

BUSINESS OVERVIEW

The Group is a provider of business equipment and tax control equipment based in the PRC. The Group excels, in particular, in the production of SDM printers. Its headquarters and operation base are located in Jiangmen. The Group's core activities are (i) the design, manufacture and sale of business equipment and tax control equipment under its owned brand name "Jolimark"; (ii) the distribution in the PRC of Epson branded SDM printers and (iii) the manufacture in the PRC of business equipment, tax control equipment and other electronic products on EMS/ODM/OEM basis.

During the Track Record Period, the products manufactured and sold by the Group can be divided into the following categories:

1. Business equipment — SDM printers, mini printers, LCD projectors and electronic white boards
2. Tax control equipment — tax control printers, anti-fraud invoice printers (VAT invoice) and other tax control equipment
3. Other electronic products — PCBAs, mail folder inserter machines and car audio products

The Group is experienced in producing business equipment utilising optical, mechanical and electrical engineering technology. Such business equipment includes SDM printers, LCD projectors and other digital display products. In addition, the Group has produced, on an EMS/ODM/OEM basis, tax control equipment and other electronic products by capitalising on its know-how in SMT and PCBA. The Group's top EMS/ODM/OEM customers include international brand owners of consumer electronic equipment and business equipment, which include Epson, OKI and Neopost.

The Group's Jolimark branded products include SDM printers, LED colour printers, mini printers, tax control printers, anti-fraud invoice printers (VAT invoice) and other tax control equipment. The Group's Jolimark branded products are suitable for users in various industries, including government authorities and business sectors such as the banking, finance and medical healthcare sectors.

According to the data issued in April 2005 by IDC, Jolimark branded SDM printers was ranked the largest among domestic brands and the fourth largest brand of SDM printers in the PRC in terms of unit shipment and accounted for approximately 8.3% of the total SDM printers shipments in the PRC during 2004. In 2003, Kongyue Jolimark was awarded the "Twenty Years Reliable Brand PRC Computer Users" (中國計算機用戶二十年信賴品牌) by the China Computer Users Association for its SDM printers and LED colour printers. In 2004, Kongyue Jolimark was also elected one of the top 100 suppliers in the PRC computer industry in the Top 500 Computer Companies Election organized by Computer Partner World (電腦商報), a PRC trade magazine.

With over 15 years experience in distributing printers in China, the Group has established an extensive product distribution and after sales services network in major cities in the PRC, enabling the Group to offer distribution and after sales services to its EMS/ODM/OEM customers. Due to its extensive domestic and overseas procurement network and experience, the Group is also able to extend its services into the area of supply chain management. In addition, the Group has a research and development team which comprises mostly of staff with background in various engineering disciplines to carry out product design functions for enhancing product quality and expanding the Group's product mix. The Group also plans to seek strategic partnership with overseas design houses to strengthen its product development capability as it seeks to broaden its EMS/ODM/OEM customer base.

As part of its strategy to expand its business by broadening its own branded product mix, the Group seeks to expand its own branded product range to include digital display products through its 65% owned subsidiary, Phenix Digital. Trial production of Phenix Digital commenced in May 2005. Commencement of production is expected to take place in the third quarter of 2005. Current plans are for Phenix Digital initially to produce digital display products for the use by commercial sector only.

STRENGTHS OF THE GROUP

The Group considers that its achievements are principally attributable to the following competitive strengths of the Group:

- **The Group is an established manufacturer of SDM printers and tax control equipment in the PRC**

Being one of the leading manufacturers of SDM printers in the PRC, the Group (together with its management) has over 15 years and 9 years of experience in distributing and manufacturing SDM printers in the PRC respectively. Currently, the Group is engaged in the design, manufacture and sale of its own branded SDM printers and in the provision of EMS/ODM/OEM services to other providers of SDM printers.

Leveraging on the Group's expertise in manufacturing SDM printers and sizable production facilities in Jiangmen, the Group expanded its product range in 2000 to include tax control equipment when it produced its first anti-fraud invoice printers (VAT invoice). Jolimark branded anti-fraud invoice printers (VAT invoice) was ranked the largest among domestic brands and the second largest brand of anti-fraud invoice printers (VAT invoice) in China in terms of unit shipment in 2004, according to the CCW Research.

- **The Jolimark brand is well recognised in the PRC**

According to the data issued in April 2005 by IDC, Jolimark branded SDM printers was ranked the largest among domestic brands and the fourth largest brand of SDM printers in China in terms of unit shipment and accounted for approximately 8.3% of the total SDM printers shipments in China during 2004.

On 25th March, 2003, Kongyue Jolimark was awarded the "Twenty Years Reliable Brand PRC Computer Users" (中國計算機用戶二十年信賴品牌) by the China Computer Users Association for its SDM printers and LED colour printers. The Directors consider that brand recognition, once established, would facilitate distribution and sales of the Group's own branded products. At the same time, the overall increase in profile of the Group through promotion of its own branded products could also help the Group to develop further its EMS/ODM/OEM business.

In 2004, Kongyue Jolimark was elected one of the top 100 suppliers in the PRC computer industry in the Top 500 Computer Companies Election organised by Computer Partner World (電腦商報), a PRC trade magazine.

The Jolimark brand has been successful in securing recognition from government authorities and the Group has been successful in bidding for government procurement tender. For example, the Group was accepted as one of the approved suppliers of SDM printers and LED colour printers for the government procurement program coordinated by the China Government Procurement Network (中國政府採購網) in 2003 and 2004 under its own brand.

- **The Group has an extensive product distribution and after sales services network in the PRC**

The Group has established branches in major cities/provinces in the PRC, including Beijing, Guangzhou, Shanghai, Shenyang, Wuhan, Chengdu, Xian, Hunan and Nanning, which are responsible for liaising with and managing distributors and serve as after sales centres. The Group had a network of authorised distributors covering all provinces in the PRC (except Xizang Autonomous Region), as at 30th April, 2005. The Group also had, as at the same date, a network of over 146 after sales service centres covering about 20 provinces, 4 autonomous regions and 4 municipalities in the PRC. While the Group's distribution and after sales services networks primarily deals with Jolimark branded products, the network could also service products of the Group's EMS/ODM/OEM customers, if required. The Directors believe that this network significantly enhances the Group's ability to develop into a full EMS/ODM/OEM service provider.

- **The Group is capable of providing supply chain management, product development, distribution and after sales services**

The Group currently manages its own supply procurement and also provides procurement services to certain of its customers. In addition, the Group possesses its own design and manufacturing capabilities. For example, the Group has helped to develop and manufacture certain printer models for some international brand owners which are Independent Third Parties. The Group has also designed and manufactured tax control ECRs for an Independent Third Party. As the Group also has a strong distribution and after sales services network, the Directors believe that the Group is well placed to provide full EMS services to its customers.

- **The Group has a strong international EMS/ODM/OEM customer base and maintains a balanced EMS/ODM/OEM and its own branded Jolimark business mix**

During the Track Record Period, the Group has produced business equipment and other electronic products for international brand owners such as Epson, Seiko Precision, OKI and Neopost. With the establishment of the subsidiary AUI in Japan in June 2004, the Group will seek cooperation with medium size companies in Asia which plan to outsource their manufacturing process to manufacturers in the PRC. At the same time, the continued development of the Group's Jolimark business could help the Group diversify its sources of revenue without compromising its EMS/ODM/OEM sales, and allow the Group to benefit from increased economies of scale and help improve cost efficiency and overall profitability. The Group's Jolimark business contributed to approximately 55.5% of the gross profit of the Group for the year ended 31st December, 2004 while approximately 33.2% and 11.3% of the Group's gross profit was attributable by EMS/ODM/OEM businesses and the sale of Epson branded SDM printers respectively.

- **The Group enjoys the “first mover” advantage in the production of tax control equipment**

Following the promulgation of the “Golden Tax Project” by the PRC government in 1994, the Group started to develop tax control equipment in 1999. Kongyue Jolimark was also one of the 28 members who were appointed in 2002 to the Tax Control ECR Standards Working Group (税控收款機標準工作組) which was established under the MII and tasked with the drafting of national standards for tax control ECRs. The Directors believe that with its early participation in the market of tax control equipment, the Group would be able to attract quality distributors and end users for its tax control equipment.

The Group also has the capability of providing full manufacturing solutions for tax control equipment, as it possesses the production capacity for PCBA, SDM printers and mini printers, as well as ECRs. Furthermore the Group is able to integrate production with direct material supply management and distribution capabilities. On the supply side, the Group could source key components from its suppliers including the Connected Suppliers. At the distribution end, the Group has established an extensive distribution network in the PRC and has over 134 distributors for tax control equipment in 23 provinces/autonomous regions in the PRC, as at 30th April, 2005. In this way the Directors believe that the Group is well positioned as a major provider of tax control equipment in the PRC.

- **The Company's management team has in-depth knowledge and experience in the business equipment and tax control equipment market in the PRC**

The senior management team of the Group has in-depth knowledge in the production and sales of the business equipment and tax control equipment in the PRC. The education background and working experience of the Directors and senior management of the Group are described in detail in the "Directors, senior management and staff" section of this prospectus. Through its Directors and senior management, the Group has accumulated considerable depth of experience and expertise in the manufacture and distribution of business equipment, in particular, SDM printers, and tax control equipment in the PRC. The Directors believe that such experience and knowledge of the industry bolster the Group's ability to expand its business and to compete effectively in the market for its existing products.

HISTORY AND DEVELOPMENT

Business development

The Group's business history could be traced back to 1986 when Mr. Au, the founder of the Group, first started to conduct trading business in Hong Kong. In 1989 Mr. Au started to engage in the trading of printers in the PRC.

Mr. Au and his family members first formed a sino-foreign equity joint venture company, Kongyue Printing, in the PRC in December 1995 to commence production of SDM printers. After completion of construction of the production premises, installation of production lines and training of workers, Kongyue Printing commenced production of SDM printers for Epson and Citizen in 1997.

Until Kongyue Information (the Group's principal manufacturing arm) and Kongyue Jolimark (the Group's principal marketing arm for its Jolimark branded products) came into full operation as described below, the Au Family Shareholders' manufacturing, distribution and after sales operations for business equipment and tax control equipment were developed as follows:

- in terms of manufacturing, Kongyue Printing entered into a contract for the manufacturing and distribution of Epson branded SDM printers with Epson in April 1999 for a term of three years; and with the promulgation of the "Golden Tax Project" by the State Council of the PRC in 1998, collaborated with an Independent Third Party, Guangdong Tax for the development of anti-fraud invoice printers (VAT invoice) and tax control ECRs in September 1999;
- in terms of distribution network, capitalising on Mr. Au's experience and network built during the years he engaged in the trading of printers in the PRC, Kongyue Technology initially and, from 1999 onwards, with local assistance from the Connected Distributors, distributed through local distributors in the PRC Epson branded SDM printers (not produced by the Group) for the

Epson Group. By 1999, this distribution network covered 11 provinces, one autonomous region and one municipality in the PRC. Since April 2004, Kongyue Technology ceased to assist the Group in the distribution of such Epson SDM printers in the PRC as the Epson SDM printers were then shipped direct to the PRC instead of via Hong Kong;

- with the commencement of distribution of products manufactured by the Group in the PRC, an after sales network was established through Industrial Park, which by 2000 covered 8 provinces, two autonomous regions and one municipality in the PRC. Although the actual after sales services were provided either by the authorised service providers or by Kongyue Information, the after sales service contracts had been entered into by Industrial Park until April 2001. This was because Mr. Au and the then controlling shareholders of Industrial Park believed that Industrial Park had at the relevant time the strongest reputation amongst the private group of companies controlled by Mr. Au. After sales services providers had then also indicated to the Group that they would prefer to contract with (and they did contract with) Industrial Park on behalf of Kongyue Information. Industrial Park received no payment from the Group for entering into the after sales contracts on its behalf with the customers. After the establishment of Kongyue Jolimark in March 2001, Kongyue Jolimark took over the after sales service network established under the name of Industrial Park and Industrial Park ceased to enter into further after sales service agreements on behalf of the Group with third parties.

In December 1998, with a view to expanding its product mix and business scope to provide full OEM services and taking full control over the manufacturing process, Kongyue Information was established. Kongyue Information was awarded the ISO 9002:1994 Quality Management Certification in December 1999 and obtained the ISO 9001:2000 Quality Management Certification in 2003.

After a year of setting up and testing its manufacturing plant, Kongyue Information commenced full operation in January 2000. At around the same time, Kongyue Printing ceased its manufacturing operations, and Kongyue Information leased from Kongyue Printing its SDM printer production lines, transportation fleet and other office equipment for a fixed term of four years till May 2004 for rental of RMB384,020, RMB946,126, RMB849,025, RMB835,261 and RMB348,025 for the four years ended 31st December, 2003 and the five months ended 31st May, 2004 respectively. Following that, with the permission of the relevant counterparties, Kongyue Information took over the manufacturing and sales of Epson branded printers and the development and production of anti-fraud invoice printers (VAT invoice) and tax control ECRs on the terms of the contracts which Kongyue Printing had signed. No new contracts had been entered into between Kongyue Information and the relevant counterparties at the time.

Since it started producing and selling printers, Kongyue Information also started to contract direct with distributors within the distribution network which have by then been built up by the Au Family Shareholders and their associates, gradually taking over it, with the continued assistance of the Connected Distributors on the basis described later in this prospectus.

In December 2000, the Group started to manufacture Epson branded LCD projectors pursuant to an agreement signed in June 2000 for production of Epson LCD projectors on an OEM basis, thereby expanding its product mix.

In May 2000, Kongyue Information produced its first anti-fraud invoice printers (VAT invoice) under its cooperation with Guangdong Tax. The turnover attributable to the sale of such printers for the year ended 31st December, 2001 was approximately RMB6.1 million.

BUSINESS

In March 2001, with a view to developing products with its own brand name, the Group established Kongyue Jolimark, principally to engage in the design and development of Jolimark branded products while Kongyue Information would concentrate on the Group's EMS/ODM/OEM customers. Kongyue Jolimark has also been designated the distribution arm of the Group, responsible for distribution of Jolimark branded products, EMS products for Epson SDM printers and the SDM printers supplied by Epson either directly to distributors or indirectly through the Connected Distributors. It also took over the after sales network established under the name of Industrial Park. In the same year the Group has also expanded its OEM business to include the manufacture of SDM printers for Seiko Precision. The turnover contributed by Seiko Precision to the Group during the three years ended 31st December, 2004 amounted to approximately RMB2,635,000, RMB5,837,000 and RMB13,712,000 respectively, which represent approximately 0.47%, 0.72% and 1.42% of the total turnover of the Group during the corresponding periods.

Kongyue Jolimark was one of the 28 members who were appointed in 2002 to the Tax Control ECR Standards Working Group (稅控收款機標準工作組) which was established under the MII and tasked with the drafting of standards for tax control ECRs.

In August 2002, with the expiry of the printer manufacturing and sales agreement between Epson and Kongyue Printing which as mentioned above has since 2000 been taken over by Kongyue Information, Kongyue Information and a member of the Epson Group entered into a new OEM agreement. This agreement does not carry a fixed term.

In 2003, the Group further diversified its own branded Jolimark product range to include electronic white boards. In the same year, Kongyue Jolimark established branch offices in Hunan and Nanning in the PRC for marketing and distribution. Products manufactured on EMS/ODM/OEM basis were also expanded to cover car audio system and mail folder inserter machines.

With the promulgation of the "Golden Tax Project" by the PRC government, and in order to capitalise on market opportunities for tax control equipment, the Group entered into joint ventures with a number of Independent Third Parties as well as associates of the Au Family Shareholders to form strategic partnerships to carry out tax control equipment-related business. These include Jolimark Information formed in January 2004 and Jolimark Tax formed in April 2003 which are indirect subsidiaries of the Company. In addition, the Company has also through its subsidiaries invested during April 2003 to September 2004 in six other joint ventures in which the Company has at least 10% equity interest, being Suzhou Jolimark, Guangdong Jolimark, Shanghai Qijie, Beijing Stone, Shanghai Liang Biao and Hebei Sheng Hong. The six joint ventures were established for the purpose of marketing tax control ECRs and other tax control equipment manufactured by the Group, out of which four were established for distribution and sales of tax control products and two for manufacturing such products. Details of the joint venture arrangements are set out under the sub-section headed "Corporate Development" below in this section of this prospectus.

