in respect of land and buildings	2,827	2,014	5,724	3,780
Research and development expenses (note (a))	8,075	4,939	20,714	8,776
Auditors' remuneration	797	4	887	574

Note (a): Research and development expenses included staff costs and depreciation of approximately RMB3,943,000, RMB7,059,000, RMB7,023,000 and RMB13,244,000 for the three and six months ended 30 June 2003 and 2004, respectively. The Group had not capitalized any of the research and development expenses for the three and six months ended 30 June 2003 and 2004, respectively.

4 Taxation

(a) Cayman Islands and British Virgin Islands Profits Tax

The Group is not subject to any taxation under these jurisdictions for the three and six months ended 30 June 2003 and 2004, respectively.

(b) Hong Kong Profits Tax

No Hong Kong profits tax has been provided as the Group has no assessable profit arising from Hong Kong for the three and six months ended 30 June 2003 and 2004, respectively.

(c) PRC Enterprise Income Tax

PRC Enterprise Income Tax (“EIT”) is provided on the assessable income of the Company and the Group for the three and six months ended 30 June 2003 and 2004, respectively, calculated in accordance with the relevant regulations of the PRC after considering the available tax benefits from refunds and allowances.

According to the provisions stipulated in the tax circular, Shendishuierhan 2002 No. 128, a subsidiary of the Group, Shenzhen Tencent Computer Systems Company Limited (“Tencent Computer”) is exempt from EIT for the one year starting from the first year of profitable operations after offsetting prior years' tax losses, followed by a 50% reduction for the next two years (the “Tencent Computer Tax Holiday”). The first profit-making year of Tencent Computer was 2002 and the Tencent Computer Tax Holiday commenced in that year. EIT was levied at 7.5% on its assessable profits for the three and six months ended 30 June 2003 and 2004, respectively.

In addition, another subsidiary of the Group, Tencent Technology (Shenzhen) Company Limited (“Tencent Technology”) has been approved by relevant tax authorities 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 years' tax losses, followed by a 50% reduction for the next three years if its annual productive sales income exceeds 50% of its reported total sales income (the “Tencent Technology Tax Holiday”). 2003 is the first profit-making year of Tencent Technology after offsetting all tax losses brought forward from prior years. 2004 is the second year of the Tencent Technology Tax Holiday and accordingly, no provision for EIT was made in the financial statements for the three and six months ended 30 June 2003 and 2004, respectively.

The other subsidiaries of the Group incorporated in the PRC had insignificant or no assessable profits during the three and six months ended 30 June 2004.

An analysis of the profits tax charges for the three and six months ended 30 June 2003 and 2004, respectively, is as follows:

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
PRC current tax	4,644	4,342	10,993	6,465
Deferred tax	(1,351)	—	(988)	—
	3,293	4,342	10,005	6,465

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 Shenzhen, the PRC, where the principal activities of the Group are conducted, as follows:

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Profit before taxation	116,582	86,562	230,598	146,030
Tax calculated at a tax rate of 15%	17,488	12,985	34,590	21,905
Effects of different tax rates available to different companies of the Group	—	(5,624)	—	(11,999)
Effects of tax holiday on assessable income of companies within the Group	(30,912)	(4,502)	(52,258)	(6,432)
Expenses not deductible for tax purposes	229	—	582	—
Deferred tax assets not recognised	16,667	—	26,795	—
Utilisation of previously unrecognized tax losses	(230)	—	(230)	—
Unrecognised tax losses sustained by companies of the Group	51	1,483	526	2,991
Tax charge	3,293	4,342	10,005	6,465

(d) Value-added tax, Business tax and related taxes

The operations of the Group are also subject to the following taxes in the PRC:

Category	Tax rate	Basis of levy
Value-added tax (“VAT”)	17%	Sales value of goods sold, offsetting by VAT on purchases
Business tax (“BT”)	3–5%	Services fee income
City construction tax	1%	Net VAT and BT payable amount
Educational surcharge	3%	Net VAT and BT payable amount

5 Dividends

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Final, paid, of RMB0.023 (2003: RMB0.008) per ordinary share	28,935	10,334	28,935	10,334

Pursuant to a resolution passed by the Board of Directors on 20 January 2004, the final dividend of 2003 was proposed at RMB0.023 per ordinary share (after taking into account two share splits in September 2003 and March 2004, respectively (the “Share Splits”) with an aggregate amount of US\$3,500,000 (equivalent to approximately RMB28,935,000), of which approximately US\$3,482,500 (equivalent to approximately RMB28,790,000) had been paid up to 30 June 2004. The remaining balance of US\$17,500 (equivalent to approximately RMB145,000) was recorded as dividends payable in the consolidated balance sheet as at 30 June 2004. This proposed dividend was not reflected as a dividends payable in 2003, but was reflected as an appropriation of retained earnings for the three and six months ended 30 June 2004.

