

Tencent 腾讯
TENCENT HOLDINGS LIMITED
騰訊控股有限公司
(Incorporated in the Cayman Islands with limited liability)
(Stock Code: 700)

ANNOUNCEMENT OF THE INTERIM RESULTS FOR 2005

The Board of Directors (the “Board”) of Tencent Holdings Limited (the “Company”) is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (collectively, the “Group”) for the three and six months ended 30 June 2005. These interim results have been reviewed by PricewaterhouseCoopers, the auditors of the Company (the “Auditors”), in accordance with the International Standard on Review Engagements 2400 “Engagements to review financial statements” issued by the International Auditing and Assurance Standards Board, and by the Audit Committee of the Company, comprising a majority of the independent non-executive directors of the Company.

CONDENSED CONSOLIDATED BALANCE SHEETS
AS AT 30 JUNE 2005 AND 31 DECEMBER 2004

		Audited (as restated) (Note) 31 December 2004 RMB'000	Unaudited 30 June 2005 RMB'000	
	Note			
ASSETS				
Non-current assets				
Fixed assets		142,080	190,653	
Intangible assets		–	18,055	
Held-to-maturity investments		167,374	167,358	
Deferred tax assets	5	–	86,748	
		309,454	462,814	
Current assets				
Accounts receivable		192,725	232,358	
Prepayments, deposits and other receivables		50,347	32,910	
Financial assets held for trading		666,900	675,200	
Term deposits with initial term of over three months		784,054	547,459	
Cash and cash equivalents		859,841	1,124,492	
		2,553,867	2,612,419	
Total Assets		2,863,321	3,075,233	
EQUITY				
Shareholders' equity				
Share capital		192	193	
Share premium		1,777,721	1,781,904	
Share-based compensation reserve	1	5,583	15,426	
Other reserves		52,442	66,609	
Retained earnings		816,300	954,024	
		2,652,238	2,818,156	
LIABILITIES				
Non-current liabilities				
Deferred tax liabilities		–	358	
Current liabilities				
Accounts payable		2,506	1,401	
Other payables and accruals		79,912	110,006	
Dividends payable		145	–	
Current income tax liabilities		5,648	18,119	
Other tax liabilities		59,650	13,269	
Deferred revenue		63,222	113,924	
		211,083	256,719	
Total Liabilities		211,083	257,077	
Total Equity and Liabilities		2,863,321	3,075,233	

Note: The retained earnings and share-based compensation reserve as at 31 December 2004 have been restated as a result of the adoption of IFRS 2 (issued 2004), “Share-based Payment” (see Note 1.1).

CONDENSED CONSOLIDATED INCOME STATEMENTS
FOR THE THREE AND SIX MONTHS ENDED 30 JUNE 2005

		Unaudited Three months ended 30 June 2005 RMB'000	(as restated) (Note) 2004 RMB'000	Unaudited Six months ended 30 June 2005 RMB'000	(as restated) (Note) 2004 RMB'000
	Note				
Revenues					
Internet value-added services		169,883	99,913	318,947	204,499
Mobile and telecommunications value-added services		136,498	156,054	270,769	298,871
Online advertising		25,170	12,847	40,463	21,062
Others		2,114	1,699	3,957	3,634
		333,665	270,513	634,136	528,066
Cost of revenues		(108,963)	(100,652)	(210,891)	(188,315)
Gross profit		224,702	169,861	423,245	339,751
Other gains, net		15,148	1,061	27,053	1,928
Selling and marketing expenses		(45,501)	(26,773)	(84,014)	(50,005)
General and administrative expenses		(75,596)	(28,957)	(144,122)	(63,436)
Operating profit		118,753	115,192	222,162	228,238
Finance (costs)/income, net		(51)	(18)	(166)	108
Profit before income tax		118,702	115,174	221,996	228,346
Income tax benefit/(expenses)	5	68,271	(3,293)	61,931	(10,005)
Profit for the period		186,973	111,881	283,927	218,341
Earnings per share for profit attributable to the equity holders of the Company during the period (expressed in RMB per share)					
- basic	6	0.106	0.084	0.161	0.169
- diluted	6	0.103	0.083	0.156	0.168

Note: The cost of revenues, selling and marketing expenses and general and administrative expenses for the three and six months ended 30 June 2004 have been restated as a result of the adoption of IFRS 2 (issued 2004), “Share-based Payment” (see Note 1.1).

NOTES

1 Summary of significant accounting policies

1.1 General information, basis of preparation and presentation

The Company was incorporated in the Cayman Islands. The shares of the Company have been listed on the Main Board of The Stock Exchange of Hong Kong Limited since 16 June 2004.

The Company is an investment holding company. The Company and its subsidiaries (collectively the “Group”) are principally engaged in the provision of Internet and mobile value-added services and online advertising services to users in the People's Republic of China (the “PRC”).

The condensed consolidated balance sheet as at 30 June 2005 and condensed consolidated income statements for the three and six months ended 30 June 2005 (collectively defined as “Interim Financial Information”) of the Group are prepared in accordance with International Accounting Standard (“IAS”) 34, “Interim Financial Reporting” issued by the International Accounting Standards Board.

The Interim Financial Information should be read in conjunction with the Auditors' report on the audited consolidated financial statements of the Group for the year ended 31 December 2004 (the “2004 Financial Statements”) as set out in the 2004 annual report of the Company dated 17 March 2005.