In early 2004, Kongyue Information and Kongyue Jolimark established 7 and 9 new branches in the major cities of the PRC including Beijing, Shanghai and Guangzhou with a view to consolidating the management of the Group's sales and distribution network. After the establishment of its own branches, Kongyue Jolimark now manages its own after sales service network. For Kongyue Information, after the establishment of the 7 new branches, Kongyue Information has enhanced its capability in exploring more opportunities in EMS/ODM/OEM business and has taken over the distribution of the remaining stock of the EMS Epson SDM printers which it ceased to produce in 2004. As advised by the PRC legal advisers to the Company, the establishment of these branches in major cities of the PRC is legal and valid under the laws of the PRC.

By May 2004, Kongyue Printing has transferred all SDM printer production lines, transportation fleet and other office equipment to Kongyue Information for a consideration of RMB2,312,000, based on the then net book value of those Kongyue Printing assets.

The Group established a subsidiary AUI, in Japan in June 2004 with the intention of strengthening its marketing efforts to potential mid-sized OEM customers in Japan, as well as using it as a base to seek strategic partners for technology transfer and for recruiting design personnel to enhance its in-house product research and design capabilities and to facilitate the sourcing of electronic and high precision raw materials.

In September 2004, Kongyue Information and Kongyue Jolimark had each been fined RMB5,000 by Jiangmen City Industrial and Commercial Administrative Bureau for having engaged in the distribution of SDM printers which were not manufactured by them, as such distribution activities were not specified in their business licences. As disclosed in the paragraph headed “Government Laws and Regulations in the PRC” in the “Industry Overview” section of this prospectus, the Group relied on a notice issued by the Jiangmen City People’s Government in 1992 (the “1992 Notice”) for the conduct of that business activity which, the Directors subsequently discovered, in the course of preparing for the listing of the Shares, was inconsistent with the PRC laws. As advised by the PRC legal advisers of the Company, any regulations or notice issued by the local government cannot be inconsistent or be in conflict with national laws and regulations published by the central PRC government. Since Kongyue Information and Kongyue Jolimark relied on the 1992 Notice without knowing that it was inconsistent with the relevant PRC national laws and regulation, they had each been fined RMB5,000 for engaging in the distribution of SDM printers not manufactured by themselves which was outside the scopes of their scope of business stated in their respective business licences. Kongyue Information applied for and was issued in the same month a new business licence to cover such distribution activities. Kongyue Jolimark has since then discontinued such distribution activities until such time it is issued with a business licence which allows it to do so, in order to ensure compliance with the prevailing PRC laws. In December 2004, Kongyue Jolimark applied to relevant authority to expand its business scope in order to engage in distribution and provision of after sales services of information technology products produced by other electronic companies. On 14th March, 2005, Kongyue Jolimark obtained the approval for an expanded scope of business from Jiangmen City Industrial and Commercial Administrative Bureau.

The Group has reviewed and sought legal advice on the relevant regulatory requirements, including the PRC national legislation, to make sure that the business activities of the relevant members of the Group fall within their respective business scopes as stated in their respective business licences. The Directors also confirmed that the business activities currently conducted by the Group fall within the scopes of business as stated on the relevant business licences. The Company has been advised by its PRC legal advisers that, based on their due diligence, written confirmations from Jiangmen City Industrial and Commercial Administrative Bureau and the Company, save as disclosed in this prospectus (see the paragraph headed “Government Laws and Regulations in the PRC” in the “Industry Overview” section of this prospectus), Kongyue Information and Kongyue Jolimark have since their respective dates of incorporation lawfully carried on their operations in compliance with the industrial and commercial administrative laws and regulations of the PRC, and have not been subject to any penalty or sanction by the industrial and commercial administrative regulatory authorities in respect of any breaches of such laws and regulations.

In order to cater for its expansion, the Group has established Xin Yue, a subsidiary of the Company in Hong Kong in October 2004 to manage the logistics services of the Group.

Furthermore, as part of the Reorganisation, the Group has also acquired the entire share capital of Jolimark Technology, a company incorporated in Hong Kong in May 2004 from Mr. Ou Guo Liang and Mr. Au Kwok Lun, both being Directors and Au Family Shareholders. Jolimark Technology is the holding company of Jolimark China, a company established in Beijing of the PRC in September 2004. Neither Jolimark Technology nor Jolimark China had operations prior to such acquisition. Jolimark China is intended to take over gradually the function of Kongyue Jolimark in the brand development and management activities in the PRC.

Corporate development*Establishment of Kongyue Information and Kongyue Jolimark*

Kongyue Information and Kongyue Jolimark were the two major operating subsidiaries of the Company during the three years ended 31st December, 2004 and are currently the major contributors to the Group's results.

- Kongyue Information was established on 11th December, 1998 as a sino-foreign joint venture company established between KY Import/Export (then holding 55% equity interest) and Dinomax (then holding 45% equity interest) for a period of 30 years. KY Import/Export was owned as to 50% by Jiangmen Information, 30% by Mr. Ou Bo Chou and 20% by Ms. Ou Nu Chan, family members of Mr. Au, while Dinomax held its equity interest in Kongyue Information on trust for the Au Family Shareholders in equal shares. On 11th December, 1998, KY Import/Export entered into an agreement with Dinomax to delegate its control over Kongyue Information to govern its financial and operating policies to Dinomax. Accordingly, the Directors consider that Kongyue Information fulfilled the definition of subsidiary for the purpose of SSAP32 "Consolidated financial statements and accounting for investments in subsidiaries" issued by the HKICPA, and therefore consolidated Kongyue Information in its group accounts during January to October 2001 when its interest in Kongyue Information did not exceed 50%. Kongyue Information was established to engage in the manufacture of new PCBAs and ancillary products. On 17th January, 2000, the scope of business of Kongyue Information was expanded to cover the manufacture and sales of computers, printers, digital projectors, ECRs and other computer peripherals and information technology/electronic products. This scope of business was further expanded to cover the production of tax control devices, POS, LCD monitors and other computer peripherals and information/electronic products.

With the intention of concentrating on its trading business, KY Import/Export disposed of its interest in Kongyue Information by selling 5% interest in Kongyue Information to Jiangmen Information for US\$130,000 and the remaining 50% interest to Dinomax (held on trust for the Au Family Shareholders in equal shares) for US\$1,300,000 in October 2001. Upon completion of such transfers, Kongyue Information was held as to 95% by Dinomax (on trust for the Au Family Shareholders in equal shares) and as to 5% by Jiangmen Information. The consideration was based on the then registered capital of Kongyue Information of US\$2.6 million. Jiangmen Information was owned as to 90% by Mr. Ou Guo Liang and 10% by Mr. Ou Bo Chou, an associate of the Au Family Shareholders. The then new shareholders of Kongyue Information invested a total of US\$560,000 in cash in Kongyue Information, bringing its total registered capital to US\$3.16 million. Kongyue Information's registered capital was further increased in June 2002 to US\$3.86 million through the pro rata reinvestment by its shareholders of part of their respective profit entitlement. The scope of business was further expanded to include the production of folder inserter machines and electronic white boards. In September 2002 and March 2003, approval was granted for the increase of Kongyue Information's registered capital to US\$8.86 million and US\$9.08 million, respectively. The increase of its scope of business to include production of audio and visual decoding devices was also approved. The entire registered capital of Kongyue Information has been paid up in full as at 21st March, 2003.

Starting from early 2004, Kongyue Information has established 7 branches in Beijing, Shenyang, Wuhan, Chengdu, Xian, Guangzhou and Shanghai to provide sales and distribution service for the Group's EMS products. The branches are not separate legal entities, and therefore are not required to have registered capital separate from Kongyue Information.

On 3rd September, 2004, Kongyue Information was issued a new business licence which increases its scope of business to include sales agency and services of electronic products of other companies (except restricted types of products). In respect of its distribution of SDM printers which were not manufactured by it prior to the issue of such business licence, Kongyue Information was fined RMB5,000 on 8th September, 2004 by the Jiangmen Administration of Industry and Commerce.

The Company has been advised by its PRC legal adviser that Kongyue Information has obtained all requisite approvals for the above changes in registered capital and business scope from the relevant PRC authorities.

In December 2004, as part of the Reorganisation, Kong Yue Investment acquired a 95% interest in Kongyue Information from Dinomax (as trustee for and on behalf of the Au Family Shareholders) for HK\$71,077,000. As directed by Dinomax, 99 shares of Kong Yue Investment of US\$1.00 each were issued and allotted to Kytronics Holdings credited as fully paid.

- Kongyue Jolimark was established on 22nd March, 2001 as a sino foreign joint venture company then owned as to 10% by Jiangmen Information and 90% by Dinomax (held on trust for the Au Family Shareholders in equal shares) to engage in the research and development and sale of printers, PCBAs, ECRs, POS, tax-control devices, LCD monitors, computer software and related information technology/electronics products and related services. Kongyue Jolimark was established by the Group to engage in the design, production and sales of Jolimark branded products. This scope of business was altered to cover the research and development, manufacture and sale of printers, PCBAs, tax-control equipment, ECRs, POS, LCD monitors, computer software and related information technology/electronics products and related services. The then registered capital of Kongyue Jolimark was HK\$5 million which had been fully paid up on 3rd July, 2001.

Currently, Kongyue Jolimark is the principal marketing arm of the Group's Jolimark products and its principal activities include (1) brand development and management; (2) research and development; and (3) sales and marketing.

On 8th May, 2003, Kongyue Jolimark became a WFOE after Dinomax (who held its interest in Kongyue Jolimark on trust for the Au Family Shareholders in equal shares) acquired the 10% interest for a consideration of HK\$500,000 which is equal to 10% of the then registered capital of Kongyue Jolimark of HK\$5 million. Its scope of business was changed on 26th November, 2003 to cover the research and development, manufacture and sale of printers, PCBAs, ECRs (including tax-control ECRs, financial tax control ECR and POS), tax-control equipment, LCD monitors, computer software and related information technology/electronics products and related services. On 8th May, 2004, the scope of business of Kongyue Jolimark was further expanded to include the re-processing, sales and services of information electronic products of other companies (except restriction type of products).

In August 2003 and August 2004, Kongyue Jolimark established branch offices in Hunan and Nanning respectively and in 2004, Kong Jolimark established seven branches in Beijing, Shanghai, Guangzhou, Shenyang, Wuhan, Chengdu and Xian. These are branches and branch offices of Kongyue Jolimark to facilitate management of the Group's distribution and after sales network. As they are not separate legal entities, they are not required to have any registered capital separate from Kongyue Jolimark.

Kongyue Jolimark was fined RMB5,000 in September 2004 by the Jiangmen Administration of Industry and Commerce for having distributed for sale products which were not manufactured by itself. The Directors have confirmed that Kongyue Jolimark has since ceased to engage in the distribution of such products until after 14th March, 2005, being the day on which Kongyue Jolimark obtained a new business licence which permits such business activity.

On 23rd September, 2004, the registered share capital of Kongyue Jolimark was increased to HK\$61,604,000, all of which has been fully paid up in cash by way of reinvestment by Dinomax of part of its profit entitlement in 2003.

The Company has been advised by its PRC legal adviser that Kongyue Jolimark has obtained all approvals for the above changes in registered capital and business scope and the establishment of WFOE of Kongyue Jolimark from the relevant PRC authorities.

Upon Reorganisation, 100% equity interest in Kongyue Jolimark was transferred from Dinomax to Ying Mei Investment in consideration of Ying Mei Investment's issue and allotment of 99 shares to Kytronics Holdings in October 2004.

Subsidiaries for tax control products

Seeing the growing opportunities in the business of tax control equipment, the Group established two subsidiaries predominantly with a view to engaging in the developing of tax control equipment business.

- Jolimark Tax was established on 16th April, 2003 with a registered capital of RMB500,000 by Mr. Ou Guo Liang, a Director, and Kongyue Jolimark, owning 10% and 90% equity interest in Jolimark Tax respectively, for the purpose of distributing and providing maintenance and training services to users of tax control equipment in Jiangmen in accordance with the agreement with Guangdong Tax. For details of the agreement, please refer to the sub-section headed "Product Range" in this section of this prospectus. On 21st May, 2004, Mr. Ou Guo Liang transferred 5% equity interest in Jolimark Tax to Kongyue Jolimark for a consideration of RMB25,000 which is equivalent to 5% of the registered capital of Jolimark Tax. As a result of the transfer Jolimark Tax is owned as to 5% by Mr. Ou and 95% by Kongyue Jolimark. The registered capital of Jolimark Tax has been fully paid up.
- Jolimark Information was established on 20th January, 2004 with a registered capital of RMB1 million by Mr. Ou Guo Liang, a Director, and Kongyue Jolimark, owning 15% and 85% equity interest in Jolimark Information respectively, for the development of Jolimark branded tax control equipment and the related computer software. On 21st May, 2004, Mr. Ou transferred 10% of equity interest in Jolimark Information to Kongyue Jolimark for a consideration of RMB100,000 which is equivalent to 10% of the registered capital of Jolimark Information of RMB1 million. Following such transfer, Jolimark Information is owned as to 5% by Mr. Ou and 95% by Kongyue Jolimark. The registered capital of Jolimark Information has been fully paid up.

Subsidiaries for product development

- Shenzhen Jolimark was established on 26th February, 2002 with a registered capital of RMB3 million by Kongyue Jolimark and Kong Yue Holding Limited, owning 75% and 25% equity interest in the joint venture respectively, for the purpose of developing software products. In June 2004, Kong Yue Holding Limited transferred all its 25% interest in Shenzhen Jolimark to Kongyue Information for a consideration of RMB750,000 which is equivalent to 25% of the registered capital of Shenzhen

Jolimark of RMB3 million. On 21st July, 2004, Shenzhen Jolimark was converted from a joint venture to a limited liability company. There has been no change in the registered capital of Shenzhen Jolimark since its incorporation. The registered capital of Shenzhen Jolimark was fully paid up as at 25th October, 2002.

- Phenix Digital was established on 25th February, 2004 with a registered capital of RMB30 million by Phenix Optics and Visionic Pte Ltd., a Singaporean company whose shareholders are Ms. Ou Ri Oi, an Au Family Shareholder and her associate, owning 35% and 65% equity interest in the joint venture company respectively, for the purpose of developing and manufacturing digital display products under the brand name of “Phenix”. Phenix Optics and its ultimate shareholders are Independent Third Parties. On 30th September, 2004, Visionic Investment acquired the 65% equity interest in Phenix Digital from Visionic Pte Ltd. at a cash consideration of RMB11.7 million which is equivalent to 65% of RMB18 million, being the registered capital of Phenix Digital that has then been paid up. As at the Latest Practicable Date, a total amount of RMB18 million of the registered capital, representing 60% of the total registered capital of Phenix Digital has been paid up. According to the approval given by Shanghai Jiabei District People’s Government (上海市閘北區人民政府) dated 12th February, 2004, all registered capital of Phenix Digital should be paid up within 6 months from 25th February, 2004, the date of the business licence of Phenix Digital. On 10th August, 2004 and 22nd December, 2004, Shanghai Jiabei District Foreign Economic Committee (上海市閘北區外經委) approved that the remaining 40% of the registered capital of Phenix Digital be fully paid up before 30th June, 2005.