The Board has resolved not to declare any interim dividend in respect of the six months ended 30 June 2004 (2003: Nil).

6 Earnings per share

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

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2004	2003	2004	2003
Profit for the period (RMB'000)	113,289	82,220	220,593	139,565
Weighted average number of ordinary shares in issue (in thousand) (note a)	1,329,738	1,359,808	1,295,109	1,359,808
Basic earnings per share (RMB) (note a)	0.085	0.060	0.170	0.103
Diluted earnings per share (RMB) (notes a & b)	0.085	0.060	0.170	0.103

Notes:

- (a) All per share information has been adjusted retroactively as if the aggregate effect of the Share Splits had taken place at the beginning of 2003.
- (b) The diluted earnings per share are calculated based on the weighted average number of ordinary shares outstanding and the potentially dilutive ordinary shares. The potentially dilutive shares of the Company mainly relate to the pre-IPO share options granted to employees which remained outstanding as at 30 June 2004. The number of dilutive shares is determined by the number of ordinary shares of the Company that could have been acquired at fair value (determined based on the average market share price of the Company's shares) based on the monetary value of the subscription rights attached to these share options.

Upon the listing of the Company's shares on the Stock Exchange on 16 June 2004, the exercisability of the pre-IPO share options granted to employees became unconditional, subject to the vesting schedule. As a result, the diluted earnings per share for the three and six months ended 30 June 2004 were presented to reflect the dilutive effects of pre-IPO stock options granted. There were no potential dilutive instruments for the three and six months ended 30 June 2003 as the pre-IPO share options had not met the pre-condition for their exercisability before the listing. Accordingly, the diluted earnings per share are equal to the basic earnings per share.

7 Share option plans

The Company adopted two share option schemes for the purpose of providing incentives to its directors, eligible employees and consultants:

- a. Pre-IPO Share Option Scheme (the “Pre-IPO Option Scheme”)

Under the Pre-IPO Option 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.

As at 30 June 2004, there were 72,386,370 options outstanding. No further options will be granted under the Pre-IPO Option Scheme.

- b. Post-IPO Share Option Scheme (the “Post-IPO Option Scheme”)

The Post-IPO Option Scheme was adopted by the Company on 24 March 2004. The Board of Directors may, at its discretion, invite any employee, consultant or director of any company in the Group to take up options to subscribe for shares at a price determined by it.

The maximum number of shares in respect of which options may be granted under the Post-IPO Option Scheme, and under any other share option scheme of the Company (including the Pre-IPO Option Scheme), shall not exceed 10% of the relevant class of securities of the Company in issue as of the date of listing of the Company's ordinary shares. The option period is determined according to the Board of Directors but may not exceed 10 years.

The Post-IPO Option Scheme will remain in force for a period of ten years, commencing on the adoption date.

During the six months ended 30 June 2004, no options were granted under the Post-IPO Option Scheme.

Financial Performance — Comparison of Second Quarter 2004 with First Quarter 2004 and Second Quarter 2003

Our unaudited consolidated revenues for the three months ended 30 June 2004 were RMB270.5 million, an increase of 57.1% over the same period in 2003 and an increase of 5.0% quarter on quarter.

Revenues from our Internet value-added services were RMB99.9 million, representing an increase of 108.6% from the same period in 2003 and a decrease of 4.5% quarter on quarter.

Revenues from our mobile and telecommunications value-added services were RMB156.1 million, representing an increase of 35.6% from the same period in 2003 and an increase of 9.3% quarter on quarter.

Revenues from our online advertising were RMB12.8 million, representing an increase of 50.6% from the same period in 2003 and an increase of 56.4% quarter on quarter.