Except for those mentioned below, the accounting policies and method of computation used in the preparation of this Interim Financial Information are consistent with those used in the 2004 Financial Statements, which have been prepared in accordance with International Financial Reporting Standards (“IFRS”) under the historical cost convention, as modified by the revaluation of financial assets at fair value through the income statement.

In 2005, the Group adopted the following revised and newly released IFRS which should be applied for periods beginning on or after 1 January 2005 and are relevant to its operations. The 2004 Financial Statements have been restated as required, in accordance with the relevant requirements.

IAS 1 (revised 2003), Presentation of Financial Statements
IAS 8 (revised 2003), Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10 (revised 2003), Events after the Balance Sheet Date
IAS 16 (revised 2003), Property, Plant and Equipment
IAS 17 (revised 2003), Leases
IAS 21 (revised 2003), The Effects of Changes in Foreign Exchange Rates
IAS 24 (revised 2003), Related Party Disclosures
IAS 27 (revised 2003), Consolidated and Separate Financial Statements
IAS 32 (revised 2003), Financial Instruments: Disclosure and Presentation
IAS 33 (revised 2003), Earnings per Share
IAS 38 (revised 2004), Intangible Assets
IAS 39 (revised 2003), Financial Instruments: Recognition and Measurement
IFRS 2 (issued 2004), Share-based Payment

The adoption of IAS 1, 8, 10, 16, 17, 21, 24, 27, 32, 33 and 39 (all revised in 2003) did not result in substantial changes to the Group's accounting policies. The adoption of IAS 38 formed the accounting policy for intangible assets recognised by the Group in the current period (see Note 1.3).

The adoption of IFRS 2 has resulted in a change in the accounting policy for share-based payment. Prior to this, the provision of share options to employees did not result in a charge in the income statement. Subsequent to the adoption of IFRS 2, the Group charges the cost of share options to the income statement (see Note 1.2).

The adoption of IFRS 2 requires retrospective application of all the share options granted to employees after 7 November 2002 and not vested as at 1 January 2005 which has resulted in the following:

	Three months ended 30 June 2005 RMB'000		2004 RMB'000	Six months ended 30 June 2005 RMB'000		2004 RMB'000
Increase in share-based compensation reserve	5,306		1,408	15,426		2,252
Decrease in retained earnings brought forward as previously reported	–		–	5,583		–
Increase in cost of revenues	1,146		493	2,220		788
Increase in selling and marketing expenses	915		308	1,801		496
Increase in general and administrative expenses	3,245		607	5,822		968
Decrease in basic earnings per share	RMB0.0030		RMB0.0011	RMB0.0056		RMB0.0017
Decrease in diluted earnings per share	RMB0.0029		RMB0.0011	RMB0.0054		RMB0.0017

1.2 Share-based compensation

The fair value of the employee services received in exchange for the grant of options is recognised as an expense. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted by using an option-pricing model, excluding the impact of any non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the Company revises its estimate of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

1.3 Intangible assets

Intangible assets mainly include non-compete agreement and computer software and technology acquired from a third party company (the “Vendor”). They are initially recognised at their respective fair values by allocating the total purchase consideration paid to the Vendor as ascertained by a third party professional valuer. Intangible assets other than goodwill are amortised on a straight-line basis over their estimated useful lives of three to five years.

2 Segment information

Business segment is the Group's primary basis of segment reporting. The business segment information of the Group for the three months and six months ended 30 June 2005 and 2004 are presented as follows:

	Unaudited Three months ended 30 June 2005				
	Internet value-added services RMB'000	Mobile and telecommunications value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
Revenues	169,883	136,498	25,170	2,114	333,665
Gross profit/(loss)	117,108	89,963	18,357	(726)	224,702
Other gains, net				15,148	
Selling and marketing expenses				(45,501)	
General and administrative expenses				(75,596)	
Operating profit				118,753	
Finance costs, net				(51)	
Profit before income tax				118,702	
Income tax benefit				68,271	
Profit for the period				186,973	

	Unaudited (as restated) Three months ended 30 June 2004				
	Internet value-added services RMB'000	Mobile and telecommunications value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
Revenues	99,913	156,054	12,847	1,699	270,513
Gross profit/(loss)	65,793	95,955	9,484	(1,371)	169,861
Other gains, net					1,061
Selling and marketing expenses					(26,773)
General and administrative expenses					(28,957)
Operating profit					115,192
Finance cost, net					(18)
Profit before income tax					115,174
Income tax expenses					(3,293)
Profit for the period					111,881

	Unaudited Six months ended 30 June 2005				
	Internet value-added services RMB'000	Mobile and telecommunications value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
Revenues	318,947	270,769	40,463	3,957	634,136
Gross profit/(loss)	223,595	174,168	27,665	(2,183)	423,245
Other gains, net					27,053
Selling and marketing expenses					(84,014)
General and administrative expenses					(144,122)
Operating profit					222,162
Finance costs, net					(166)
Profit before income tax					221,996
Income tax benefit					61,931
Profit for the period					283,927

	Unaudited (as restated) Six months ended 30 June 2004				
	Internet value-added services RMB'000	Mobile and telecommunications value-added services RMB'000	Online advertising RMB'000	Others RMB'000	Total RMB'000
Revenues	204,499	298,871	21,062	3,634	528,066
Gross profit/(loss)	137,649	190,348	13,824	(2,070)	339,751
Other gains, net					1,928
Selling and marketing expenses					(50,005)
General and administrative expenses					(63,436)
Operating profit					228,238
Finance income, net					108
Profit before income tax					228,346
Income tax expenses					(10,005)
Profit for the period					218,341

The Group mainly operates its businesses in the PRC (excluding Hong Kong) and the respective assets are located in the PRC. The Group also holds certain financial assets as investments which are traded in other territories.