Other subsidiaries

- Jolimark Technology, a limited company, was incorporated in Hong Kong on 17th May, 2004. On 11th June, 2004, 8,999 shares in Jolimark Technology were allotted and issued to Mr. Au Kwok Lun and 1,000 shares in Jolimark Technology were allotted and issued to Mr. Ou Guo Liang credited as fully paid. On the same day, Mr. Au Kwok Lun acquired one share from the initial subscriber of the company which is an Independent Third Party for a consideration of HK\$1. As a result Mr. Au Kwok Lun owned a total of 9,000 shares in Jolimark Technology. Both Mr. Au Kwok Lun and Mr. Ou Guo Liang are Directors and Au Family Shareholders. Upon Reorganisation, in February, 2005, Ying Mei Investment acquired the beneficial interest in 10,000 shares in Jolimark Technology (representing the entire interest in Jolimark Technology) of which the beneficial interest in 9,000 shares was transferred from Mr. Au Kwok Lun, and the beneficial interest in 1,000 shares from Mr. Ou Guo Liang at a consideration of HK\$7,050 which was satisfied by the allotment and issue of 100 shares in Ying Mei Investment to Kytronics Holdings. Upon completion of the acquisition, Jolimark Technology was held as to 9,999 shares by Ying Mei Investment and as to 1 share by Mr. Au Kwok Lun (as trustee for Ying Mei Investor). Jolimark Technology is intended to be an investment holding company to wholly own Jolimark China. Jolimark China is a newly incorporated subsidiary of the Company and is intended to take over gradually the brand development and management activities, such as arranging for and coordinating advertising and marketing campaigns, of Kongyue Jolimark. Jolimark China’s registered capital is RMB50 million. According to the approval of its establishment granted by the PRC authorities and its articles of association, RMB7.5 million, representing 15% of its registered share capital, has to be paid up within three months of its incorporation, i.e. on or before 7th December, 2004. According to the approval given by Beijing Haidian District Bureau of Commerce (北京海淀區商務局) dated 9th December, 2004, the deadline for the payment of 15% registered capital of Jolimark China was postponed to 6th March, 2005, which was subsequently further postponed to 6th June 2005. 15% registered share capital of Jolimark China being RMB7.5 million has been paid by the Group on 3rd June, 2005. The remainder of the registered capital has to be paid up within two years of its incorporation, i.e. on or before 7th September, 2006.

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- AUI was established in Japan on 18th June, 2004 in line with the plans of the Company to expand its EMS/ODM/OEM customer base. It was formed with the intention of strengthening its marketing efforts to potential medium size EMS/ODM/OEM customers in Japan, as well as using it as a base to seek strategic partners for technology transfer and for recruiting design personnel to enhance its in-house product research and design capabilities and to facilitate the sourcing of electronic and high precision raw materials.
- Xin Yue was incorporated in Hong Kong on 18th October, 2004 to be responsible for the provision of logistics service to the Group. It is also responsible for importing direct materials sourced by the Group directly or indirectly through the Connected Purchase Agent. Before the establishment of Xin Yue, the Group's wholly-owned subsidiary in Hong Kong, in October 2004, the Group did not have any operation in Hong Kong. In order to handle the sourcing and logistic activities in Hong Kong efficiently, the Group appointed the Connected Logistics Agents (Kongyue Technology (prior to June 2003) and New Success (from July 2003 to December 2004)) as its logistic agents in Hong Kong. For details of the Group's logistics services now and during the Track Record Period, please refer to the sub-section headed "Direct materials and sourcing" in this section of this prospectus.

Other joint ventures for tax control equipment

The Group has also established the following joint ventures with Independent Third Parties through its subsidiaries in the PRC, to engage in the marketing and/or distribution of tax control equipment.

- Shanghai Qijie was established on 13th May, 1999 with a registered capital of RMB3 million by three individuals, namely Zhang Qi, Li Si Min and Gao Hui Ling whose then shareholding in the joint venture company was 68%, 10% and 22% respectively. It engages in the sales and marketing of tax control equipment. The business scope of Shanghai Qijie as stated in its business licence does not include the production of tax control equipment. In April 2003, 10% equity interest in Shanghai Qijie held by Zhang Qi was acquired by Kongyue Jolimark for a consideration of RMB1 million which was based on the intended profit sharing arrangement under which future profits will be shared in proportion to the actual total capital invested and not just the capital paid up for registered capital of the joint venture company. As at the Latest Practicable Date, the registered capital of Shanghai Qijie has been fully paid up.

Shanghai Qijie has entered into a joint venture agreement on 25th December, 2002 with 上海華博科技(集團)有限公司 ("Shanghai Huabo") to form two joint venture companies for the purpose of marketing and distribution of Jolimark branded tax control ECRs, one in Liaoning province and one in Shanghai. Shanghai Huabo and their ultimate shareholders are Independent Third Parties.

The joint venture in Liaoning is jointly held by Shanghai Qijie and Shanghai Huabo in equal shares of equity interest. It has remained dormant pending promulgation of laws and regulations in relation to tax control ECRs. Now that the Measures on the Management of Tax Control ECR Manufacturing Companies Qualification (《稅控收款機生產企業資質管理辦法》) (the "Measures") (effective on 1st December, 2004) set out the standards of manufacturing tax control ECRs, the joint venture company in Liaoning is expected to become active in the second half of 2005.

The joint venture in Shanghai which is intended to engage in marketing and/or distribution of tax control equipment has not yet been incorporated and is expected to be established by the second half of 2005. The expected business scope of the joint venture company in Shanghai is expected to include distribution of tax control equipment.

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According to the share transfer agreement between Kongyue Jolimark and Zhang Qi dated 3rd April, 2003, if Shanghai Qijie is unable to sell a minimum of 2,000 units of Jolimark tax control ECRs in Liaoning province and Shanghai within two years from the establishment of the joint venture companies, Kongyue Jolimark has the right to require Zhang Qi to purchase all of its shareholding in the joint venture for a consideration of RMB1 million with interest at an interest rate of 2% per annum. As at the Latest Practicable Date, sales of tax control ECRs in Liaoning and Shanghai has not yet commenced pending promulgation of the procedure and standard in manufacture of tax control ECRs.

- Guangdong Jolimark was established on 24th February 2004 with a registered capital of RMB5 million by Guangzhou Auction and Kongyue Jolimark, owning 90% and 10% equity interest in the joint venture respectively for the purpose of marketing and distributing Jolimark branded tax control equipment in Guangzhou City. Guangzhou Auction and its ultimate shareholders are Independent Third Parties. As at the Latest Practicable Date, the registered share capital of Guangdong Jolimark has been fully paid up.
- Beijing Stone was established on 2nd March, 2004 with a registered capital of RMB18.9 million by Beijing Computer and Kongyue Information, owning 80% and 20% equity interest in the joint venture company, respectively, to manufacture tax control equipment under the brand names of “四通” (Beijing Stone) and Jolimark. Beijing Computer and its ultimate shareholders are Independent Third Parties. As at the Latest Practicable Date, a total amount of RMB18.9 million of the registered capital, representing 100% of the total registered capital of Beijing Stone has been paid up.

Within 5 years from the incorporation of Beijing Stone, Kongyue Information has the right to purchase the shareholding held by Beijing Computer in Beijing Stone from time to time (on each occasion acquiring not less than 5% equity interest in Beijing Stone) until its equity interest in the joint venture rises to 51% or above. When the equity interest of Kongyue Information in Beijing Stone exceeds 50%, Beijing Computer has the right to require Kongyue Information to purchase from them such further equity interest in Beijing Stone which upon completion will bring Kongyue Information's equity interest to 70%. The transfer, in either case is to be determined by reference to the then valuation of the entire joint venture company at the higher of 5 times of the then latest 12 months net profit of the joint venture company or the aggregate of RMB73 million plus an increment at 8% per annum of the RMB73 million from the date of incorporation. The purpose of this arrangement is to give flexibility to the Group in enhancing its control of Beijing Stone and make further investment in this joint venture.

Kongyue Information has not exercised and does not at present intend to exercise its purchase rights.

- Suzhou Jolimark was established on 27th May, 2004 with a registered capital of RMB2 million by Kongyue Jolimark and two individuals, Du Wen Chao and Li Wei, owning 10%, 50% and 40% equity interest in the joint venture company, respectively, for the purpose of marketing and distributing Jolimark branded tax control equipment in Jiangsu Province. Du Wen Chao and Li Wei are Independent Third Parties. The registered capital of Suzhou Jolimark has been fully paid up.
- Shanghai Liang Biao was established on 2nd July, 2004 with a registered capital of RMB2 million by Kongyue Jolimark and two companies, 上海良標智能終端股份有限公司 (Shanghai Liang Biao Intellectual Termius Shares Limited)* and 上海敦勛電子科技有限公司 (Shanghai Dunxun Electronics Technology Limited)*, owning 35%, 40% and 25% equity interest in the joint venture company respectively, for the purpose of manufacturing and distributing tax control ECRs in Shanghai under the brand name of “良標” (Liang Biao). The two companies, 上海良標智能終端股份有限公司

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(Shanghai Liang Biao Intellectual Termius Shares Limited)* and 上海敦勛電子科技有限公司 (Shanghai Dunxun Electronics Technology Limited)* are Independent Third Parties. The registered capital of Shanghai Liang Biao has been fully paid up.

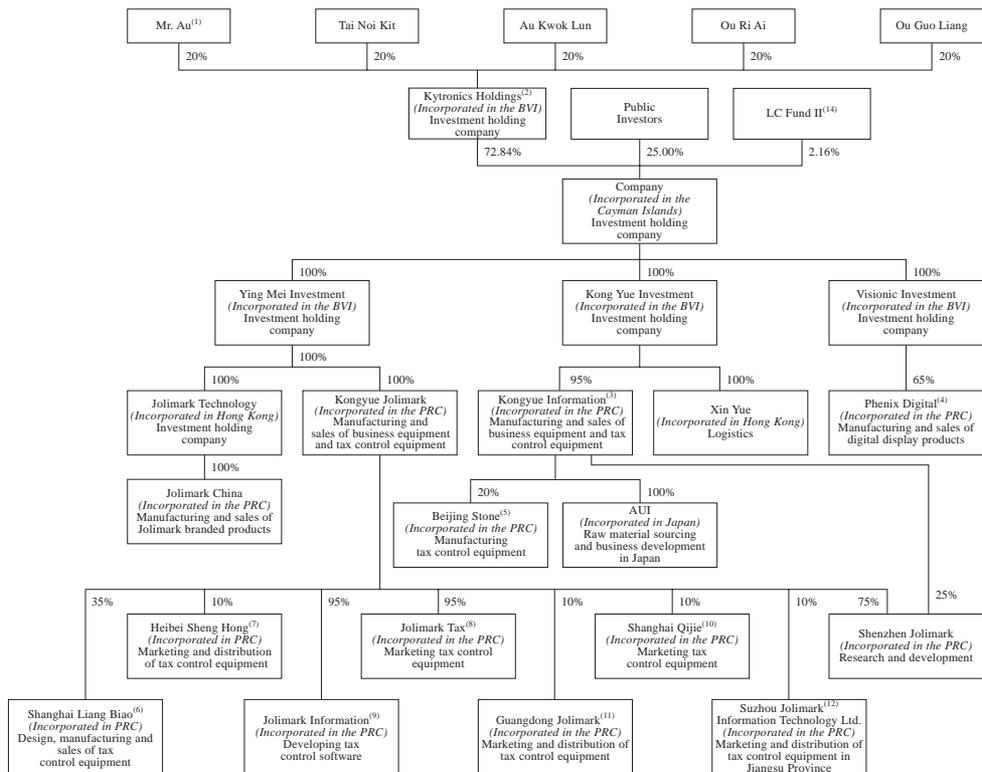
- Hebei Sheng Hong was established on 6th September, 2004 with a registered capital of RMB500,000 by Kongyue Jolimark and 石家莊晟宏科貿有限公司 (Shijiazhuang Sheng Hong Kemao Limited), owning 10% and 90% equity interest in the joint venture company respectively, for the purpose of marketing and distributing tax control ECRs and tax control printers under the Jolimark brand name in Hebei Province. The partner of the joint venture company, 石家莊晟宏科貿有限公司 (Shijiazhuang Sheng Hong Kemao Limited)*, is an Independent Third Party. The registered capital of Hebei Sheng Hong has been fully paid up.

Reorganisation

The Company was incorporated in the Cayman Islands on 22nd July, 2004 as a company with limited liability. The companies comprising the Group underwent a reorganisation in preparation for the listing of the Shares on the Stock Exchange. As a result, the Company became the holding company of the Group. The major steps of the Reorganisation are described in detail in the paragraph under the heading “Corporate Reorganisation” in Appendix V to this prospectus.

GROUP AND SHAREHOLDING STRUCTURE

Set out below is the Group’s corporate and shareholding structure immediately after completion of the Share Offer and the Capitalisation Issue, assuming the Over-allotment Option has not been exercised and no Shares are issued pursuant to options granted under the Share Option Scheme.



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Notes:

- (1) Mr. Au and Ms. Tai Noi Kit, who is the spouse of Mr. Au, are the father and mother of Mr. Au Kwok Lun, Mr. Ou Guo Liang and Ms. Ou Ri Ai respectively. Each of Ms. Tai Noi Kit and Ms. Ou Ri Ai will not hold any position in any members of the Group.
- (2) Mr. Au Kwok Lun is the sole director of Kytronics Holdings. The 5 beneficial shareholders of Kytronics Holdings, being Mr. Au, Mr. Au Kwok Lun, Mr. Ou Guo Liang, Ms. Tai Noi Kit and Ms. Ou Ri A, are the Au Family Shareholders.
- (3) The remaining 5% interest in Kongyue Information is held by Jiangmen Information.
- (4) The remaining 35% interest in Phenix Digital is held by Phenix Optics.
- (5) The remaining 80% interest in Beijing Stone is held by Beijing Computer.
- (6) The remaining 65% interest in Shanghai Liang Biao is held as to 40% by 上海良標智能終端股份有限公司 (Shanghai Liang Biao Intellectual Terminus Shares Limited)* and 25% by 上海敦勛電子科技有限公司 (Shanghai Dunxun Electronic Technology Limited)*, each of them being an Independent Third Party.
- (7) The remaining 90% interest in Hebei Sheng Hong is held by 石家莊晟宏科技有限公司 (Shijiazhuang Sheng Hong Kemao Limited)*, being an Independent Third Party.
- (8) The remaining 5% interest in Jolimark Tax is held by Mr. Ou Guo Liang.
- (9) The remaining 5% interest in Jolimark Information is held by Mr. Ou Guo Liang.
- (10) The remaining 90% interest in Shanghai Qijie is held as to 58% by Mr. Zhang Qi, as to 22% by Ms. Gao Hui Ling and as to 10% by Mr. Li Si Ming, each of them being an Independent Third Party.
- (11) The remaining 90% interest in Guangdong Jolimark is held by Guangzhou Auction.
- (12) The remaining 90% interest in Suzhou Jolimark is held as to 50% by Mr. Du Wen Chao and as to 40% by Mr. Li Wei, each of them being an Independent Third Party.
- (13) Kongyue Information, Kongyue Jolimark, Xin Yue, Phenix Digital, Jolimark China, AUI, Jolimark Information, Jolimark Tax and Shenzhen Jolimark are the operating subsidiaries of the Company.
- (14) LC Fund II is a venture capital investment entity managed by Legend Capital Management Limited.

BUSINESS STRATEGIES

“Golden Tax Project” is a nationwide project for the computerisation of the tax collection system in the PRC. In addition to the “Golden Tax Project”, the PRC government has launched a series of separate E-government infrastructure initiatives which aim at developing an information economy and building administrative capabilities (such initiatives and the “Golden Tax Project” are collectively known as the “Twelve Gold Projects”). The “Twelve Gold Projects” cover the whole range of IT systems for intra-government communications, education, health care and medical research, and agriculture.

The Directors consider that the implementation of the “Twelve Gold Projects” will prompt the replacement of handwritten records by the usage of computerised information systems, in turn, more hardcopy documents, including computerised reports and multi-part forms, will be printed by computer printers in both governmental and commercial sectors. Such reports and forms are often required to be printed in multi-part forms and multiple sheets in a single pass which require the use of SDM printers. Therefore, the implementation of the “Twelve Gold Projects” is expected to lead to an increase in demand for SDM printers in both governmental and commercial sectors in the PRC.

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The implementation of “Golden Tax Project” in China since 1994 not only has directly stimulated the demand for SDM printers in the governmental and commercial sectors in China, it has also created a sizeable market for a range of tax control equipment, including tax control ECR, mini printers, external tax control device, anti-fraud invoice printers (business tax invoice) and anti-fraud invoice printers (VAT invoice).

According to CCW Research, the accumulated sales of tax control equipment in the PRC between 2005 and 2011 will reach approximately RMB57.9 billion. The Directors believe that the Group, by virtue of its high brand recognition, well-established production capacity and distribution network, and solid relationship with major customers and suppliers in the PRC and overseas, is now well positioned to capture the sizeable business opportunities arising from the implementation of the “Golden Tax Project” and the “Twelve Gold Projects”.