Cost of revenues was RMB100.2 million, representing an increase of 94.7% from the same period in 2003 and an increase of 14.6% quarter on quarter. As a percentage of revenues, cost of revenues accounted for 37.0% for the second quarter of 2004, compared to 29.9% for the second quarter of 2003 and 33.9% for the first quarter of 2004.

Selling and marketing expenses were RMB26.5 million, representing an increase of 141.2% from the same period in 2003 and an increase of 14.8% quarter on quarter.

General and administrative expenses were RMB28.3 million, representing an increase of 25.8% from the same period in 2003 and a decrease of 16.9% quarter on quarter.

Profit for the second quarter of 2004 was RMB113.3 million, representing an increase of 37.8% from the same period in 2003 and 5.6% from the first quarter of 2004. As a percentage of revenues, profit for the period accounted for 41.9% for the second quarter of 2004, compared to 47.8% for the same period in 2003 and 41.7% for the first quarter of 2004.

Operating Information

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

	For the 16- day period ended 31 March 2004 (In millions)	For the 15-day period ended 30 June 2004
Registered IM user accounts (at end of period)	291.3	330.8
Active user accounts	97.1	110.1
Peak simultaneous online user accounts (for the quarter)	6.1	6.4
Average daily user hours	64.7	78.0
Average daily messages <sup>(1)</sup>	848.8	936.9
Fee-based Internet value-added service registered subscriptions (at end of period)	7.3	6.9
Fee-based mobile and telecommunications value-added service registered subscriptions (at end of period) <sup>(2)</sup>	12.8	12.6

- Notes:
- (1) Average daily messages include messages exchanged between PCs only and exclude messages exchanged with mobile handsets.
- (2) Includes registered subscriptions for services provided directly by the Group or through mobile operators.

Management's Discussion and Analysis

Three Months Ended 30 June 2004 Compared to Three Months Ended 31 March 2004

The following table sets forth the comparative figures for the first quarter ended 31 March 2004 and second quarter ended 30 June 2004:

	Three months ended 30 June 2004 Unaudited RMB'000	Three months ended 31 March 2004 Audited RMB'000
Revenues	270,513	257,553
Cost of revenues	(100,159)	(87,368)
Gross profit	170,354	170,185
Other operating income, net	—	18
Selling and marketing expenses	(26,465)	(23,044)
General and administrative expenses	(28,310)	(34,074)
Profit from operations	115,579	113,085
Finance income, net	1,003	931
Profit before taxation	116,582	114,016
Taxation	(3,293)	(6,712)
Profit for the period	113,289	107,304

Revenues. Revenues increased by 5.0% from RMB257.6 million for the first quarter of 2004 to RMB270.5 million for the second quarter of 2004. The following table sets forth our revenues by lines of business for the first and second quarters of 2004:

	Three months ended		30 June 2004	
	31 March 2004	% of total revenues	Amount	% of total revenues
	Amount		(RMB in thousands)	
Internet value-added services	104,586	40.6%	99,913	37.0%
Mobile and telecommunications value-added services	142,817	55.5	156,054	57.7
Online advertising	8,215	3.2	12,847	4.7
Others	1,935	0.7	1,699	0.6
Total revenues	257,553	100.0%	270,513	100.0%

Revenues from our Internet value-added services decreased by 4.5% from RMB104.6 million for the first quarter of 2004 to RMB99.9 million for the second quarter of 2004. The decrease reflected a slight decline in revenues from some of our IM services as a result of the “cleaning up” of inactive customer accounts undertaken by mobile operators, which in turn reduced the number of subscriptions for some of our services. Revenues from some of our community services and interactive entertainment, such as QQ Dating, also declined. These decreases in revenues were partially offset by growth in some of our newer products and services, such as QQ Show, E-Cards and online games.

Revenues from our mobile and telecommunications value-added services increased by 9.3% from RMB142.8 million for the first quarter of 2004 to RMB156.1 million for the second quarter of 2004. The increase in revenues reflected the growth in revenues from mobile news and information content services and our music and picture/image downloading services, which began to gain popularity among our user base, and from mobile voice services and ringback tone downloading services (together referred to as “mobile voice value-added services”), both of which were launched in recent months. In addition, revenues from WAP, K-Java, BREW and MMS (together referred to as “2.5G-related services”) increased due to the increased popularity of 2.5G services offered by mobile operators. Revenues from Mobile QQ subscriptions, however, declined in the second quarter of 2004 as a result of the “cleaning up” of inactive customer accounts undertaken by mobile operators.