3 Share option schemes

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

(i) Pre-IPO Share Option Scheme (the “Pre-IPO Option Scheme”)

Under the Pre-IPO Option Scheme, the Board granted 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 were granted under the Pre-IPO Option Scheme was not permitted to exceed 7.5% of the shares in issue on the date the offer of the grant of an option was made. The number of ordinary shares in respect of which options were granted to any individual was not permitted to exceed 10% of the number of ordinary shares issued and issuable under the scheme. Options granted had to be taken up within 15 days of the date of grant, upon payment of RMB1 per grant. As at the effective date of the IPO of the Company on 16 June 2004, all options under this scheme had been granted.

The options vest in four equal tranches either after the expiration of a 12-month, 24-month, 36-month and 48-month period beginning on the date of the grant, respectively, or after the expiration of a 24-month, 36-month, 48-month and 60-month period beginning from the commencement date of employment, respectively. All the options are exercisable in installments from the commencement of the relevant vesting period until 31 December 2011.

In the event of any alterations made to the capital structure of the Company whilst any options granted remain 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 species) 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.

(ii)

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 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 pursuant to the terms of the Post-IPO Option Scheme.

The options vest in four equal tranches either after the expiration of a 12-month, 24-month, 36-month and 48-month period beginning on the date of the grant, respectively, or after the expiration of a 24-month, 36-month, 48-month and 60-month period beginning from the commencement date of employment, respectively. The Post-IPO Option Scheme will remain in force for a period of ten years, commencing on the adoption date.

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 at the date of the IPO of the Company.

4

Expenses by nature

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	(as restated)		(as restated)	
	2005	2004	2005	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Employee benefits expenses (Note)	72,278	34,094	134,099	67,216
Mobile and telecom charges and bandwidth and server custody fees	66,101	77,641	132,916	143,918
Promotion and advertising expenses	22,062	13,117	39,647	24,975
Travelling and entertainment expenses	12,361	7,598	22,739	13,586
Depreciation of fixed assets (Note)	11,372	6,454	21,375	12,185
Amortisation of intangible assets	352	–	352	–
Operating lease rentals in respect of office buildings	6,717	2,827	12,074	5,724
Value-added tax paid upon transfer of software within the Group	–	3,300	–	5,402
Other expenses	38,817	11,351	75,825	28,750
Total cost of revenues, selling and marketing expenses and general and administrative expenses	230,060	156,382	439,027	301,756

Note: Research and development expenses were RMB32,527,000(for the three months ended 30 June 2004: RMB8,075,000) and RMB59,092,000 (for the six months ended 30 June 2004: RMB20,714,000) for the three and six months ended 30 June 2005, respectively. The expenses included employee benefit expenses and depreciation totalling RMB30,933,000 (for the three months ended 30 June 2004: RMB7,059,000) and RMB56,491,000 (for the six months ended 30 June 2004: RMB13,244,000) for the three and six months ended 30 June 2005, respectively.

The Group did not capitalise any research and development expenses for such periods.

5

Tax expenses

(a)

Income tax

(i)

Cayman Islands and British Virgin Islands Profits Tax

The Group has not been subject to any taxation in these jurisdictions for the six months ended 30 June 2005 and 2004, respectively.

(ii)

Hong Kong Profits Tax

No Hong Kong profits tax has been provided as the Group has no assessable profit arising in Hong Kong for the six months ended 30 June 2005 and 2004, respectively.

(iii)

PRC Enterprise Income Tax

PRC Enterprise Income Tax (“EIT”) is provided on the assessable income of entities within the Group incorporated in the PRC for the six months ended 30 June 2005 and 2004, respectively, calculated in accordance with the relevant regulations of the PRC after considering the available tax benefits from refunds and allowances.

There are five direct and indirect subsidiaries of the Company in the PRC, namely, Shenzhen Tencent Computer Systems Company Limited (“Tencent Computer”), Tencent Technology (Shenzhen) Company Limited (“Tencent Technology”), Shiji Kaixuan Technology Company Limited, Shidai Zhaoyang Technology (Shenzhen) Company Limited and Tencent Technology (Beijing) Company Limited. The applicable EIT tax rates applicable to these five companies for the three and six months ended 30 June 2005 range from 0% to 15%.