Regarding the EMS/ODM/OEM business, the Directors believe that competition in the PRC is intense because of low entry barrier. However, amid the trend of globalisation, the cost advantages of the PRC have attracted substantial foreign companies to outsource its manufacturing activities to the manufacturers in the PRC. In order to maintain the competitiveness of the Group and sustain its profitability, the Group is not only able to offer manufacturing services to customers, but also to provide a range of value-added services, including direct material procurement, sales distribution and after-service services. The Directors believe there is a sizeable unexplored outsourcing market in the developed countries. To strengthen its position as a key EMS/ODM/OEM services provider, the Group intends to strengthen its effort in developing the outsourcing market and to target to medium-sized companies in the developed countries, including Japan, US and Europe which wish to outsource their manufacturing operations to the PRC to achieve cost reduction and/or to enter to the PRC domestic market.

To achieve these business objectives, the Group has formulated the following major business strategies:

- **Capitalise on strong and growing demand for SDM printers, digital display products and tax control equipment in the PRC**

The Directors believe that the increasing wide spread of the use of SDM printers and digital display products in the PRC provide business opportunities to the Group.

The PRC government has, in recent years, initiated the “Twelve Gold Projects” under which, the use of information technology is encouraged throughout the PRC government so as to implement the “E-Government” infrastructure. Together with the promulgation of the Golden Tax Project by the PRC government that promote the use of SDM printers and tax control equipment such as tax control ECRs and anti-fraud invoice printers (VAT invoice), the Directors believe that demand for SDM printers and tax control equipment will increase, especially the demand for tax control ECRs and mini printers. The Directors also believe that with its early participation in the market of tax control equipment, the Group is able to attract quality distributors and end users for its tax control equipment.

- **Maintain and broaden its overseas EMS/ODM/OEM customer base**

The Group’s strategy is to continue to strengthen its relationships with existing customers. The Group will continue to collaborate with its customers to improve existing product designs and their manufacturing process, to enhance its capacity in producing and designing opto-mechanical and electrical products.

In addition, the Group intends to expand its relationships with leading customers in the sector of business equipment and other electronic products, and to broaden its overseas EMS/ODM/OEM customer base. The Group will target medium-sized companies in the USA, Japan, South Korea and Europe. The Directors consider there is substantial demand for outsourced manufacturing services from these medium-sized companies in developed countries where production costs tend to be higher. The Company has set up AUI, a subsidiary in Japan, in June 2004 with the intention of establishing a relationship with potential EMS/ODM/OEM customers in Japan. Representative offices will also be set up in Singapore and Hong Kong where the Asian headquarters of some of the potential customers from the USA and Europe are located.

The Group will expand its overseas customer base in the USA, Europe, Japan and South Korea in a proactive way by appointing agents or representatives in these areas to help market and promote the Group's services through active participation in the local trade shows and contact with potential customers in order to enhance the Group's profile in these key markets.

In particular, the Group plans to expand its customer base in the overseas ODM market by enhancing its capability in product design and development through the expansion of its research and development team and strategic partnership with design houses in these overseas market in the form of joint ventures. The Group will also seek to develop its design capability of other products such as automobile electronic products, so as to broaden its customer base. The Directors believe that the provision of complete solution of services in full product design in addition to manufacturing will enhance the scope of business and help broaden the customer base of the Group.

In order to implement the above strategies of expanding its overseas EMS/ODM/OEM market, the Group will set up, internally, a special team for business development comprising personnel with international experience in the marketing and technological aspect of the business equipment industry.

- **Enhance brand recognition for Jolimark products**

The Group currently manufactures and markets its own branded printer and tax control products under its own brand name "Jolimark" and it aims to expand the market for its Jolimark branded products in the PRC by enhancing its brand recognition in the PRC.

The Group plans to launch intensive marketing programmes targeting both distributors and end users with the assistance of professional public relations consultants to be appointed by it. Such programmes will include the organisation of annual conference or seminars to promote new products or to provide training for distributors, organising trade shows and exhibitions for end users, advertising in trade magazines, in newspapers, and on bill boards in the PRC.

- **Expand the sales and distribution network for Jolimark branded products**

In order to expand its distribution network of Jolimark branded products, the Group intends also to set up through franchise arrangements with its distributors specialty counters, shops and flagship stores for the retail of its Jolimark branded products in the PRC. The Group plans to set up specialty shops throughout the PRC by franchising operational rights to its distributors. The Group plans to expand to having a network of 300 specialty counters, shops, and flagship stores by the end of 2006.

- **Strengthen its capabilities in product design and development**

The Group offers product design and development services to its customers. To enhance its existing product design capabilities, the Group intends to develop strategic partnerships with overseas design houses in the form of technology transfer or cooperation so as to satisfy customers' demand for more EMS services. By advancing its product design and development capabilities by partnering with design houses, the Group aims to be able to assist its EMS/ODM/OEM customers in improving their products and manufacturing process.

The Group will focus its efforts on printer products, including mini thermal printers, mini inkjet printers and SDM printers designed specifically for industrial application such as the banking and finance sectors and tax control equipment. The Group seeks also to enhance its capabilities in printer production by emphasising on its manufacturing technology. Beside printer products, the Group will focus on the research of digital display technology.

As the Group expects increasing demand in tax control equipment after the launch of the third phase of "Golden Tax Project", the Group will also concentrate on developing and improving its anti-fraud invoice printers, tax control ECRs and other tax control equipment under its own brand name "Jolimark".

The Group has also capitalised on its know-how in PCBA manufacturing in broadening its product range. For example, in 2004, the Group has also produced, besides business equipment, other electronic products including car audio products and mail folder inserter machines. The Group will continue to enhance its capabilities in designing and developing other electronic products that the Directors perceive to have considerable market demand.

In order to enhance its capability in product design and development, the Group will expand its current research and development team by appointing experienced executives to key positions as well as other new team members.

PRODUCTS

Product range

During the Track Record Period, the products manufactured and sold by the Group can be divided into the following categories:

1. Business equipment — SDM printers, mini printers, LCD projectors and electronic white boards
2. Tax control equipment — tax control printers, anti-fraud invoice printers (VAT invoice) and other tax control equipment
3. Other electronic products — PCBAs, mail folder inserter machines and car audio products

(I) *Business equipment*

The business equipment currently produced by the Group mainly include printers, LCD projectors and electronic white boards.

(a) *Printers*

The Group produces and markets SDM printers and related products on an EMS/ODM/OEM basis and under the brand name of Jolimark. Its SDM Printers include flat-bed printers, as well as mini dot matrix printers. These printers are largely used for printing invoices, certificates and accounting spread sheets. According to data issued in April 2005 by IDC, Jolimark was ranked the largest among domestic brands and the fourth largest brand of SDM printers in China in terms of unit shipment and accounted for approximately 8.3% of the total SDM printers shipments in the PRC during 2004. With respect to LED colour printers, as the Group does not have the necessary skill and technology in manufacturing LED colour printers, the Group subcontracts the production of LED colour printers to a printer manufacturer which is an Independent Third Party. The Group has entered into an OEM supply agreement with that manufacturer in August 2003 for an initial term of one year which has been renewed for a further one-year term expiring in August 2005.

(b) *LCD projectors*

LCD projectors are useful in image projections during presentations. The Group currently produces LCD projectors on OEM basis for Epson pursuant to an agreement they entered into in June 2001. That agreement was for an initial term of two years which can thereafter be renewed automatically on an annual basis unless terminated by three months notice by either party. Under the agreement, Group is required to produce Epson branded LCD projectors using certain specified parts purchased from Epson such as projector lenses.

(c) *Electronic white boards*

Electronic white boards are convenient office tools in the way that any text or graphics written on the board can be reproduced in printed copies. The electronic white boards are also applicable in classrooms, conferences and training sessions. Electronic white boards of the Group are manufactured under the brand name of Jolimark.

During the Track Record Period, the Group had also manufactured and sold LCD monitors on an OEM basis. The Group has since March 2003 ceased production of such products.

(II) *Tax control equipment*

In order to capture the sizeable business opportunities arising from the “Golden Tax Project”, the Group has allocated some of its resources towards the development of anti-fraud invoice printers (VAT invoice) and tax-control ECRs and other tax control equipment since 1999.

Tax-control equipment is designed to monitor and prevent falsification of tax receipts or accounts which facilitates tax evasion by businesses. They include tax control printers, anti-fraud invoice printers, external tax control devices and tax control ECRs which encompass commercial management, cashier management and tax control functions. Applications cover a wide range of industries, including restaurants, transportation, entertainment and other service industries. According to the Notice on the Strengthening of Monitoring and Controlling Tax Sources by Promoting the Application of Cash Registers for Tax Control Purposes (關於推廣應用稅控收款機加強稅源監控的通知) (the “Notice”) promulgated by the State Administration of Tax, the Ministry of Finance, MII and the Administration for Quality Supervision, Inspection and Quarantine in April 2004, the use of tax control ECRs is to monitor and prevent falsified tax receipts/accounts for illegal tax evasion.

With the promulgation of the Notice, production and distribution of tax control ECRs is restricted to duly licensed manufacturers who produce products which meet specifications laid down by the PRC authorities. There is no such requirement for producing other tax control equipment. Pending issue of the production licence, save as disclosed below, Kongyue Information is not allowed under the Notice and does not, produce tax control ECRs for sale for the time being. However, during the two years ended 31st December, 2004, the Group has produced a small amount of Jolimark branded tax control ECR on a trial basis pending finalisation of the national standard for the products specifications of tax control ECR by the relevant authorities in the PRC. The Company has been advised by its PRC legal adviser that the production restriction under the Notice applies to mass production only and not to trial production. In addition, the Group also designed and manufactured tax control ECRs for an Independent Third Party on OEM basis during the Track Record Period. To the best knowledge of the Directors, the tax control ECRs designed and manufactured for the Independent Third Party were sold only in Beijing, which is one of the forty-two selected cities in the PRC for the trial run application of tax control ECRs. Kongyue Information has applied to the MII in June 2004 for their inspection of its qualification for producing tax control ECRs in preparation for the application for the production licence. The Group has been advised by its PRC legal adviser that there appears no legal impediment for Kongyue Information to obtain such licence according to the current laws and regulations available. In addition, The Company has been advised by its PRC legal advisers that the purpose of the Notice was to regulate the marketing and the distribution of tax control ECRs in the PRC market. As the Group has not engaged in marketing or distribution of tax control ECRs, the Group's production of tax control ECRs on OEM basis does not violate the Notice.

In addition, manufacturers obtaining the relevant production licence of tax control ECRs do not automatically have the right to distribute their products but qualify for the participation in the product selection tender programs organised by the relevant local PRC government. Before a specific model of tax control ECR could be distributed in a province, autonomous region or municipality, it must have received sanction from the relevant local government. Only specific models of tax control ECRs that have received sanction from the local governments can be used by the end-users in those areas. The Notice provides that manufacturers may decide whether to sell their tax control ECRs direct to end users or through distributors. However, it does not prohibit other business entities from engaging in the distribution of tax control ECRs in the PRC. Strategically, with a view to capitalising on the local distribution network and existing relationship with local governments of its joint venture partners to enhance the Group's prospects of securing necessary government recognition of its tax control ECR products, the Group has set up a number of joint ventures for the purpose of distributing tax control ECR products.

Pursuant to the Notice, the State Tax Administration promulgated the Timing of Commencing Work on Cash Registers for Tax Control Purposes (關於稅控收款機推廣應用工作啓動時間問題的通知) in June 2004 and Notice of Opinions on the Application and Implementation of Cash Registers for Tax Control Purposes (《稅控收款機推廣應用實施意見的通知》) (the "Opinion") in August 2004. Pursuant to the Opinion, once the PRC Quality Control Department announces the first batch of companies with permission to manufacture tax control ECRs, the local selection tender programs can commence.

On March 2003, the Group entered into an collaboration agreement with Guangdong Tax. Under the collaboration agreement, the Group has been appointed by Guangdong Tax for the provision of maintenance and training services to users of tax control equipment in Jiangmen. The Group is entitled to receive a service fee from Guangdong Tax which is calculated with reference to the number of users of tax control equipment approved by Guangdong Tax in Jiangmen. In 20th March, 2004, this collaboration agreement has been renewed for one year commencing from 20th March, 2004. While the renewed term of agreement has expired, the collaboration arrangements between the Group and Guangdong Tax has continued since then and has not been terminated.

Currently, the Group has one production line for manufacturing tax control ECRs which commenced its operation in August 2003. During the period between August 2003 and December 2003, the tax control ECRs production line was used to manufacture tax control ECRs on a trial basis pending finalisation of the national standard for the products specifications of tax control ECR by the relevant authorities in the PRC. In addition, it also served as a back-up production line for SDM printers. In order to capture the business opportunities arising from the tax control ECR, the Group re-structured its production facilities and reserved this production line solely for the production of tax control ECR in January 2004. The Group also produced tax control ECRs for independent third parties on an OEM basis.

As the Group is well prepared for the mass production of tax control ECRs, the Directors expect that the commencement of mass production of tax control ECR (if and when the Group obtains the requisite permits and sanctions) will not affect the normal operation of the Group. The Group has also been advised by its PRC legal adviser that there appears no legal impediment for the Group to obtain the requisite production licence for such production activities according to the current laws and regulations.

(III) Other electronic products

The Group is an EMS provider presently manufacturing car audio products and mail folder inserter machines on an OEM basis for overseas customers. Such products use the SMT/PCBA, and generally the OEM manufacturing capabilities of the Group. In addition to finished products, the Group also uses its SMT/PCBA lines to produce PCBA on an OEM basis for Independent Third Parties. In addition, PCBA manufactured by the Group are also used by the Group in its manufacturing process for Jolimark branded products and products of the Group's OEM customers, including LCD projectors and car audio products.

The following table sets out the different types of products manufactured by or on behalf of the Group under (i) Jolimark brand name; and (ii) on EMS/ODM/OEM basis in brand names other than Jolimark:

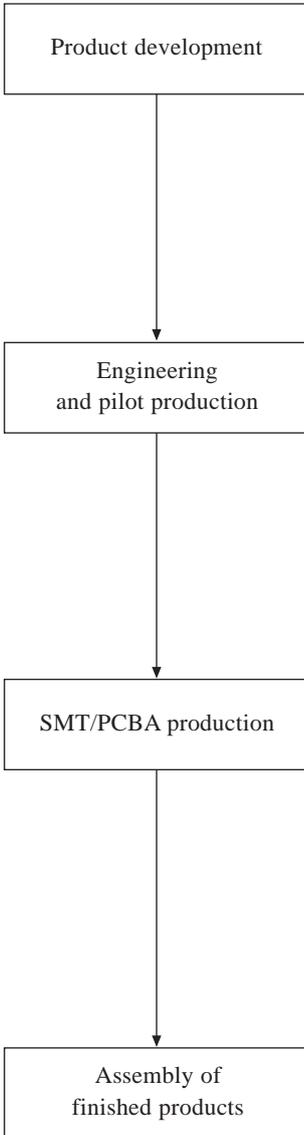
Manufactured and sold under Jolimark brand name	Manufactured and sold on EMS/ODM/OEM basis which products are in brand names other than Jolimark
Business equipment including SDM printers, mini printers, LED colour printers* and electronic white boards	Business equipment including SDM printers and related products and LCD projectors
Tax control equipment including tax control printers, anti-fraud invoice printers (VAT invoice) and other tax control equipment	Tax control equipment including anti-fraud invoice printers (VAT invoice), tax control ECRs and other tax control equipment
	Other electronics products including PCBAs, mail folder inserter machines and car audio products

* The production of LED colour printers has been subcontracted to an independent printer manufacturer.

PRODUCTION

The production of business equipment, tax control equipment and other electronic products principally comprise four stages: product development, engineering and pilot production, SMT/PCBA production and general assembly of products.