Revenues from online advertising increased by 56.4% from RMB8.2 million for the first quarter of 2004 to RMB12.8 million for the second quarter of 2004. The improvement reflected an increase in our pricing terms and also greater marketing efforts relating to our online advertising business following the launch of the QQ.com portal. Moreover, there was a seasonal increase from the previous fiscal quarter.

Revenues from our other businesses decreased by 12.2% from RMB1.9 million for the first quarter of 2004 to RMB1.7 million for the second quarter of 2004. The decrease was mainly the result of a strategic reduction in our short-term fee charge for RTX in order to gain market share.

Cost of revenues. Cost of revenues increased by 14.6% from the first quarter of 2004 to RMB100.2 million in the second quarter of 2004. The increase principally reflected the increase in the amount of telecommunications operators’ revenue share and imbalance fees and bandwidth and server custody fees. As a percentage of revenues, cost of revenues increased from 33.9% in the first quarter of 2004 to 37.0% in the second quarter of 2004. The following table sets forth our cost of revenues by lines of business for the first and second quarters of 2004:

	Three months ended		30 June 2004	
	31 March 2004	% of segment revenues	Amount	% of segment revenues
	Amount		(RMB in thousands)	
Internet value-added services	32,687	31.3%	34,049	34.1%
Mobile and telecommunications value-added services	48,265	33.8	59,836	38.3
Online advertising	3,857	47.0	3,336	26.0
Others	2,559	132.2	2,938	172.9
Total cost of revenues	87,368		100,159	

Cost of revenues for our Internet value-added services increased by 4.2% from RMB32.7 million for the first quarter of 2004 to RMB34.0 million for the second quarter of 2004. The increase mainly reflected increased expenses associated with our bandwidth capacity and servers as we supported more bandwidth intensive services. In addition, we increased the amount paid for our QQ.com website content as we continued to expand those services. These increases were partially offset by a decrease in the amount of fees retained by mobile operators for their share of revenues as the amount of revenues collected through that channel decreased.

Cost of revenues for our mobile and telecommunications value-added services increased by 24.0% from RMB48.3 million for the first quarter of 2004 to RMB59.8 million for the second quarter of 2004. The increase mainly reflected the increase in the amount of fees retained by mobile operators for their share of revenues and imbalance fees. In addition, the amount of imbalance fees grew due to the increased traffic imbalance as we undertook various promotional activities which involved the transmission of promotional messages to our subscribers.

Cost of revenues for our online advertising decreased by 13.5% from the first quarter of 2004 to RMB3.3 million for the second quarter of 2004. The decrease reflected the reduced rate of sales commissions as we gained leverage due to seasonality and our increased user base and as we became more selective with respect to the advertising agencies that we engaged to match the IM and QQ.com portal services that we offer.

Cost of revenues for our other businesses increased by 14.8% from the first quarter of 2004 to RMB2.9 million for the second quarter of 2004. The increase mainly reflected the higher cost of sales related to RTX.

Selling and marketing expenses. Selling and marketing expenses increased by 14.8% from the first quarter of 2004 to RMB26.5 million for the second quarter of 2004. The increase principally reflected additional promotional and advertising activities and related travel expenses relating to the launch and promotion of our new products and services.

General and administrative expenses. General and administrative expenses decreased by 16.9% from the first quarter of 2004 to RMB28.3 million for the second quarter of 2004. The decrease was mainly attributable to lower research and development expenses being incurred in the second quarter of 2004 compared to the previous fiscal quarter. In the first quarter of 2004, these expenses were relatively high because several project-specific research and development activities were undertaken in that quarter. In addition, advisory fees relating to our reorganization and initial public offering preparation were recorded as part of general and administrative expenses in the first quarter of 2004, but were offset against the proceeds from our initial public offering in the second quarter of 2004 as we became a publicly-held company before the end of June 2004.

Taxation. We recorded profit taxes of RMB3.3 million for the second quarter of 2004 compared to RMB6.7 million for the first quarter of 2004. The effective tax rate applicable for the second quarter of 2004 was lower than that for the first quarter of 2004 primarily due to the reversal of deferred tax liability as a result of our transfer of profits derived from Tencent Computer to Tencent Technology by implementing our structure contracts in the second quarter of 2004.