The taxation charges of the Group for the three months and six months ended 30 June 2005 are analysed as follows:

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	(as restated)		(as restated)	
	2005	2004	2005	2004
	RMB'000	RMB'000	RMB'000	RMB'000
PRC current tax	18,119	4,644	24,459	10,993
Deferred tax	(86,390)	(1,351)	(86,390)	(988)
	(68,271)	3,293	(61,931)	10,005

The tax on the Group’s profit before income tax differs from the theoretical amount that would arise using the tax rate of 15%, the tax rate enacted in Shenzhen, the PRC, where the principal activities of the Group are conducted. The difference is analysed as follows:

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	(as restated)		(as restated)	
	2005	2004	2005	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Profit before income tax	118,702	115,174	221,996	228,346
Tax calculated at a tax rate of 15%	17,805	17,276	33,299	34,252
Effects of different tax rates available to different companies of the Group	(1,497)	–	(2,953)	–
Effects of tax holiday on assessable profit of subsidiaries	3,097	(30,912)	(979)	(52,258)
Expenses not deductible for tax purposes	794	441	1,452	920
Utilisation of previously unrecognised tax assets/deferred tax assets not recognised	(1,091)	16,667	(6,760)	26,795
Recognition of previously unrecognised deferred tax assets (Note)	(88,638)	–	(88,638)	–
Utilisation of previously unrecognised tax losses	–	(230)	–	(230)
Unrecognised tax losses	1,259	51	2,648	526
Tax (credit)/charge	(68,271)	3,293	(61,931)	10,005

Note: Certain intragroup software sales have been transacted within the Group. The costs of the self-developed software purchased have been amortised by a group company, Tencent Computer, over their contracted useful lives (the “Amortisation”). The Amortisation has been allowed as a deductible expense in ascertaining the assessable profits and income tax of Tencent Computer (“Tax Deduction Claim”). These have given rise to a potential temporary difference between the accounting base (which is zero) and the tax base (which is the unamortised net book value of these software) of the amounts of software sold in these transactions. In prior periods, no deferred tax assets arising from this potential temporary difference were recognised because there was no reasonable certainty that Tencent Computer would obtain the approval from the local tax bureau for the Tax Deduction Claim. On 8 June 2005, a formal approval document, Shendishuierhan 2005 No.99, was issued by the local tax bureau and deferred tax assets of approximately RMB88,638,000 was recognised by the Group. The amount was calculated based on the unamortised net book value of the software recorded by Tencent Computer at approximately RMB590,918,000 and the enacted EIT rate for enterprises in Shenzhen of the PRC at 15%.

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<i>Revenues.</i> Revenues increased by 20.1% to RMB634.1 million for the first half of 2005 from RMB528.1 million for the first half of 2004.				
	Six months ended 30 June			
	2005		2004	
	Amount	% of total revenues	Amount	% of total revenues
	(RMB in thousands, except percentages)			
Internet value-added services	318,947	50.3%	204,499	38.7%
Mobile and telecommunications value-added services	270,769	42.7%	298,871	56.6%
Online advertising	40,463	6.4%	21,062	4.0%
Others	3,957	0.6%	3,634	0.7%
Total revenues	<u>634,136</u>	<u>100.0%</u>	<u>528,066</u>	<u>100.0%</u>
<i>Cost of revenues.</i> Cost of revenues increased by 12.0% to RMB210.9 million for the first half of 2005 from RMB188.3 million for the first half of 2004.				
	Six months ended 30 June			
	2005		2004	
	Amount	% of segment revenues	Amount	% of segment revenues
	(RMB in thousands, except percentages)			
Internet value-added services	95,352	29.9%	66,850	32.7%
Mobile and telecommunications value-added services	96,601	35.7%	108,523	36.3%
Online advertising	12,798	31.6%	7,238	34.4%
Others	6,140	155.2%	5,704	157.0%
Total cost of revenues	<u>210,891</u>		<u>188,315</u>	
<i>Second Quarter of 2005</i>				
Our unaudited consolidated revenues for the second quarter of 2005 were RMB333.7 million, an increase of 23.3% over the same period in 2004 and an increase of 11.0% quarter on quarter.				
Operating profit for the second quarter of 2005 was RMB118.8 million, representing an increase of 3.1% over the same period in 2004 and an increase of 14.8% quarter on quarter.				
Profit for the second quarter of 2005 was RMB187.0 million, representing an increase of 67.1% from the same period in 2004 and an increase of 92.8% quarter on quarter. As a percentage of revenues, profit for the period accounted for 56.0% for the second quarter of 2005, compared to 41.4% for the same period of 2004 and 32.3% for the first quarter of 2005.				
Management Discussion and Analysis				
<i>Effective 1 January 2005, we have adopted International Financial Reporting Standard (IFRS) 2 “Share-based Payment” which resulted in a change in our accounting policy with respect to share option grants made to employees. The adoption of IFRS 2 requires a retrospective adjustment to the financial information for 2004. Accordingly, our financial information for the second quarter of 2004 set forth below has been restated.</i>				
<i>Second Quarter of 2005 Compared to First Quarter of 2005</i>				
The following table sets forth the comparative figures for second quarter of 2005 and the first quarter of 2005:				
	Unaudited Three months ended			
	30 June 2005		31 March 2005	
	(RMB in thousands)			
Revenues	333,665		300,471	
Cost of revenues	<u>(108,963)</u>		<u>(101,928)</u>	
Gross profit	224,702		198,543	
Other gains, net	15,148		11,905	
Selling and marketing expenses	<u>(45,501)</u>		<u>(38,513)</u>	
General and administrative expenses	<u>(75,596)</u>		<u>(68,526)</u>	
Operating profit	118,753		103,409	
Finance costs, net	<u>(51)</u>		<u>(115)</u>	
Profit before income tax	118,702		103,294	
Income tax benefit/(expenses)	<u>68,271</u>		<u>(6,340)</u>	
Profit for the period	<u>186,973</u>		<u>96,954</u>	
<i>Revenues.</i> Revenues increased by 11.0% to RMB333.7 million for the second quarter of 2005 from RMB300.5 million for the first quarter of 2005. The following table sets forth our revenues by line of business for the second quarter of 2005 and the first quarter of 2005:				
	Three months ended			
	30 June 2005		31 March 2005	
	Amount	% of total revenues	Amount	% of total revenues
	(RMB in thousands, except percentages)			
Internet value-added services	169,883	50.9%	149,064	49.6%
Mobile and telecommunications value-added services	136,498	40.9%	134,271	44.7%
Online advertising	25,170	7.6%	15,293	5.1%
Others	2,114	0.6%	1,843	0.6%
Total revenues	<u>333,665</u>	<u>100.0%</u>	<u>300,471</u>	<u>100.0%</u>
Revenues from our Internet value-added services increased by 14.0% to RMB169.9 million for the second quarter of 2005 from RMB149.1 million for the first quarter of 2005. The increase mainly reflected the continuing success of our online identity business, the significant growth of Premium QQ offered through fixed-line operators’ channels and the growth in our online games. Revenues from fairly new services, such as our online reminder service and personalized icon services, also contributed to the increase in revenues.				
Revenues from our mobile and telecommunications value-added services increased by 1.7% to RMB136.5 million for the second quarter of 2005 from RMB134.3 million for the first quarter of 2005. Revenues from ringback tones and mobile IVR increased significantly in the second quarter of 2005 due to an overall growth in popularity of these services. The increase, however, was partially offset by the continuing decline in revenues relating to our mobile communication-based and content-based SMS services. In addition, the continuing “cleaning up” of customer accounts undertaken by the mobile operators negatively affected our revenues derived from mobile and telecommunications value-added services. In the second quarter of 2005, we were in the final stages of winding-down the settlement of fees relating to the 161 Mobile Chat arrangement with China Mobile, which was terminated in late 2004.				
Revenues from online advertising increased by 64.6% to RMB25.2 million for the second quarter of 2005 from RMB15.3 million for the first quarter of 2005. The change was mainly attributable to the seasonal pick-up of our online advertising business and increased marketing of our advertising services. The increase in revenues also reflected some new advertising revenues relating to the Internet searching functions that we initiated in early 2005.				
<i>Cost of revenues.</i> Cost of revenues increased by 6.9% to RMB109.0 million for the second quarter of 2005 from RMB101.9 million for the first quarter of 2005. The increase principally reflected the increase in content costs and bandwidth and server custody fees as we offered richer content and a broader range of products and services. On the other hand, telecommunications operators’ revenue share and imbalance fees decreased as we finalized the settlement of our fee sharing arrangements with certain provincial operators of China Mobile relating to 161 Mobile Chat, which was terminated in late 2004. As a percentage of revenues, cost				