The following diagram illustrates the principal stages involved in the manufacture of the Group's products:



At present, product development is carried out with respect to the Group's own branded products and products produced on an ODM/OEM basis. Based on perceived market requirements, the Group's research and development team (comprised of hardware, software, optical, mechanical engineers) seeks to develop new products and enhanced models of existing products. New technology has been applied to newly developed products and enhanced products. Products are targeted to be made in high quality at low costs to meet the demands of both the PRC and international markets, aiming to achieve the relevant standards as enforced by both the PRC and overseas governments.

Before mass production, with respect to each new/enhanced product developed in-house or new EMS/OEM/ODM products, the Group's engineering and pilot production centre will lay down the technical specifications, material approval standards, technical process, based on the specific requirements of each new/enhanced product. It also arranges for test-production to further upgrade the developed products through test-production to fit the manufacturing under mass production lines. In addition, an overall standardized testing including testing on functions, reliability, durability and safety etc. will be carried out on products undergoing test-production.

Mass production of the Group's own branded products and EMS/OEM/ODM products usually commences with the mounting of IC chips and other electronic components onto PCBs to create the SMT/PCBA circuit boards. Flat mounted chips and electronic components and devices are mounted using the Group's five fully automated SMT lines. Other IC chips and vertical and horizontal electronic components are mounted at the Group's three insertion lines either manually or on fully automated basis, depending on the size and complexity of the PCBAs in question. The mounted PCBAs are then proceeded to the next stage of the general assembly and production after satisfactory completion of testing procedure. Software may be downloaded at this stage.

The components of PCBAs and other component modules and parts (injection moulds, dies, shaft/rubber parts, photo-electric switches, links etc.) including plastic casing and other precision components (sourced from preferred suppliers) are assembled at various positions in the production line to produce the final product (except where PCBAs will be directly sold to customers); and are tested and packaged as required internally (for Jolimark branded products) and by its customers (for OEM branded products).

The Group's production base is located at Levels 1 to 4 of an industrial building in Kong Yue Industrial Park, 18 Jiangyue Road, Jinguzhou, Xinhui District, Jiangmen, leased from Industrial Park. The existing leases for the production base (being those described in respect of properties numbered 3 and 6 in the property valuation report set out in Appendix III to this prospectus) will expire in 2009 and 2010 respectively.

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To ensure the quality of the Group's final product, relevant quality inspection stations are installed as an integral part of each production line (see sub-section headed "Quality Control" in this section). All of the SMT/PCBA production equipment and the testing equipment for various on-line and final products employed by the Group in its production lines are high precision equipment, most of which were imported from Japan.

As at 30th April, 2005, the Group's production lines were staffed by more than 550 workers working in 2 shifts and over 16 supervisory staff members. A further team of 24 engineering staff 30th April, 2005 is responsible for the maintenance and repairs of plant and machinery. The machinery is regularly checked and repaired on a daily, monthly and annual basis depending on the scale of check-up required.

The following table sets forth the total maximum annual production capacity of the Group's production facilities at Industrial Park as at the Latest Practicable Date:

Production lines	Maximum annual production capacity (Note 1) ('000 units)	Date of commencement
(1) <i>SDM printers and tax control equipment (Note 2)</i>		
Assembly line 1	141	January 1999
Assembly line 2	225	January 1999
Assembly line 3	<u>25</u>	April 2002
Total:	<u><u>391</u></u>	
(2) <i>PCBAs</i>		
Production lines 1-8	<u><u>1,450</u></u>	January 1999 (production lines 1-4), January 2002 (production lines 5-7) and January 2003 (production line 8)
(3) <i>LCD projectors</i>		
Assembly line 1	22	November 2001
Assembly line 2	<u>36</u>	August 2002
Total:	<u><u>58</u></u>	
(4) <i>Tax control ECR</i>		
Assembly line 1	<u><u>217</u></u>	August 2003
(5) <i>Mail folder inserter machines</i>		
Assembly line 1	18	May 2003
(6) <i>Car audio products</i>		
Assembly line 1	217	January 2003
Assembly line 2	<u>217</u>	January 2003
Total:	<u><u>434</u></u>	

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Notes:

- Annual production capacity has been calculated on the following assumptions:
 - each production line is operated on two seven-hour shifts daily, except for statutory holidays in the PRC (totalling about 3,619 man hours per year); and
 - all direct materials and parts are available when required.
- For the purpose of the table above and the table below, references to “tax control equipment” exclude tax control ECRs.

The following table sets forth actual production volume of the Group’s production facilities:

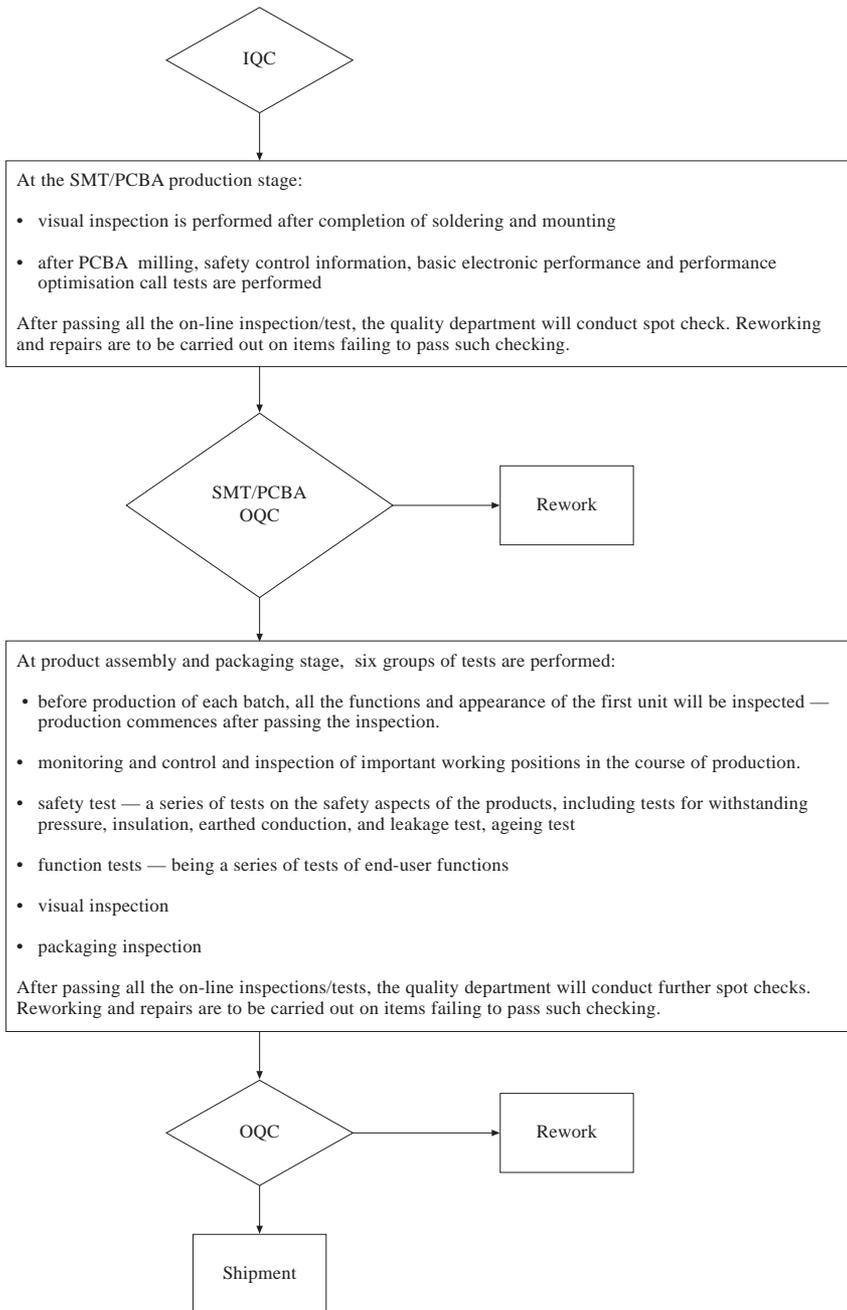
	Actual production volume of the Group for the year ('000 units)		
	2002	2003	2004
1. SDM printers and tax control equipment (<i>Note 2</i>)	178	218	181
2. PCBA	838	1,383	1,896
3. LCD projectors	11	20	31
4. Tax control ECR	—	—	9
5. Mail folder inserter machines	—	3	6
6. Car audio products	—	8	110

QUALITY CONTROL

To comply with the PRC and international regulatory requirements on product quality standards which must be satisfied before such products could be sold in the PRC and which are required for exports or other standards specified by the customers, the Group places strong emphasis on the quality control of its products. As at 30th April, 2005, the Group had a quality control team of 20 full-time employees who are responsible for the implementation of Group’s quality control policy. In addition, production staff stationed at Group’s production lines are responsible for line testing of semi-finished products.

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The Group's quality control procedures are carried out throughout its operations from the sourcing of raw materials, at each stage of its production process up to the delivery of products to customers. Those procedures could be illustrated by the following chart:



In the diagram above:

IQC means incoming quality control

OQC means outgoing quality control

In brief, these procedures comprise the following:

- **Direct materials:** The Group sources its direct materials only through its preferred suppliers who satisfied the Group's in-house standards, in terms of quality of raw materials and services (see sub-section headed "Raw Materials and Sourcing" below). In addition, production and delivery of direct materials by suppliers are authorised by the Group only after "first article approval" has been given, that is, when the sample materials could satisfy specifications and quality requirements designated by the Group or its customers. Direct materials delivered are also examined on an agreed sampling basis before acceptance.
- **Production:** Quality inspections are carried out during, and at completion of, each stage of production. At a specified point of each stage of production, each semi-finished item goes through quality audit and is reworked, where necessary. In addition to standard inspection procedures, the Group also performs specific product testing and inspection procedures in accordance with the Group's internal requirements for that product (for Jolimark product) or as agreed upon with its customers (for EMS/ODM/OEM products).
- **Finished product:** The packaged products are checked on a sampling basis prior to delivery to customers.

Since 1999, Kongyue Information has been accredited with the ISO 9002:1994 Quality Management System Certification and obtained to the ISO 9001:2000 Quality Management System Certification in 2003.

ENVIRONMENTAL MATTERS

The Group has adopted an environmental protection policy setting out environmental objectives and targets as well as a management system necessary to attain these targets. Kongyue Information was accredited with the ISO 14001:1996 Environmental Management System Certification in July 2003.

The Group has not been prosecuted for, or charged with, any material violation under any of the environmental laws, regulations or administrative rules since its establishment.

DIRECT MATERIALS AND SOURCING

(1) Manufacturing operations

Direct materials used by the Group for producing Jolimark branded products and for EMS/ODM/OEM customers (excluding products only traded but not manufactured by the Group) could be broadly divided into six main categories: electrical parts (such as mother boards, electric motors and semi-conductors), mechanical parts (such as gears and shafts), casing parts (both plastic and metallic), packaging materials (primarily boxes and manuals), accessories (such as cables and ink ribbon) and ancillary materials (such as lubricants, solder).

The extent to which an EMS/ODM/OEM customer requires the Group to source direct materials on its behalf is typically pre-agreed on a product by product basis. Suppliers of direct materials, in particular for key direct materials such as printer heads and projector lenses, are often prescribed by the EMS/ODM/OEM customers as suitable suppliers and their products are typically identified during product development. There are perceivable benefits for a customer to use consistent sources of suppliers (in terms of both quality control and bulk purchase benefits). In the case of PCBAs, SDM printers and LCD projectors produced by the Group for Epson, the Group may be required under their OEM contract with Epson to source certain types of Epson licensed components, including SDM printer heads and projector lenses from members of

the Epson Group. Amongst the Group's suppliers are the Connected Suppliers, who produce and sell to the Group precision plastic parts for SDM printers, and metal stamped parts. The Group has not entered into any long term contract with any of its suppliers for provision of direct materials, Epson Group and the Connected Suppliers inclusive. Terms of purchases are negotiated on an order by order basis, except in the case of direct materials sourced from Epson or Epson designated suppliers, those terms may be fixed by Epson for the manufacture of the relevant products.

The Group manages the supply of the direct materials required for the production of the EMS/ODM/OEM and Jolimark branded products. The Group has adopted a centralised procurement policy for direct materials. Purchases are made depending on the orders received from customers and also forecasted sales of Jolimark branded products. Major EMS/ODM/OEM customers of the Group are usually required to provide, on a non-committed basis, their projected requirements of products at the beginning of each year to facilitate annual budgeting and planning of the Group. The same policy applies to materials planning for Jolimark branded products, subject to regular internal review of requirements. It is the policy of the Group not to accumulate excessive direct materials. In anticipation for future uncertain demand of products, it generally places orders for direct materials by reference to confirmed orders from EMS/ODM/OEM customers, forecast sales of Jolimark branded products and the lead time required for sourcing different types of direct materials. As at 30th April, 2005, the Group's sourcing functions are covered by a team of 46 full-time employees.

Each of the Group's suppliers will have passed the Group's qualification review procedures, and are typically chosen by reference to the quality of their products and services, production capacities, pricing offered and delivery time by the supplier. To avoid over-dependence on a single supplier, the Group generally has at least two preferred suppliers for each type of direct material. The Group conducts routine internal reviews on the performance of its suppliers. For suppliers of key parts and those suppliers whose performance falls short of the Group's requirements, the Group also carries out site inspection of their operations on an annual basis. In addition, the Group also holds an annual convention with its suppliers to review their overall performance, discuss particular issues and inform them of the plans and expectations of the Group for the following year. Persistently substandard suppliers may lose their preferred supplier status. In this way, the Group seeks to control the quality of its suppliers.

(2) Distribution operations

During the Track Record Period, the Group distributed both Epson branded printers supplied by Epson direct and those which were manufactured by the Group on behalf of Epson on EMS/ODM/OEM basis. In respect of the distribution of Epson printers not manufactured by the Group, the Group purchases, as principal, products from Epson for resale. The Group typically enters into one-year fixed term non-exclusive distribution agreements for specified products with Epson, renewable annually. The Group is not obliged to make minimum purchases under these agreements.

As regards the distribution of Epson branded SDM printers manufactured by the Group, in addition to the usual manufacturing terms found in OEM contracts, the Group would also negotiate and agree in such contracts the quantity of SDM printers to be produced and distributed by the Group by reference to the Group's perceived market demand for the relevant Epson branded SDM printer model. Since 2004, the Group ceased manufacturing Epson branded SDM printers.