Profit for the period. As a result of the factors discussed above, profit for the period increased by 5.6% from RMB107.3 million for the first quarter of 2004 to RMB113.3 million for the second quarter of 2004. As a percentage of revenues, profit for the period accounted for 41.7% for the first quarter of 2004 compared to 41.9% for the second quarter of 2004.

Six Months Ended 30 June 2004 Compared to Six Months Ended 30 June 2003

Revenues. Revenues increased RMB230.9 million, or 77.7% from RMB297.2 million for the six months ended 30 June 2003 to RMB528.1 million for the six months ended 30 June 2004, as a result of a significant increase in revenues from both Internet value-added services and mobile and telecommunications value-added services. The following table sets forth our revenues by lines of business for the six months ended 30 June 2003 and 2004:

	Six months ended 30 June 2003		2004	
	Amount	% of total revenues	Amount	% of total revenues
	(RMB in thousands)		(RMB in thousands)	
Internet value-added services	80,910	27.2%	204,499	38.7%
Mobile and telecommunications value-added services	199,383	67.1	298,871	56.6
Online advertising	15,347	5.2	21,062	4.0
Others	1,512	0.5	3,634	0.7
Total revenues	297,152	100.0%	528,066	100.0%

Revenues from our Internet value-added services increased RMB123.6 million, or 152.7%, from RMB80.9 million for the six months ended 30 June 2003 to RMB204.5 million for the six months ended 30 June 2004. The significant increase in revenues reflected the growth in our fee-based Internet value-added services from 5.4 million registered subscriptions as of 30 June 2003 to 6.9 million registered subscriptions as of 30 June 2004. Growth in our premium IM services, QQ Membership and QQ Xing, gained momentum in the second half of 2003 through various promotional activities. As our subscriber base grew, we were also able to increase revenues from our various community services and interactive entertainment, such as QQ Show for which we started charging fees in April 2003. The revenues from Internet value-added services for the six months ended 30 June 2004 also included several new products and services, such as E-Card and MMOG, for which we began charging fees subsequent to 30 June 2003.

Revenues from our mobile and telecommunications value-added services increased RMB99.5 million, or 49.9%, from RMB199.4 million for the six months ended 30 June 2003 to RMB298.9 million for the six months ended 30 June 2004. The increase in revenues reflected the growth in subscriptions for fee-based mobile and telecommunications value-added services provided directly by us or through mobile operators from 10.3 million registered subscriptions as of 30 June 2003 to 12.6 million registered subscriptions as of 30 June 2004. Revenues from 161 Mobile Chat, mobile news and information content services and our music and picture/image downloading services grew rapidly, while new revenues from newly launched services, such as mobile voice value-added services, contributed to the increased revenues. In addition, revenues from 2.5G-related services increased significantly due to the increased popularity of 2.5G services offered by mobile operators. Revenues from Mobile QQ subscriptions, however, declined in the six months ended 30 June 2004 compared to the same period of the previous year as a result of the “cleaning up” of inactive customer accounts undertaken by mobile operators.

Revenues from online advertising increased RMB5.8 million, or 37.2%, from RMB15.3 million for the six months ended 30 June 2003 to RMB21.1 million for the six months ended 30 June 2004. The increase in revenues reflected our growing customer base and our increased pricing, as our IM services and QQ.com portal attracted more users. Moreover, revenues from online advertising for the six months ended 30 June 2003 were negatively affected due to the outbreak of the SARS epidemic.

Revenues from our other businesses increased RMB2.1 million, or 140.3%, from RMB1.5 million for the six months ended 30 June 2003 to RMB3.6 million for the six months ended 30 June 2004. The increase mainly reflected sales of RTX which was commercially launched in September 2003.