of revenues decreased to 32.7% in the second quarter of 2005 from 33.9% in the first quarter of 2005. The following table sets forth our cost of revenues by line of business for the second quarter of 2005 and the first quarter of 2005:

	Three months ended			
	30 June 2005		31 March 2005	
	Amount	% of segment revenues	Amount	% of segment revenues
		(RMB in thousands, except percentages)		(RMB in thousands, except percentages)
Internet value-added services	52,775	31.1%	42,577	28.6%
Mobile and telecommunications value-added services	46,535	34.1%	50,066	37.3%
Online advertising	6,813	27.1%	5,985	39.1%
Others	2,840	134.3%	3,300	179.1%
Total cost of revenues	108,963		101,928	

Cost of revenues for our Internet value-added services increased by 24.0% to RMB52.8 million for the second quarter of 2005 from RMB42.6 million for the first quarter of 2005. The increase mainly reflected the increased content costs relating to our expanded content offerings and the higher expenses associated with our bandwidth capacity and servers as we supported more bandwidth intensive services. As the volume of our Internet value-added services increased, we also recognized higher amounts of telecommunications operators' revenue share and higher revenue sharing costs through our mobile collection channels. In addition, staff costs increased as we continued to recruit additional staff to develop and support new products and services.

Cost of revenues for our mobile and telecommunications value-added services decreased by 7.1% to RMB46.5 million for the second quarter of 2005 from RMB50.1 million for the first quarter of 2005. The decrease mainly reflected the lower amount of fees retained by mobile operators for their share of revenues as we finalized the settlement of our fee sharing arrangement with certain provincial operators of China Mobile relating to the 161 Mobile Chat, which was terminated in late 2004. The decrease also reflected the decline in MMS related sharing costs as China Mobile's change in MMS billing policy significantly reduced our revenues derived from such services. The decrease was partially offset by increased staff costs and content costs as we offered a broader range of products.

Cost of revenues for our online advertising increased by 13.8% to RMB6.8 million for the second quarter of 2005 from RMB6.0 million for the first quarter of 2005. The increase mainly reflects additional expenses incurred to offer Internet searching functions beginning in early 2005 in order to create a new source of advertising revenues. In addition, the amount of sales commission paid to advertising agencies increased as we had more online advertising business volume.

Other gains, net. Other gains reflects primarily the interest income generated from bank deposits and other interest-earning financial assets and fair value gains on financial instruments. Other gains increased by 27.2% to RMB15.1 million for the second quarter of 2005 from RMB11.9 million for the first quarter of 2005. Interest income for the second quarter of 2005 was higher due to the increase in interest rates, particularly for U.S. dollars denominated investments.