(3) Overseas sourcing logistics

The Group sources direct materials, principally printer heads, IC chips, electronic parts, and components for LCD projectors from overseas suppliers from time to time for its manufacturing operations. It also imported from Epson their SDM printers for distribution in the PRC prior to 2004. Thereafter Epson

BUSINESS

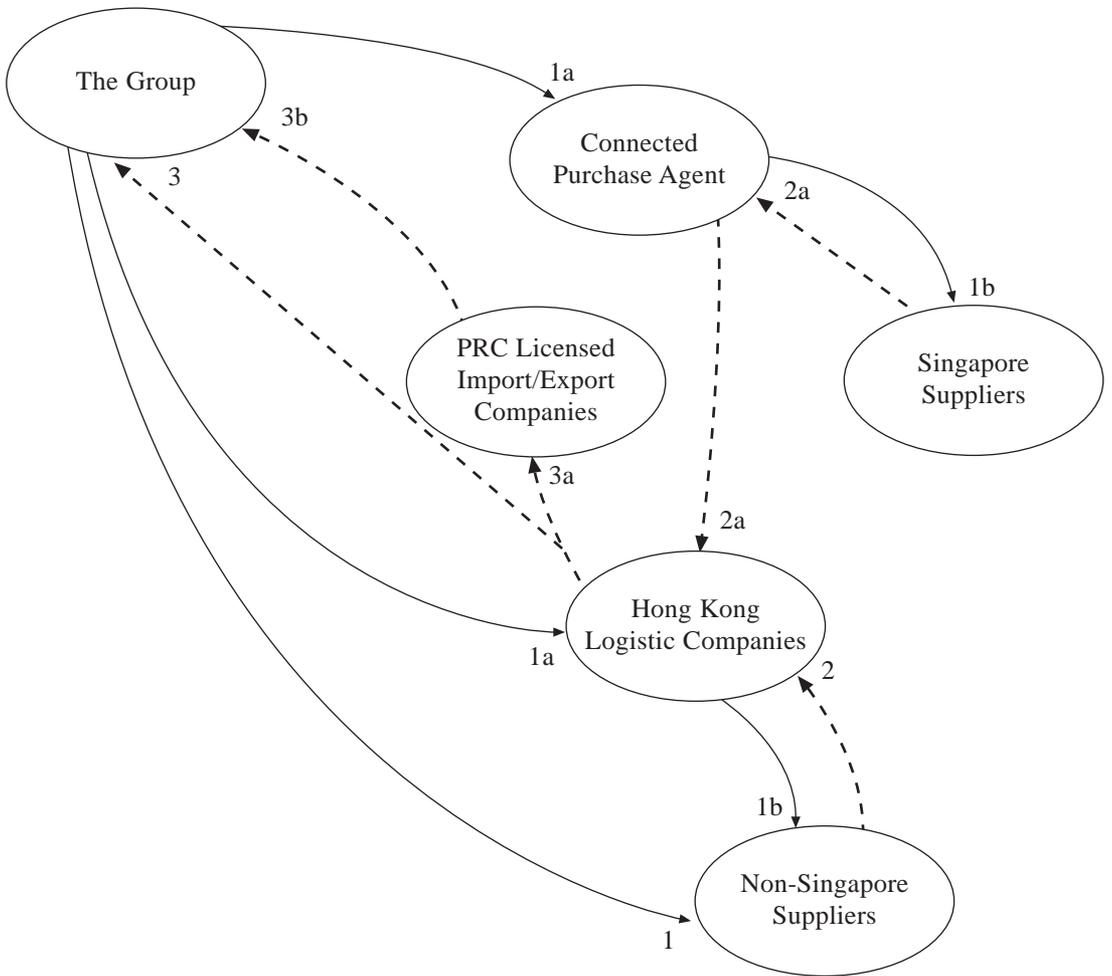
branded SDM printers distributed (and not produced by the Group) are sourced locally in the PRC. Due to Hong Kong's vicinity with Jiangmen and its position as a key transportation hub in Asia, the Group consolidates its required supplies in Hong Kong before forwarding them to the Group's operation headquarters in Jiangmen. For this purpose, the Group has established Xin Yue in Hong Kong in October 2004 which commenced operation in January 2005 to act as its logistic agent in Hong Kong. The logistics services provided by Xin Yue includes assisting the Group primarily in procuring direct materials from Hong Kong, arranging for imports from overseas suppliers and where necessary dealing with settlement, and liaising with export customers in Hong Kong in respect of the delivery of the Group's products. Prior to the commencement of operation in January 2005 of Xin Yue, logistics services were provided by New Success. Taking into account that (1) the relevant employees of New Success transferred to Xin Yue; and (2) the business nature of New Success, the Directors do not consider that the replacement of New Success will affect the Group's operation.

To lower its direct materials procurement cost, the Group also uses the services of the Singapore based Connected Purchase Agent. The Connected Purchase Agent is required to deliver products to (and settle with) the Group's logistics agent in Hong Kong for forwarding to the Group.

Where the Group's imports are not designated for its OEM operations and for certain exports, the Group is required under PRC laws to effect such imports from PRC licensed import/export companies. KY Import/Export was one of the import/export companies whose services were retained by the Group.

Further details regarding the Group's relationships with its Hong Kong based logistic agents (including the Connected Logistics Agents), the Connected Purchase Agent and KY Import/Export are set out below.

The following diagram illustrates the Group's overseas sourcing logistics:



Legend:

—————> Flow of sourcing instructions/purchase orders

- - - - -> Flow of goods

1–3 denotes the order of the transaction flow.

1: The Group places purchase orders direct to its overseas suppliers (except suppliers in Singapore). Until August, 2003, it placed orders to overseas suppliers through Kongyue Technology, its then Hong Kong based Connected Logistics Agent. From June 2003, the Group started to migrate to the practice of placing purchase orders direct with its overseas suppliers. Such migration was completed in July 2004 when New Success, the Group's Connected Logistics Agent was appointed. Xin Yue has since October 2004 been established to replace the Connected Logistics Agents. For suppliers in Singapore, during the Track Record Period and thereafter, purchase orders are placed to those suppliers through the Connected Purchase Agent. Orders were placed by the relevant Connected Logistic Agent or Connected Purchase Agent only with the prior approval or on instructions of the Group.

2 & 3: Goods from the suppliers are delivered to the party who placed the relevant order except that goods for which purchase orders are made by the Group direct are delivered through the Hong Kong based logistic agents. In the case of the Hong Kong based logistic agents (including the Connected Logistics Agents), during the Track Record Period, they settled with the overseas suppliers (except suppliers in Singapore) and the Connected Purchase Agent after being put in funds by the Group, except that before June 2003 Kongyue Technology settled with its own resources and billed the Group for purchases made. For payments by letters of credit, the Group arranged for the letters of credit to be issued direct to the suppliers. The Connected Purchase Agent settled with suppliers in Singapore with its own funds and then settled with the Connected Logistics Agents and, since January 2005, settles with Xin Yue for direct materials delivered to them. In the second half of 2004 the Directors considered it not cost effective to establish a subsidiary or representative office solely for direct material procurement. However, in preparation for the proposed Listing and to handle the increasing amount of direct materials, the Group established Xin Yue in October 2004 to manage its direct material procurement. Mainly direct materials or products which are not designated for domestic sales are delivered to the Group through PRC licensed import/export companies (including KY Import/Export) to the Group.

Before August, 2003, the Connected Logistics Agent was Kongyue Technology. Thereafter and until January 2005 after Xin Yue became fully operational, New Success (being a company set up solely for the purpose of providing logistics services, as opposed to Kongyue Technology which was then also engaged in trading and property investment) acted as the Hong Kong based logistics agent for the Group.

The Connected Logistics Agents were responsible principally for consolidating and attending to management of settlement for certain offshore purchases of the Group (including those purchases made by the Connected Purchase Agent). At the request of the Group, they may also provide nominal liaison services on a pro bono basis for the Group with its export customers in Hong Kong, since the Group had insignificant exports. The Group prescribes and decides on the specifications and terms of purchases from or sales to the Group's suppliers/customers, although the Connected Logistics Agents will in the course of their duties liaise with those suppliers/customers on behalf of the Group. Since Xin Yue became fully operational, the Group places all its orders direct with overseas suppliers. Other than that, the functions of Xin Yue and the Connected Logistics Agents are substantially the same.

In return for their procuring services in Hong Kong, the Connected Logistics Agents are entitled to receive a fee equal to around 1% of the value of goods they source direct from the Group's suppliers which is charged as a mark up on the price of goods delivered to the Group. They do not impose any additional charge for consolidating materials delivered by the Connected Purchase Agent as the volume and quantity of those materials are not substantial. The reasons for not including the Connected Logistics Agents in the Group is set out in the sub-section headed "Relationship with the Au Family Shareholders and the Directors" in this section.

The Connected Purchase Agent acts as the interface between the Group and its suppliers in Singapore, principally being suppliers of IC chips and electronic parts. Typically, the Group having identified prospective possible suppliers, instructs the Connected Purchase Agent to contact the relevant suppliers in respect of specified quantities of materials of prescribed specifications, for example, to obtain product samples, to discuss terms with the prospective suppliers within the parameters laid down by the Group. It will, after the Group has decided to effect the purchase, place appropriate orders with the relevant suppliers. The Connected Purchase Agent attends to settlement with those suppliers and also for delivery of the direct materials received from suppliers to the Group's logistics agents in Hong Kong, as the Directors consider it more cost effective for the Group to consolidate all offshore purchases in Hong Kong before onward delivery to it in Jiangmen.

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In return for services provided by the Connected Purchase Agent, it is entitled to receive a fee of around 1% of the value of goods purchased, charged as a mark up on the price of such direct materials. The reasons for not including the Connected Purchase Agent in the Group are set out in sub-section headed “Relationship with the Au Family Shareholders and the Directors” in this section.

As mentioned above, KY Import/Export was one of the PRC licensed import/export companies whose services were retained by the Group, principally for importing materials and goods which are designated for domestic sales under PRC laws. Such import/export corporations attend to customs documentation in the PRC in respect of the materials and goods imported by the Group (except for certain direct materials used for OEM production) and arrange for the conversion of the Group’s RMB payments into the appropriate foreign currency for settlement of trade payables, principally due to the Hong Kong logistics agent of the Group. The Group also from time to time exports through KY Import/Export. They do not impose any additional charge for consolidating materials delivered by the Connected Purchase Agent as the volume and quantity of those materials are not substantial. While the nature of services provided by KY Import/Export has not changed at all material times, settlement arrangements with Jiangmen customs authorities and the Connected Logistics Agents in respect of the Group’s imports through KY Import/Export have changed since January 2004 due to the removal of settlement restriction of the Jiangmen customs authorities. Before then, settlement was effected through KY Import/Export and therefore, invoices issued by KY Import/Export to the Group covered amounts payable to Jiangmen customs authorities, KY Import/Export and the Connected Logistics Agents. Since January 2004, the Group settled with those parties direct. In respect of exports, the Group cannot settle its exports with KY Import/Export in a similar manner because under prevailing practices of the customs authority, apart from the goods for which prior notification has been given by the Group to the customs authorities, the Group is not allowed to export products without engaging the services of a licensed import/export company. Therefore, products which have not been notified to the customs authorities are exported through KY Import/Export by sale to KY Import/Export and resale to the ultimate customers.

KY Import/Export is entitled to receive a fee of about 1% of the value of the imported materials and goods (which includes the fees charged by the Group’s Hong Kong based logistic agents and the Connected Purchase Agent). For exports through KY Import/Export (which have been insubstantial) the Group is “charged” a fee equal to 1% of the value of the goods exported through KY Import/Export by way of a reduction in prices of those products sold to KY Import/Export for export. The reasons for not including KY Import/Export in the Group is set out in sub-section headed “Relationship with the Au Family Shareholders and the Directors” in this section of this prospectus.

(4) General

After taking into account the actual suppliers from whom purchases were made by the Group through the Connected Logistics Agents, the Connected Purchase Agent and KY Import/Export, the total purchases from the Group’s top five suppliers which are Independent Third Parties for each of the three years ended 31st December, 2004 accounted for approximately 72.9%, 84.7%, and 79.6% respectively of the total purchases made by the Group and the purchases from the Group’s largest supplier among these five, was Epson Group who accounted for approximately 33.3%, 47.9%, and 56.9% respectively of the total purchases made by the Group. None of the Directors or their respective associates or any shareholder (which to the knowledge of the Directors will own more than 5% of the issued share capital of the Company immediately after the close of the Share Offer and assuming no exercise of the Over-allotment Option) has any interest in any of the top five suppliers.

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Aggregate purchases from the Connected Suppliers accounted for approximately nil, 0.2% and 1.6% of the Group's total purchase during the three years ended 31st December, 2004 respectively. The aggregate value of direct materials and goods procured by (including related service charges of) the Connected Logistic Agents and KY Import/Export accounted for approximately 46.7%, 51.9% and 44.5% respectively of the Group's total purchases for each of the three years ended 31st December, 2004.

Purchases made by the Group are usually settled by telegraphic transfer on delivery or by letters of credit (with credit periods up to 90 days) for imported materials and by cash payment (generally with credit periods ranging from 30 days to 45 days) for materials sourced domestically.

The Group's trade payables turnover for each of the three years ended 31st December, 2004 was approximately 59 days, 57 days and 48 days, respectively.

For the year ended 31st December, 2004, approximately 38.9%, 48.7%, 7.3%, 4.0% and 1.1% of the Group's purchases were denominated in Renminbi, US dollars, Japanese Yen, Hong Kong dollars and Euro respectively. Since the official exchange rate for the conversion of Renminbi into US dollars and Hong Kong dollars remained stable during the Track Record Period, the Company has not adopted any measures to hedge the movement of US dollars and Hong Kong dollars. To minimise the effect of fluctuations of exchange rate of Japanese Yen in the future, the Group is currently negotiating with its suppliers in Japan to settle the Group's purchases by US dollars. Save for the above, the Group does not adopt other measures to hedge the movement of foreign currencies.

INVENTORY CONTROL

The Group manages its direct materials used in production through a centralised materials management system, which facilitates smooth production and helps minimise wastage. By being able to consolidate the direct materials requirements for production of Jolimark branded products and (to the extent that materials procurement services are being provided by the Group) EMS/ODM/OEM products and to closely monitor its inventory level and future demands, the Group is able to source more cost effectively.

Direct materials that are not immediately deployed in production are stored at the Group's warehouse in a temperature and humidity controlled environment to ensure that they are kept in good condition and high value parts (such as integrated circuits and central processing units) are separately stored to which access is restricted to certain authorised persons.

At the end of each of the three years ended 31st December, 2004 the Group's inventory of direct materials amounted to approximately RMB92 million, RMB143 million and RMB103 million, respectively; at the end of each of the same periods the Group's inventory of finished goods amounted to approximately RMB59 million, RMB69 million and RMB50 million respectively.

The inventory turnover of the Group for each of the three years ended 31st December, 2004 was about 105, 102 and 85 days, respectively.

SALES AND MARKETING

As at 30th April, 2005, the Group had a sales and marketing team of 179 full-time employees (including 95 staff who were employed by the Connected Distributors and are now employed by the Group after the Reorganisation).

The strategy of the Group is to maintain international brand owners as core customers, to develop other EMS, ODM and OEM customers as well as to offer its own-branded Jolimark products. The Directors believe that this strategy will broaden the Group's income base, and help improve overall profitability by providing value added services to customers both in terms of direct materials procurement and design customisation capabilities. The marketing and sales strategy for the EMS/ODM/OEM clients and those of Jolimark products are different as follows:

(1) EMS/ODM/OEM products

The target EMS/ODM/OEM customers for the Group are those in the information technology/electronics product and automobile sectors. The marketing strategy of the Group includes the promotion of its products through online advertising, attending trade shows, and the Group's own website.

Currently, the EMS/ODM/OEM customers of the Group are mainly located in Japan and Europe. The Group works closely with its OEM customers in manufacturing and supply chain management. The Group is also looking to develop the US and South Korean markets. The Group's strategy also includes developing strategic partnerships with overseas design houses with the intent of tapping the customer base of those design houses for EMS/OEM customers. In addition, the Group could also provide, upon request, value added services for certain products in the form of marketing, distribution and provision of after sales services in the PRC through the Group's own network. For example, while the Group produces PCBAs and LCD projectors on an OEM basis for sale to Epson, during the Track Record Period, the Group provided distribution and after sales services in respect of those Epson branded SDM printers it manufactured for Epson. In connection with such services, the Group agreed with Epson the number of units of each type of Epson branded SDM printers to be manufactured (by reference to market demand estimated through the Group's own distribution network) and the price for production of such printers. The price at which the Group sells to its distributors need not be fixed and agreed by Epson but the Group will usually follow the prices recommended by Epson. Printers produced under this arrangement were sold and delivered through the Group's distribution network and were paid by the Group's distribution customer base. Further information regarding arrangements in respect of after sales services provided by the Group are set out in the sub-section headed "After Sales Services" in this section of this prospectus.

(2) Jolimark branded products

(i) Printers

Customers of the Group's Jolimark branded products are either distributors or end users (mainly those in commercial sectors and the government/state owned sectors). In order to approach these users, the Group's marketing strategy aims both at the end users and at distributors. To enhance brand recognition and promote the Group's services and products, the Group places outdoor advertisements, participates in seminars targeted at different customer groups to promote their products and offers free trials. Where appropriate, the Group provides on-site training courses for its end-users. The Group also organises conventions for its existing distributors and end users, to introduce new products to its distributors and end users.

Kongyue Jolimark has established nine branches in major cities/provinces in the PRC, including Beijing, Guangzhou, Shanghai, Shenyang, Wuhan, Chengdu, Xian, Hunan and Nanning which are responsible for liaising with and managing distributors and after sales

centres. It also had a network of authorised distributors covering all provinces in the PRC (except Xizang Autonomous Region), as at 30th April, 2004. Further information regarding the Group's distribution network is set out below.