Cost of revenues. Cost of revenues increased RMB99.7 million, or 113.6%, from RMB87.8 million in the six months ended 30 June 2003 to RMB187.5 million in the six months ended 30 June 2004. The increase principally reflected the increases in the amount of telecommunications operators’ revenue share and imbalance fees, bandwidth and server custody fees and staff costs directly attributable to our services and products. As a percentage of revenues, cost of revenues increased from 29.5% in the six months ended 30 June 2003 to 35.5% in the six months ended 30 June 2004 mainly due to the increase in the amount of imbalance fees as a result of the increased traffic imbalance as we undertook various promotional activities which involved the transmission of promotional messages to our subscribers. Staff costs also increased faster than our revenues as we expanded our product and service offerings. The following table sets forth our cost of revenues by lines of business for the six months ended 30 June 2003 and 2004:

	Six months ended 30 June 2003		2004	
	Amount	% of segment revenues	Amount	% of segment revenues
	(RMB in thousands)		(RMB in thousands)	
Internet value-added services	29,711	36.7%	66,736	32.6%
Mobile and telecommunications value-added services	53,763	27.0	108,101	36.2
Online advertising	4,034	26.3	7,193	34.2
Others	268	17.7	5,497	151.3
Total cost of revenues	87,776		187,527	

Cost of revenues for our Internet value-added services increased RMB37.0 million, or 124.6%, from RMB29.7 million for the six months ended 30 June 2003 to RMB66.7 million for the six months ended 30 June 2004. The amount of fees retained by mobile operators for their share of revenues increased as the fees collected through that channel continued to increase. In addition, as we expanded our subscriber base and as we offered an increasing variety of Internet value-added services, we had to increase the number of employees responsible for those services and also had to increase our bandwidth and server capacity.

Cost of revenues for our mobile and telecommunications value-added services increased RMB54.3 million, or 101.1% from RMB53.8 million for the six months ended 30 June 2003 to RMB108.1 million for the six months ended 30 June 2004. The increase mainly reflected the increase in the amount of fees retained by mobile operators for their share of revenues and imbalance fees. Imbalance fees grew as the traffic imbalance grew and as certain mobile operators increased the amount of imbalance fees. Staff costs also increased as we increased the number of staff to support our various new products and services.

Cost of revenues for our online advertising increased RMB3.2 million, or 78.3%, from RMB4.0 million for the six months ended 30 June 2003 to RMB7.2 million for the six months ended 30 June 2004. The increase mainly reflected the increased rate of sales commissions paid to advertising agencies as competition increased in order to obtain advertising contracts. In addition, as the technology employed for our online advertisements became more complex, we increased the number of development and technical staff and our bandwidth and server capacity.

Cost of revenues for our other businesses for the six months ended 30 June 2004 was RMB5.5 million compared to RMB0.3 million for the six months ended 30 June 2003. The increase mainly reflected the cost of sales, such as staff costs, related to RTX which was commercially launched in September 2003.

Selling and marketing expenses. Selling and marketing expenses increased RMB26.2 million, or 112.6%, from RMB23.3 million for the six months ended 30 June 2003 to RMB49.5 million for the six months ended 30 June 2004. The increase principally reflected increased promotional and advertising activities relating to the launch of and promotional efforts relating to several new products and new distribution channels, such as RTX, mobile voice value-added services and QQ Show. In addition, we incurred higher level of travel and entertainment costs relating to our marketing efforts as we participated in trade shows and exhibitions more actively.

General and administrative expenses. General and administrative expenses increased RMB23.2 million, or 59.3%, from RMB39.2 million for the six months ended 30 June 2003 to RMB62.4 million for the six months ended 30 June 2004. The increase primarily reflected the increase in research and development costs from RMB8.8 million for the six months ended 30 June 2003 to RMB20.7 million for the six months ended 30 June 2004 as a result of an increase in the number of research and development staff and technical personnel supporting our overall business. Staff cost also increased significantly as a result of a higher number of staff and salary increases. As a result of our Shenzhen office relocation in May 2004, we discontinued the high level of office maintenance expenses recorded at our previous office space.

Taxation. We recorded profit taxes of RMB10.0 million for the six months ended 30 June 2004 compared to RMB6.5 million for the six months ended 30 June 2003. The increase in profit taxes mainly reflected the increase in our profit before tax.

Profit for the period. As a result of the factors discussed above, profit for the period increased RMB81.0 million, or 58.1%, from RMB139.6 million for the six months ended 30 June 2003 to RMB220.6 million for the six months ended 30 June 2004. As a percentage of revenues, profit for the period accounted for 47.0% for the six months ended 30 June 2003, compared to 41.8% for the six months ended 30 June 2004.