Selling and marketing expenses. Selling and marketing expenses increased by 18.1% to RMB45.5 million for the second quarter of 2005 from RMB38.5 million for the first quarter of 2005. The increase principally reflected higher promotional and advertising expenses and related staff costs and travel and entertainment costs. These expenses were incurred in order to further enhance our strong brand recognition, to diversify and explore new collection channels, and to launch new value-added Internet services and products. We also incurred higher expenses to improve our customer care services. As a percentage of revenues, selling and marketing expenses increased to 13.6% in the second quarter of 2005 from 12.8% in the first quarter of 2005.

General and administrative expenses. General and administrative expenses increased by 10.3% to RMB75.6 million for the second quarter of 2005 from RMB68.5 million for the first quarter of 2005. The increase was mainly attributable to increased strategic research and development investments in key technologies, including IM functionalities, online games and our web portals. We also incurred increased professional consulting fees relating to areas such as human resources consulting and tax consulting. As a percentage of revenues, general and administrative expenses decreased to 22.7% in the second quarter of 2005 from 22.8% in the first quarter of 2005.

Income tax benefit/(expenses). We recorded a net tax credit of RMB68.3 million for the second quarter of 2005 compared to income tax expenses of RMB6.3 million for the first quarter of 2005. Since 2003, Tencent Technology has been selling self-developed software to Tencent Computer under our structural contracts. The cost of the software, which is amortized as expenses at Tencent Computer over its estimated contractual useful lives, might be allowed for income tax deduction claims in ascertaining the assessable profits of Tencent Computer. As a result, these intra-group arrangements had given rise to a potential temporary difference between the accounting base in our consolidated financial statements and the tax base in the financial statements of Tencent Computer. During the second quarter of 2005, Tencent Computer had obtained the necessary approval from the local tax bureau in relation to the deduction claim, and as a result, Tencent Computer recognized related potential deferred tax assets of RMB88.6 million.

Profit for the period. As a result of the factors discussed above, profit for the period increased by 92.8% to RMB187.0 million for the second quarter of 2005 from RMB97.0 million for the first quarter of 2005. Net margin for the period was 56.0% for the second quarter of 2005 compared to 32.3% for the first quarter of 2005.

Second Quarter of 2005 Compared to Second Quarter of 2004

The following table sets forth the comparative figures for the second quarter of 2005 and the second quarter of 2004:

	Unaudited			
	Three months ended 30 June 2005		2004	
	Amount	% of total revenues	Amount	% of total revenues
		(RMB in thousands)		(Restated*)
Revenues	333,665		270,513	
Cost of revenues	108,963		(100,652)	
Gross profit	224,702		169,861	
Other gains, net	15,148		1,061	
Selling and marketing expenses	(45,501)		(26,773)	
General and administrative expenses	(75,596)		(28,957)	
Operating profit	118,753		115,192	
Finance (costs)/income, net	(51)		(18)	
Profit before income tax	118,702		115,174	
Income tax benefit/(expenses)	68,271		(3,293)	
Profit for the period	186,973		111,881	

* The adoption of IFRS 2 requires retrospective application to all share options granted to employees after 7 November 2002 and not vested as at 1 January 2005. As a result, profit for the three months ended 30 June 2004 was reduced by RMB1.4 million.

Revenues. Revenues increased by 23.3% to RMB333.7 million for the second quarter of 2005 from RMB270.5 million for the second quarter of 2004, as a result of significant increase in revenues from Internet value-added services and online advertising. The increase, however, was partially offset by the decrease in revenues from mobile and telecommunications value-added services. The following table sets forth our revenues by line of business for the second quarter of 2005 and the second quarter of 2004:

	Three months ended 30 June			
	2005		2004	
	Amount	% of total revenues	Amount	% of total revenues
		(RMB in thousands, except percentages)		(RMB in thousands, except percentages)
Internet value-added services	169,883	50.9%	99,913	36.9%
Mobile and telecommunications value-added services	136,498	40.9%	156,054	57.7%
Online advertising	25,170	7.6%	12,847	4.8%
Others	2,114	0.6%	1,699	0.6%
Total revenues	333,665	100.0%	270,513	100.0%

Revenues from our Internet value-added services increased by 70.0% to RMB169.9 million for the second quarter of 2005 from RMB99.9 million for the second quarter of 2004. Revenues from our various community services and interactive entertainment, in particular avatars and online games, increased significantly as user adoption grew. Several new products and services, such as our online reminder and online hard disk services, also contributed to the increase in revenues derived from Internet value-added services. These increases were slightly offset by a slight decrease in revenues collected through mobile operators, a decrease in revenues from our more mature products and a decrease in revenues from some of our services that faced significant competition such as online dating.

Revenues from our mobile and telecommunications value-added services decreased by 12.5% to RMB136.5 million for the second quarter of 2005 from RMB156.1 million for the second quarter of 2004. The continuing "cleaning up" of customer accounts undertaken by the mobile operators and the termination of the 161 Mobile Chat fee sharing arrangement with China Mobile had led to revenue decline. These decreases were partially offset by an increase in revenues from mobile voice value-added services, comprising ringback tones and mobile IVR. Although revenues derived from MMS declined due to China Mobile's change in its billing policy, revenues from other 2.5G-related services increased due to the increased popularity of 2.5G services offered by mobile operators.