In order to strengthen the sales of Jolimark branded products to governmental agencies of China, the Group has participated in the tendering program organised by the Chinese Government Procurement Network (中國政府採購網), which is an authorised Internet portal designed and operated by Ministry of Finance of China, during the Track Record Period. According to the tendering result for the procurement in 2003 and 2004 issued by the China Government Procurement Network, a member of the Group was accepted as an approved supplier of SDM printers and LED colour printers. During the two years ended 31st December, 2004, the total sales volume of Jolimark branded products sold by the Group, through its local distributors, to the governmental agencies of China amounted to approximately RMB21 million and RMB24 million respectively.

(ii) *Tax control equipment*

The Group started producing anti-fraud invoice printers (VAT invoice) in 2000, which were sold both through government authorised distributors and manufacturer authorised distributors. The Group, therefore, focuses both on enhancing user brand awareness through advertisement in magazines and on developing sales channels for such products by participating in user training seminars organised by authorised distributors.

With the recent promulgation of Notice on the Strengthening of Monitoring and Controlling Tax Sources by Promoting the Application of Cash Registers for Tax Control Purposes (《關於推廣應用稅控收銀機加強稅源監控的通知》) (the "Notice"), manufacturers granted the licence to produce tax control ECRs have to further bid for the PRC government recognition of the specific model of tax control ECRs in various provinces, autonomous regions and municipalities. According to the Notice, the manufacturers may decide whether to sell their tax control ECRs directly to end users or through distributors. Therefore, in addition to its efforts to secure the relevant production licences for producing tax control ECRs, the Group's strategy is also geared towards securing market share in tax control ECRs by setting up joint ventures with partners who have established local brand recognition and/or established local distribution networks that could assist the Group in successfully bidding for local governments' sanction of their tax control ECRs.

(3) Distribution Services

The Group is also a distributor of certain Epson branded SDM printers in the PRC which are not manufactured by the Group and are procured by the Group from Epson. These products are sold through the Group's distribution network.

(4) The Group's distribution network

(i) *Role of Connected Distributors during the Track Record Period*

During the Track Record Period and before the Group fully utilised its branches, the Group developed its distribution network by directly contracting with its distributors or indirectly through its Connected Distributors which were established during the period from early 1999 to 2002. The Connected Distributors include Beijing Kongyue, Shenyang Kongyue, Chengdu Kongyue, Shanghai KY Electronic, Wuhan Kongyue, Xian Kongyue, Dalian Kongyue and

Guangzhou Kongyue. Save for Shanghai KY Electronic which is owned as to 70% by Shanghai Kong Yue Technology Development which is a non wholly-owned subsidiary of KY Import/Export, all Connected Distributors were and are wholly-owned by the Au Family Shareholders and/or their associates directly or indirectly.

The Connected Distributors served as the regional distributors for the Group to facilitate the business development of the Group in different regions of the PRC. With the development of the Group's distribution network, the Group considered it desirable to facilitate its regional development and management through regional distributors. The Connected Distributors were engaged for this purpose and accordingly, some Jolimark branded products and Epson branded SDM printers were sold through the Connected Distributors to the Group's distributors.

The roles of the Connected Distributors included (1) to help develop business relationships with distributors and other customers of the Group at the designated regions of the PRC by arranging company visits to these distributors and other customers in the designated regions; (2) to assist the Group in its collection of the trade receivable; and (3) to serve as an interface between the Group and its distributors and other customers in different regions of the PRC for the sale and delivery of the Group's products.

The distributors of the Group (except for Epson products where there is no such distinction) fall into two types: core distributors and general distributors (please see below for further details). To facilitate the sale and settlement, the general distributors could place purchase orders either to the Group and the Connected Distributors in the vicinity, from time to time, during the Track Record Period. According to the Group's sales policy, the core distributors may only place purchase orders with the Group (as opposed with the Connected Distributors directly). However, if the core distributors obtained prior approval from the Group, they were allowed to place purchase orders to the Connected Distributors.

To standardise the Group's pricing and credit policy, the Connected Distributors were not authorised to determine the terms of sales. They were required by the Group to follow the Group's pricing and credit policy.

Generally, the Connected Distributors would place purchase orders with the Group after the distributors or other customers of the Group have placed the purchase orders with them and would only make payments to the Group for products purchased after they have received payment from the Group's distributors and customers. The Connected Distributors were responsible for billing and the delivery of the Group's products to the Group's distributors if that distributor placed purchase orders to them directly. To facilitate prompt delivery of products to the Group's distributors and other customers in different regions in the PRC, the Connected Distributors were also required by the Group to carry some inventory to cater for small and urgent orders.

In order to cover their operating costs, the Connected Distributors were entitled to receive a nominal service fee, which was charged in the form of a mark-up and a management fee. The mark-up and the management fee together amounted to around 2–3% of the aggregate value of the products delivered through the Connected Distributors to the Group's distributors and other customers during the Track Record Period.

In order to streamline the organisation structure of the Group and simplify the operation process, the Company has, through its subsidiaries, established branches in major cities/provinces in the PRC, including Beijing, Shanghai, Chengdu, Guangzhou, Xian, Wuhan and

Shenyang, to take over the functions of the Connected Distributors after 31st May, 2004. The establishment of such branches has been confirmed by the PRC legal adviser to the Company to be legal and valid under the PRC laws.

As confirmed by the Directors, the Group has since 1st June, 2004 ceased transacting with the Connected Distributors, which have ceased their distribution business. After 31st May, 2004, all distributors and end users may only place purchase orders with the Group directly, and the Group then bill and collect payments from them after the Group's products are delivered.

(ii) *The current distribution network of the Group*

The Group managed the distribution of products through the seven branches of Kongyue Information and nine branches of Kongyue Jolimark since June 2004. These branches are located in major cities and provinces in the PRC, including Beijing, Guangzhou, Shanghai, Shenyang, Chengdu, Wuhan, Xian, Hunan and Nanning. Kongyue Information's branches service the Group's EMS customers and distributes non-Jolimark branded products, such as Epson branded SDM printers which are not manufactured by the Group. Kongyue Jolimark's branches focus on the distribution of Jolimark branded products. The branches share the same offices where they are located in the same cities. They also share a common pool of distributors.

The Group's distributors for Jolimark branded products could be divided into two types: (i) core distributors and (ii) general distributors. As at 30th April, 2005., the Group had more than 80 core distributors and more than 400 general distributors for Jolimark branded products. Both types of authorised distributors purchase products from the Group for resale to end users. These core distributors are required to commit to the development of their distribution network for Jolimark branded products and to participate in, and contribute towards, the Group's promotional efforts in their regions. Before they qualify for appointment, they undergo a rigorous selection process that includes review of marketing track record, financial background and credit track record. The distributors are required to sell only within a specified geographical region and their operations are subject to routine reviews and on site inspections by the Group. If they do not meet specified performance targets, they may lose their core distributor status. Both core and general distributors enter into standard sales agreements with the Group. These agreements provide for the price and quantity of products, delivery method and credit period. In addition, the prices of products sold to core distributors is the same as those sold to general distributors.

All of the Group's Jolimark branded products are currently sold in the PRC. OEM products are sold both overseas and in the PRC.

During the three years ended 31st December, 2004, sales of goods to the Connected Distributors (including revenues derived from Jolimark products, Epson branded SDM printers produced on an EMS basis and Epson branded printers for distribution only) amounted to approximately RMB152.9 million, RMB271.1 million and RMB48.3 million respectively, representing approximately 27.0%, 33.3% and 5.0% of the turnover of the Group for the respective years. In particular, for the EMS/ODM/OEM turnover derived from the Connected Distributors, such turnover amounted to approximately RMB65.2 million, RMB55.4 million and RMB5.4 million respectively representing approximately 19.8%, 12.2% and 1.2% of the EMS/OEM/OEM turnover of the Group during the Track Record Period respectively. The remaining EMS/ODM/OEM revenues were derived from other third parties. The Connected Distributors were also paid a management fee amounting to approximately RMB2,040,000, RMB2,610,000 and RMB522,000 respectively.

BUSINESS

For each of the three years ended 31st December, 2004, Epson was the Group's single largest customer, accounting for approximately 34.0%, 34.0% and 31.6%, respectively, of the Group's turnover. During the same period, sales attributable to the five largest customers of the Group (after taking into account the actual customers to whom sales were made by the Group through the Connected Distributors) accounted, in aggregate, for approximately 50.4%, 49.2% and 48.4%, respectively, of the Group's turnover.

Save for the Connected Distributors, none of the Directors, their respective associates or any shareholder (which to the knowledge of the Directors will own more than 5% of the issued share capital of the Company immediately after the close of the Offering and assuming no exercise of the Over-allotment Option) has any interest in any of the Group's five largest customers.

The Group's sales to its EMS/ODM/OEM customers and core distributors are entered into on credit terms ranging from 30 to 90 days, while the credit terms offered to ordinary distributors of the Group range from 30 to 60 days.

Customers of the Group pay for their purchases in a variety of currencies. For customers of Jolimark branded products, all purchases are made in RMB. For EMS/ODM/OEM customers, purchases will be made in RMB if they are located in the PRC or US dollars or Japanese Yen if they are Hong Kong or overseas customers.

The Group's debtors turnover days for each of the three years ended 31st December, 2004 were approximately 47 days, 35 days and 48 days, respectively. The increase of debtors turnover days from 2003 to 2004 was mainly due to the Group's decision to extend the credit period to certain of its customers in order to strengthen the competitiveness of the Group in 2004.

RELATIONSHIP WITH EPSON GROUP

Epson Group is a major customer of the Group. For each of the three years ended 31st December, 2004, Epson Group was the Group's single largest customer, accounting for approximately 34.0%, 34.0% and 31.6%, respectively of the Group's turnover. It is also a major supplier of the Group. During each of the three years ended 31st December, 2004, Epson Group accounted for approximately 33.3%, 47.9% and 56.9% of the total purchases made by the Group, respectively. During the Track Record Period, the Group produced PCBAs, SDM printers and LCD projectors on an OEM basis for sale to Epson and provided distribution and after sales services in respect of those Epson branded SDM printers it manufactured and sold for Epson. The Group also distributed and continues to distribute Epson branded SDM printers procured by the Group from Epson. In connection with its OEM manufacturing services for Epson, the Group is required to source certain types of Epson licensed components including SDM printer heads and projector lenses from members of the Epson Group. The Group has since 2004 ceased to produce SDM printers for Epson on an OEM basis. It continues, however, to distribute Epson branded SDM printers through its distribution network. Further information regarding sourcing and sales arrangements of the Group are set out in the subsections headed "Direct Materials and Sourcing" and "Sales and Marketing" in this section.

AFTER SALES SERVICES

In addition to ensuring the quality of its products, the Group places much importance on the after sales services it offers both to end users of Jolimark products and the products of some of its EMS/ODM/OEM customers.

As at 30th April, 2005, the Kongyue Jolimark had a network of over 155 service centres covering about 20 provinces, 4 autonomous regions and 4 municipalities in the PRC. Most of these service centres are owned and operated by authorised service providers, who are also Independent Third Parties. The Connected Distributors also served the service centers. Through its branches located in Beijing, Shanghai, Shenyang, Chengdu, Wuhan, Xian, Guangzhou, Hunan and Nanning in the PRC, Kongyue Jolimark provides technical support and supplies parts to its distributors after sales network. Kongyue Jolimark typically enters into contracts with its authorised service providers for one year term (before 2004, the term was usually half year) which is automatically renewable on expiry for periods of six months. Under the agreements, Kongyue Jolimark will provide spare parts required during product warranty periods to the authorised service providers at a pre-agreed fee who are not entitled to charge end users for spare parts used in providing repair & marketing services during the product warranty period. Services provided by the authorised service providers to end-users during product warranty periods of one to three years will be paid by the Group according to a fixed price schedule. When the product warranty periods expire, the end users have to pay the authorised service providers for spare parts and repair and maintenance services and the Group will not reimburse the service providers for any services provided. The Group does not fix the charges to be paid by end users to the authorised service providers after expiry of product warranty periods but requires that such fees should be higher than but not more than 100% of the charges set by the Group during warranty period. The authorised service providers typically have hardware and software engineers who are familiar with the installation and structure of information technology products and are therefore able to provide technical support and maintenance services. For printer products, the authorised service providers will also provide services after warranty periods. During the Track Record Period, the warranty fee received by the Group amounted to approximately RMB251,000, RMB2.7 million and RMB1.9 million respectively.

Most of the core and general distributors as described under the sub-section headed “Sales and marketing” above in this section of this prospectus are also authorised service providers. The qualification of these companies as an authorised service provider is assessed separately from their qualification as distributors. As for all authorised service providers of the Group’s products, these companies are also required to have hardware and software engineers who are familiar with the Group’s products and are able to provide repair and maintenance services to the end users.

In providing technical support services, the Group operates a toll-free customer hotline operated by engineers. The Group also holds one to two training conferences per year at its headquarters for the authorised service providers to ensure that they are kept up to date with the Group’s latest products. The Group has adopted a stringent policy in controlling the supply of spare parts. Efficiency in spare parts supply is enhanced through the use of the Internet by authorised service providers. The end users’ degree of satisfaction in after sales services of the Group are reviewed through interviews with its end users and authorised service providers.

The after sales service network of the Group mainly serves customers of Jolimark branded products. On request, the Group can also provide after sales services on behalf of its OEM customers. During the Track Record Period, among the Connected Distributors, Beijing Kongyue, Chengdu Kongyue and Xian Kongyue had entered into agreements with Epson on provision of after sales services to users of Epson products not sold by the Group.

For each of the three years ended 31st December, 2004, the total amount of warranty provisions charged to profit and loss accounts was approximately RMB1.1 million, RMB2.6 million and RMB4.2 million, respectively.

COMPETITION

In general, the Group's products can be categorised into three broad segments, namely (1) SDM printers and other related printing products; (2) tax control equipment; and (3) electronic products like car audio products and mail folder inserter machines.

SDM printers and related printing products

Stimulated by the implementation of the "Golden Tax Project" and "Twelve Gold Projects", the overall SDM printers market in the PRC has shown remarkable growth during the past few years.

According to the "China printer forecast and analysis report" issued in July 2004 and April 2005 respectively by IDC, the SDM printer shipment units increased by 30.0% from approximately 1.0 million units in 2002 to approximately 1.3 million units in 2004. According to IDC, the SDM printers accounted for approximately 18.2% and 33.8% of the total printers shipment units and total printers shipment value in 2004 respectively.

According to the data issued in April 2005 by IDC, the SDM printers market in China was dominated by three Japanese branded products which accounted for approximately 67.7% of the total SDM printers shipments in China in 2004.

The Jolimark brand name was established by the Group in 2001 and Jolimark branded SDM printers have become the largest among domestic brands and the fourth largest brand of SDM printers in China in terms of unit shipment during 2004. The Directors believe that the success of the Jolimark branded SDM printers was contributed by its cost advantages over its overseas competitors and well-established distribution and after-sales service network.

To further expand its market share in SDM printers and related printing products in the PRC, the Group will strengthen its effort in establishing its own brand in association with affordable and versatile business equipment, designed to meet the needs of PRC end users.

Tax control equipment

The tax control equipment market is driven by PRC government policy, in particular the implementation of the "Golden Tax Project". As the "Golden Tax Project" is a nationwide project for the computerisation of the tax collection system in the PRC, the design and implementation of the project are closely monitored and controlled by the relevant authorities in the PRC, including the State Administration of Taxation and the Ministry of Information Industry in the PRC.

With the promulgation of the Notice on the Strengthening of Monitoring and Controlling Tax Sources by Promoting the Application of Cash Registers for Tax Control Purposes (關於推廣應用稅控收款機加強稅源監控的通知) in April 2004, production of tax control ECRs is restricted to duly licensed manufacturers who produce tax control ECRs which meet specifications laid down by the relevant PRC authorities. Such specifications mainly include (i) having at least RMB30 million as registered capital and (ii) possessing well-established research and development capability, sizeable production capacity and a reliable after-sales service network.

Therefore, the Directors consider that the entry barrier of the tax control equipment market, especially for tax control ECRs is high because of the demanding regulatory requirements for the production of tax control equipment in the PRC.