Liquidity and Financial Resources

On 16 June 2004, a total of 420,160,500 shares of HK\$0.0001 per share were issued at HK\$3.70 each and were fully paid up in form of cash. Our financial position significantly improved in the six months ended 30 June 2004 as we received proceeds of RMB1,656.7 million from such issuance.

As of 30 June 2004, we had cash and cash equivalents of RMB1,950.7 million, compared to RMB325.6 million as of 31 December 2003. We had no interest-bearing borrowings as of 30 June 2004.

Business Outlook

We will continue to develop and deliver new value-added communications, community entertainment and information-based services and products to enrich the experience of our users and generate new sources of revenues.

In our Internet value-added services, we have released a new version of QQ2004 IM software client, bundling value-added services, such as avatars, e-mail, music, on-line games, network file folder, browser and enterprise IM software RTX. We will gradually introduce a charging model for QQ games portal and launch more casual games and expand online music by providing a rich collection of song and music titles on QQ music channel. In our mobile and telecommunications value-added services, we will continue to develop new products and utilize content from QQ.com portal in pace with the migration to 2.5G platform. With the rapid growth of online advertising in China, we will also leverage our QQ.com portal to drive and tap future market growth.

In addition, we will seek to diversify our billing and collection channels and look for an enhancement in our existing payment channels.

We will continue to explore any strategic acquisition that is complementary to our existing business and can be integrated into our service platforms.

We are confident that with our large user community, our ability to deliver innovative services and products to our user base and our healthy financial position, the Company is on track to achieve its financial targets for the year.

Other Information

Post Balance Sheet Event

On 8 July 2004, a total of 63,024,000 additional shares (the “Over-allotment Shares”) were issued after the exercise of an over-allotment option in full by Goldman Sachs (Asia) L.L.C. on behalf of the International Purchasers, and the Company received additional gross proceeds of approximately RMB249 million from the issue of the Over-allotment Shares and, as stated in the Prospectus, such proceeds may be used as additional working capital.

Employee and Remuneration Policies

As at 30 June 2004, the Group had 804 employees (2003:383), most of whom are based in the head office of the Group in Shenzhen, the PRC. The number of workers employed by the Group varies from time to time depending on needs and they are remunerated based on industry practice.

The remuneration policy and package of the Group’s employees are periodically reviewed. Apart from social insurance and in-house training programmes, discretionary bonuses and share options may be awarded to employees according to the assessment of individual performance.

The total remuneration cost incurred by the Group for the six months ended 30 June 2004 was RMB65 million (2003: RMB28 million).

Purchase, Sale or Redemption of the Company’s Listed Securities

During the six months ended 30 June 2004, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company’s listed securities.

Corporate governance

The Audit Committee of the Company, comprising two independent non-executive directors and one non-executive director, has reviewed the accounting principles and practices adopted by the Company and discussed auditing, internal control and financial reporting matters. The Audit Committee, together with the Auditors, has reviewed the Group’s unaudited interim financial statements for the three and six months ended 30 June 2004 and endorses the accounting treatment adopted by the Company.

Compliance with the Code of Best Practice

None of the directors of the Company is aware of any information which would reasonably indicate that the Company is not, or was not, for any part of the six months ended 30 June 2004 since listing, in compliance with the Code of Best Practice as set out in Appendix 14 to the Listing Rules.

Appreciation

The dedication of the management and staff of the Group is an important ingredient necessary to meet the challenges and opportunities ahead. We would like to take this opportunity to record our cordial thanks to them all.

By Order of the Board  
Ma Huateng  
Chairman

Hong Kong, 19 August 2004

As at the date of this announcement, the Directors of the Company are Ma Huateng, Zhang Zhidong, Antonie Andries Roux, Charles Si Leger Searle, Li Dong Sheng, Iain Ferguson Bruce and Ian Charles Stone.

This announcement contains forward-looking statements relating to the business outlook, forecast business plans and growth strategies of the Group. These forward-looking statements are based on information currently available to the Group and are stated herein on the basis of the outlook at the time of this announcement. They are based on certain expectations, assumptions and premises, some of which are subjective or beyond our control. The forward-looking statements may prove to be incorrect and may not be realized in future. Underlying the forward-looking statements are a large number of risks and uncertainties. Further information regarding these risks and uncertainties is included in our other public disclosure documents.