Revenues from online advertising increased by 95.9% to RMB25.2 million for the second quarter of 2005 from RMB12.8 million for the second quarter of 2004. The increase in revenues reflected our growing customer base and some new advertising revenues relating to the Internet searching functions that we initiated in early 2005. In addition, our QQ.com portal started to generate more revenues.

Cost of revenues. Cost of revenues increased by 8.3% to RMB109.0 million for the second quarter of 2005 from RMB100.7 million for the second quarter of 2004. The increase principally reflected the increased bandwidth and server custody fees as we supported more bandwidth intensive services, and the increased content costs as we offered richer content. In addition, staff costs increased as we increased the number of employees to support our various services and products. These increases were partially offset by the lower telecommunications operators' revenue share and imbalance fees due to the diversification of some of our fee collection channels into non-mobile based channels and due to the termination of the 161 Mobile Chat fee sharing arrangement with China Mobile, which had a comparatively high revenue sharing ratio than our other services. As a percentage of revenues, cost of revenues decreased to 32.7% in the second quarter of 2005 from 37.2% in the second quarter of 2004. The following table sets forth our cost of revenues by line of business for the second quarter of 2005 and the second quarter of 2004:

	Three months ended 30 June			
	2005		2004	
	Amount	% of segment revenues	Amount	% of segment revenues
		(RMB in thousands, except percentages)		(RMB in thousands, except percentages)
Internet value-added services	52,775	31.1%	34,120	34.1%
Mobile and telecommunications value-added services	46,535	34.1%	60,099	38.5%
Online advertising	6,813	27.1%	3,363	26.2%
Others	2,840	134.3%	3,070	180.7%
Total cost of revenues	108,963		100,652	

Cost of revenues for our Internet value-added services increased by 54.7% to RMB52.8 million for the second quarter of 2005 from RMB34.1million for the second quarter of 2004. The increase mainly reflected expenses incurred to support more bandwidth intensive services, and increased content costs associated with the offering of richer content services such as our music offerings. In addition, staff costs to support our growing range of Internet value-added services increased. These increases were partially offset by a decrease in the amount of fees retained by mobile operators for their share of revenues and imbalance fees as a result of a gradual diversification of some of our collection channels into non-mobile based channels.

Cost of revenues for our mobile and telecommunications value-added services decreased by 22.6% to RMB46.5 million for the second quarter of 2005 from RMB60.1 million for the second quarter of 2004. The decrease mainly reflected the significant decrease in fees retained by mobile operators for their share of revenues and imbalance fees due to the termination of the 161 Mobile Chat fee sharing arrangement with China Mobile, which had a comparatively high revenue sharing ratio than our other services. The decrease was partially offset by an increase in content fees as we enriched our content and an increase in staff costs as we increased the number of staff to support our various new products and services.

Cost of revenues for our online advertising increased by 102.6% to RMB6.8 million for the second quarter of 2005 from RMB3.4 million for the second quarter of 2004. The increase mainly reflected the increased sales commissions paid to advertising agencies and increased bandwidth charges as the volume of our advertising contracts increased. In addition, we increased the number of staff to drive the growth of our online advertising business, and newly incurred expenses to offer Internet searching functions beginning in early 2005 in order to create a new source of advertising revenues.

Other gains, net. We recorded other gains of RMB15.1 million for the second quarter of 2005 compared to RMB1.1 million for the second quarter of 2004. The increase mainly reflected the additional interest income and fair value gains generated from increased cash investments into interest-earning financial assets by applying surplus cash proceeds derived from our initial public offering completed in the summer of 2004.

Selling and marketing expenses. Selling and marketing expenses increased by 70.0% to RMB45.5 million for the second quarter of 2005 from RMB26.8 million for the second quarter of 2004. The increase principally reflected increased promotional and advertising activities and higher staff costs as we launched and began marketing several new products and as we established new distribution channels. In addition, we increased our outsourcing as we expanded our customer support activities.

General and administrative expenses. General and administrative expenses increased by 161.1% to RMB75.6 million for the second quarter of 2005 from RMB29.0 million for the second quarter of 2004. The increase primarily reflected the increase in research and development costs as a result of an increase in the number of research and development staff and technical personnel developing new products and services to drive our future growth, including online games and IM functionalities. Staff cost also increased significantly as a result of a higher number of staff employed to support our business expansion and increased salary. Expenses relating to being a listed company also contributed to the increase in general and administrative expenses. Moreover, we have incurred increased leasing expenses as we relocated to our new offices and we have incurred increased professional consulting fees and expenses as a listed company.

Income tax benefit/(expenses). We recorded a net tax credit of RMB68.3 million for the second quarter of 2005 compared to income tax expenses of RMB3.3 million for the second quarter of 2004. As discussed above, we were able to recognize potential deferred tax assets of RMB88.6 million during the second quarter of 2005 arising from the intragroup sales of software.

Profit for the period. Profit for the period increased by 67.1% to RMB187.0 million for the second quarter of 2005 from RMB111.9 million for the second quarter of 2004. Net margin was 56.0% for the second quarter of 2005 compared to 41.4% for the second quarter of 2004.

Liquidity and Financial Resources

As at 30 June 2005 and 31 March 2005, we had the following cash and investments:

	Unaudited		
	30 June 2005	31 March 2005	
	Amount	% of total cash and investments	Amount
		(RMB in thousands)	
Cash and cash equivalents	1,124,492		1,132,054
Term deposits with initial term of over three months	547,459		560,172
Financial assets held for trading	675,200		669,948
Held-to-maturity investments	167,358		167,374
Total	2,514,509		2,529,548

A large portion of our financial resources is held in deposits and investments denominated in U.S. dollars. As we have not used any means to hedge our exposure to foreign exchange risk, we may experience a loss as a result of any foreign currency exchange rate fluctuations in connection with our deposits and investments.

We had no interest-bearing borrowings as at 30 June 2005.

Business Outlook

During the second quarter of 2005, the Internet market in China continued to exhibit robust growth in the number of Internet users and broadband penetration. This attractive market environment has benefited online companies, but has also increased the level of competition. Various companies, in particular foreign companies, have been attracted by the opportunities offered by the market and have increased their investments in the Chinese market. We believe that while the increased level of competition will create challenges for us, it will also provide new growth catalysts for the nascent market. We believe by focusing on strengthening our local online franchise, by staying close to our community of local users and by pursuing innovative research and development, we will be able to manage the challenges of intensified competition while positioning us to benefit from the market growth.

We have continued to focus on strengthening our online platforms including our IM platform, QQ.com portal and QQ Game Portal. In addition, we have made good progress in the development and testing of our new Internet value-added products and services, including Q-Zone and QQ Pet, and new online games, including QQ Tang and QQ Fantasy. To increase our ability to monetize the significant traffic on our online platforms and to effectively compete against intensifying competition, we have also increased our investment in the research and development of new products and services, branding of our online platforms, and developing new billing and payment channels for our products and services. We strongly believe that these investments will bring us long-term benefits.

In our Internet value-added services, we are working to enhance the features of existing flagship products and services, such as QQ Membership and online identity products. In addition, we have been conducting open-beta testing of our new products, Q-Zone and QQ Pet, by offering them to our users on a limited basis. We are pleased to see that both products have generated initial strong demand from our users. We are currently working to enhance their technology platforms in preparation for the release of the products on a wider basis to our users. We expect these new products to generate incremental revenue in the second half of 2005.

In our online game business, QQ Game Portal remained as the leading casual game platform in China. We are planning to increase our monetization of such leadership by increasing paid-subscriptions and game item purchases for the casual games. We have further refined our advanced casual game, QQ Tang, during the second quarter of 2005. The game was commercially launched on 7 July 2005 and we have seen encouraging performance following the launch. We have also continued our closed-beta testing for MMOG, QQ Fantasy, during the second quarter of 2005. We are targeting to generate incremental revenues from our game business in the second half of this year.

In our mobile and telecommunications value-added services, we expect continued volatility as industry policies and environment continue to evolve, and competition continues to intensify. We will strive to manage these challenges by cooperating closely with operators and developing new features and products to create more value for our users. In addition, we are also increasing our investment in the customization of our Internet-based products and services for the wireless platform, such as our WAP portal and networked wireless casual games. We believe the advent of 3G will create significant market opportunities for these products and services in the future and we want to be well-positioned to be early leaders in capturing these opportunities.

In our online advertising business, we believe that we are at an early stage in monetizing the significant traffic in our online platforms. We aim to grow our online advertising business by investing in the branding of our QQ.com, by building of a strong sales team and by developing strong relationships with leading advertisers in China.

Other Information

Employee and Remuneration Policies

As at 30 June 2005, the Group had 1,648 employees (30 June 2004: 804), most of whom are based in the Company's head office in Shenzhen, the PRC. The number of employees 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 pension funds 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 2005 was RMB134 million (2004: RMB67 million).

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

During the six months ended 30 June 2005, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

Audit Committee

The Audit Committee, which comprises two independent non-executive directors and one non-executive director of the Company, 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 2005.

Compliance with the Code on Corporate Governance Practices

Save for the deviation from code provision A.2.1 of Appendix 14 to the Listing Rules in respect of the segregation of the role of the chairman and chief executive officer ("CEO"), none of the directors of the Company is aware of any information which would reasonably indicate that the Company has not, for any part of the six months ended 30 June 2005, complied with the code provisions of the Code of Corporate Governance Practices as set out in Appendix 14 to the Listing Rules, which became effective from 1 January 2005.

Code provision A.2.1 provides that the roles of the chairman and chief executive officer should be separate and should not be performed by the same individual. The division of responsibilities between the chairman and chief executive officer should be clearly established and set out in writing.

During the period under review, Mr Ma Huateng was the Chairman and Chief Executive Officer of the Company. The Board considered that an abrupt segregation of the role of the chairman and CEO would involve a sharing of power and authority of the existing structure which might create turmoil on the daily operations of, and extra cost to, the Company. In addition, the chairman and CEO must be proficient in IT knowledge and be sensitive to the fast and myriad changes in the business in order to lead the Company to react swiftly to any market change, make timely decision in this fast-moving IT industry and ensure the sustainable development of the Company. Notwithstanding the above, the Board will review the current structure from time to time and shall make necessary amendments when the right time comes.

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, 24 August 2005

As at the date of this announcement, the directors of the Company are:

Executive Directors:
Ma Huateng and Zhang Zhidong;

Non-Executive Directors:
Antonie Andries Roux and Charles St Leger Searle; and

Independent Non-Executive Directors:
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. These forward-looking statements may prove to be incorrect and may not be realized in future. Underlying these 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.