Under the PRC regulatory requirements, manufacturers which have obtained the relevant production licence of tax control ECRs do not automatically have the right to distribute their products. Before a specific model of tax control ECR could be distributed in a province, autonomous region or municipality, it must have received sanction by the relevant local government. Only specific models of tax control ECRs that have received sanction by the local governments can be used by the end-users in those areas. Based on the above, the Directors consider that the one of key determining factors for the Group's ability develop its tax control ECRs business in the PRC is whether or not it receives sanction by the relevant local government for the distribution or the Group's tax control ECRs.

Strategically, with a view to capitalising on the local distribution network and existing relationship with local governments of its joint venture partners to enhance the Group's prospects of securing necessary government sanction for its tax control ECRs, the Group has set up a number of joint ventures for the purpose of distributing tax control ECRs.

Other electronic products

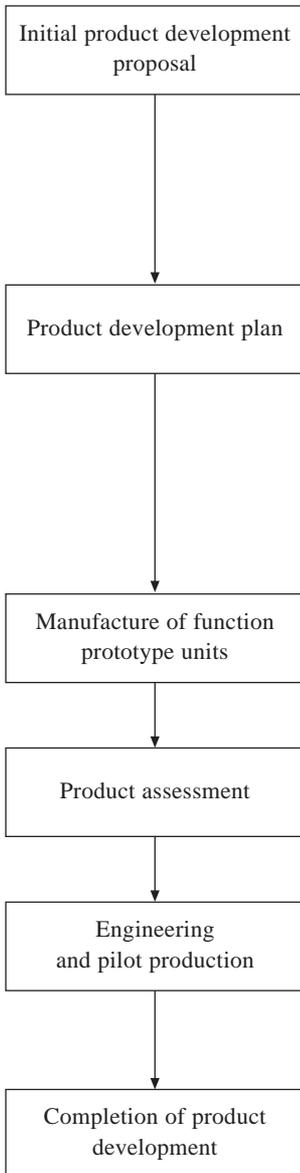
Leveraging on its know-how in SMT and PCBA, the Group produces a range of electronic products for customers on EMS/ODM/OEM basis. Such products include car audio products, mail folder inserter machines and PCBA.

General competition in the production of the above products is intense and is characterised by price erosion. To sustain the competitiveness and profitability of the Group, the Group is not only able to offer manufacturing services to customers, but also to provide a range of value-added services, including direct material procurement, sales distribution and after sales services.

PRODUCT DEVELOPMENT

As at 30th April, 2005, the Group had a research and development department of 139 full-time employees (including staff with background in optical engineering, electrical engineering, software and mechanical engineering). The team is responsible for product and module design and control of product quality.

The following diagram shows the typical steps of the product development process of the Group:



The development of each new Jolimark branded product is initiated by an inter-departmental committee comprised of members from the Group's sales and marketing department, production department and research and development department. Based on perceived market demands and forecast industry requirements, the committee formulates an initial production proposal and lays down product types (including both new products and upgrades of existing models), product specifications, and costing parameters.

After the initial product development proposal has been approved by the senior management of the Company, a project team is set up, which prepares the product development plan. This involves the setting up of a product development timetable, product specification, direct material cost estimation, product development costs and allocation of responsibilities amongst the different members of the team, depending on their areas of expertise. Where necessary, for example, in hardware and software development, the project team may also outsource part of the design work.

Component/modules developed are separately tested and then consolidated to produce function prototype units for further testing. Testing report will be issued according to the result.

The inter-departmental committee will then assess the prototype for compliance with the product development parameters laid down in the initial product development proposal. It also reviews costing for mass production.

Before mass production, pre-products engineering is carried out (see the paragraphs under the heading "Production" of this section for more detail) and the Group carries out pilot production of typically about 50 to 100 units of the developed product, to ascertain product and production stability and for further product testing.

Test production products (if successful) will be delivered for product certification by the relevant PRC regulatory department and may be provided to a limited number of customers/distributors for trial use. Arrangements will also be made for the products' mass production.

Product development cycle varies from product to product, depending on their specifications.

BUSINESS

On 22nd April, 2001, Kongyue Information entered into a product development and production cooperative agreement (“Cooperative Agreement”) with Kongyue Jolimark. The main purpose of the Cooperative Agreement was to allow both parties to leverage on the advantages and assets of each other in the manufacturing and sales of Jolimark branded products in order to minimise their respective operational cost.

According to the terms of the Cooperative Agreement, Kongyue Jolimark will contribute technical know-how, and Kongyue Information will provide the materials and technical staff required for production for certain Jolimark branded products for which Kongyue Information has obtained the relevant China Compulsory Certificate. According to PRC laws and Regulation for Compulsory Product Certification, the Compulsory Product Certification System applies to products related to human life and health, animals, plants, environmental protection and national security, and such products, including the Jolimark branded products, must acquire the China Compulsory Certification mark before they can be marketed, imported or used for any commercial purposes in China. To minimise the costs relating to product certification and accreditation, Kongyue Information is responsible for applying for and holding the China Compulsory Certification mark which will be applied to the Jolimark branded products jointly produced by Kongyue Information and Kongyue Jolimark in accordance with the Cooperative Agreement. Under the Cooperative Agreement, Kongyue Information is entitled to receive 5% of the total production cost of Jolimark branded products manufactured by Kongyue Information in accordance with the Cooperative Agreement as manufacturing fee. The manufacturing fee under the Cooperative Agreement is determined by Kongyue Information and Kongyue Jolimark on arm’s length basis with reference to the gross profit margins charged by Kongyue Jolimark to its customers who are Independent Third Parties. Under the Cooperative Agreement, Kongyue Jolimark is entitled to the turnover from the sales of Jolimark branded products to end customers. The Cooperative Agreement will remain valid until a written termination agreement is executed by Kongyue Information and Kongyue Jolimark.

During the Track Record Period, the Group has cooperated with overseas manufacturers in product development. Since November 2000, the Group has entered into an agreement with Seiko Precision for the development of a new model of printer for a term of 5 years. The intellectual property rights in the developed products (which includes the two new models of SDM printers developed by them jointly in 2003) will be owned jointly by Kongyue Information and Seiko Precision and no percentage of intellectual property rights owned by the Group was specified in the above agreement. Kongyue Information is permitted under its agreement with Seiko Precision to produce and sell such products under its own brands or for its ODM customers in the PRC. The cost of development will be borne by the Group. The product development team actively participated in the design of the new models and the production mode.

For each of the three years ended 31st December, 2004, the Group’s research and development costs was approximately RMB1,423,000, RMB4,188,000 and RMB3,615,000 respectively. Further information regarding the accounting policies adopted by the Group in relation to such expenditure is set out in the “Notes to the Accountants’ Report section in Appendix I” of this prospectus.

INTELLECTUAL PROPERTY

(1) Trademarks

As at the Latest Practicable Date, the Group was the registered proprietor and beneficial owner of the following trademark:

Trademark	Place of Registration	Classes	Registration Number	Validity Period
Jolimark 映美	PRC	9	1598514	7th July, 2001 to 6th July, 2011
映美	PRC	9	1598516	7th July, 2001 to 6th July, 2011
Jolimark	PRC	9	1598515	7th July, 2001 to 6th July, 2011

(2) Patents

As at the Latest Practicable Date, the Group was the registered owner of the following patents:

Name of patent	Registered owner	Patent Number	Validity Period
液晶顯示器 (LCD monitor) outlook design	Kongyue Jolimark	ZL02360068.3	14th August, 2002 to 13th August, 2012
打印機紙張檢測裝置 (Printer paper sorting device)	Kongyue Jolimark	ZL02250755.8	25th December, 2002 to 24th December, 2012

As at the Latest Practicable Date, the Group had applied for registration of the following patents:

Name of patent	Name of Applicant	Application Number	Application date
打印機 (Printer)	Kongyue Jolimark	02149770.2	24th December, 2002
打印機 (Printer)	Kongyue Jolimark	02151793.2	31st December, 2002
打印機 (Printer)	Kongyue Jolimark	02151792.4	31st December, 2002
稅控收款機 (Tax control ECR)	Kongyue Jolimark	03274772.1	24th September, 2003

The Group, through its patent agencies, has obtained written acknowledgement letters from State Intellectual Property Office of PRC (中華人民共和國國家知識產權局) (“SIPO”) on 30th December, 2002, 15th January, 2003 and 10th September, 2004 in respect of the Group’s applications for the registration of above four patents. Save for these letters, the Group has not received any request or opposition from SIPO. The Directors have confirmed that it is normal to take around two to three years to obtain approval from SIPO regarding registration of patents.

(3) Domain Name

As at the Latest Practicable Date, the Group was the registered owner of the following domain name:

Domain Name	Registration Date
www.jolimark.com.cn	27th September, 2001

The contents on the above website do not form part of this prospectus.

(4) Copyrights

As at the Latest Practicable Date, the Group was the registered owner of the following copyrights:

Name of copyright	Name of registered owner	Registration Number	Date of first publication
TIP-210 稅控發票機應用軟件 (tax control receipt device application software) V3.0	Kongyue Information	2004SR04772	1st March, 2004
映美稅控發票打印管理系統 (Jolimark tax control receipt printing management system) V3.2	Kongyue Information	2004SR04774	1st March, 2004
BB-610 稅控器應用軟件 (tax control device application software) V2.0	Kongyue Information	2004SR04771	1st March, 2004
ECR-680 稅控收款機應用軟件 (tax control ECR application software) V4.01	Kongyue Information	2004SR04773	1st March, 2004

The validity period of the copyright in software owned by a legal person is 50 years, ending on 31st December of the 50th year after the first publication of the software.

Save as disclosed herein, there are no other trade or service marks, patents or other intellectual or industrial property rights which are material to the Group's business.

INSURANCE

The Group maintains insurance policies in respect of its production facilities. These policies cover losses or damages in respect of its assets and vehicles in the PRC.

Currently, all of Jolimark branded products are sold in the PRC. Although the Group is not required to purchase product liability insurance under the PRC laws, the Group has voluntarily purchased product liability insurance from a PRC insurance company in respect of the Group's Jolimark branded products. The Directors consider that the Group's insurance policies to be adequate.

The Directors confirm that there have not been any material insurance claims during the Track Record Period.

RELATIONSHIP WITH THE AU FAMILY SHAREHOLDERS AND THE DIRECTORS

(A) Related party transactions that were terminated before the listing of the Shares

Apart from those connected transactions disclosed in the sub-section headed “Connected Transactions” below and the guarantees given by and to the connected persons of the Company which have been terminated, the Group had also during the Track Record Period and thereafter entered into certain transactions with the Au Family Shareholders and their associates, which were terminated before listing of the Shares. Brief particulars of such transactions are set out below.

(i) Transactions with the Connected Distributors

Until 31st May, 2004, the Group sold products to the Connected Distributors. For details of the functions of and the Group’s relationship with the Connected Distributors, please refer to the sub-section headed “Sales and Marketing” in this section.

The Connected Distributors are PRC incorporated entities owned by an Au Family Shareholder and an associate of the Au Family Shareholders except Shanghai KY Electronics which is owned as to 30% by an Independent Third Party and as to 70% by a company which Au Family owns 66.7%. They have been serving the Group as described in this prospectus and have not been involved in other distribution business. Save for Beijing Kongyue, Xian Kongyue and Chengdu Kongyue (the “Three Connected Distributors”), the Connected Distributors has not engaged in any business activities since 1st June, 2004. As at the Latest Practicable Date, the business of the remaining Three Connected Distributors was the provision of product maintenance services to users of Epson branded products. Due to the difference in nature of the remaining business and operation, the Directors are of the view that such business and operation of the Three Connected Distributors do not and will not compete with that of the Group. In any event, their entire businesses and operations will cease on or before October 2005.

Having reviewed the structural efficiency of the Group’s operations and to simplify the Reorganisation, the Group decided that it would be more efficient and cost effective if the Group were to centralise the management and administration of its distribution operations through its own branches. Accordingly, with effect from 1st June, 2004, the Group ceased all transactions with the Connected Distributors and their 106 sales and marketing staff was transferred to the Group. As the distribution business is a “people’s business”, the Group had always controlled the source of products and most of its customer base, the Directors considered there to be and the Group has experienced no difficulty in effectively taking over the Connected Distributors’ business through the employment of their staff.

On 13th June, 2005, each of the Connected Distributors gave undertakings in favour of the Company (for itself and the Group) that it shall cease its business and operation on or before 31st October, 2005 and for so long as the Shares are listed on the Stock Exchange, it:

- (1) shall not either on its own account or for any other person, firm or company, or as principal, partner, director, employee, consultant or agent through any body corporate, partnership, joint venture or other contractual arrangement, directly or indirectly, solicit,

interfere with or endeavour to entice away from any member of the Group any person, firm, company or organisation who or which to its knowledge is now or has been a customer, supplier or employee of any member in the Group; and

- (2) shall not either alone or jointly with any other person or entity, or for any other person, firm or company, or as principal, partner, director, employee, consultant or agent through any body corporate, partnership, joint venture or other contractual arrangement, be engaged in any business in any form or manner anywhere in the world that is in competition, directly or indirectly, with or is likely to be in competition, directly or indirectly, with the business from time to time carried out by any member of the Group.

(ii) *Transactions with the Connected Logistic Agents*

During the Track Record Period, only one Connected Logistics Agent acted for the Group at a time. They were principally responsible for consolidating and attending to management and settling logistics for all offshore purchases of the Group (including those purchases made by the Connected Purchase Agent based in Singapore). At the request of the Group, they also facilitated delivery and settlement with certain OEM customers of the Group who preferred transacting with non-PRC incorporated entities, whereby they purchased products from the Group against orders from OEM customers. As the role of the relevant Connected Logistic Agents in relation to exports was in substance one of liaison with the Group's OEM customers in Hong Kong and the amounts of such exports were small relative to the amounts of direct materials/goods sourced by the Group through them, they did not charge any additional service fees for such services. In October 2004, the Group established Xin Yue to takeover the function of the Connected Logistics Agents. For the three years ended 31st December, 2004, the service fees in respect of the purchase conducted on behalf of the Group paid to the Connected Logistic Agents by the Group, amounted to approximately RMB3.9 million, RMB5.7 million and RMB3.3 million respectively. The service fees paid to the Connected Logistic Agents represented approximately 1% of the aggregate value of direct materials/goods procured by the Connected Logistic Agents and were included in the total amounts billed by the Connected Logistic Agents to the Group or the import/export agents which were aggregated in the purchase cost of direct materials in the Group's accounts.

(iii) *Guarantee for the benefit of Guangdong Precision*

Kongyue Information has acted as the guarantor at no charge of a bank loan granted by a bank in the PRC to Guangdong Precision in the amount of RMB50 million from 31st October, 2003 to 31st October, 2006. The Group has not received any consideration from Guangdong Precision. As advised by the PRC legal advisers to the Company, the provision of guarantee for the benefit of Guangdong Precision does not violate any relevant PRC laws or regulations. Such guarantee was released on 25th March, 2005.

(iv) *Transactions with Kongyue Printing*

From 2000 to May 2004, the Group leased production facilities of SDM printers, transportation fleet and other office equipment from Kongyue Printing before Kongyue Information has fully developed its production capacity. For the two years ended 31st December, 2003 and the five months ended 31st May, 2004, the amount paid by the Group to Kongyue Printing for the rental of printer production lines, other production facilities, transportation fleet and office equipment amounted to approximately RMB849,025, RMB835,261 and RMB348,025 respectively. Since May, 2004, the Group acquired the production lines, other production facilities, transportation fleet and office equipment from Kongyue Printing and has ceased the leasing arrangements with Kongyue Printing.

(v) *Transactions with Industrial Park*

Kongyue Information and Kongyue Jolimark have provided cash advance on a rolling basis to Industrial Park during the Track Record Period for its second phase of construction of Kong Yue Industrial Park.

The aggregate amount of cash advances made by the Group to Industrial Park during the two years ended 31st December, 2003 amounted to approximately RMB77.4 million and RMB34.3 million respectively. These cash advances were unsecured and interest-free.

As at 30th September, 2004, cash advances made to and outstanding from Industrial Park amounted to approximately RMB775,000. According to the off-setting arrangements among the members of the Group and its related parties, this amount has been settled by off-setting with current accounts between the Group and its related parties. As at 31 December 2004, all the cash advances to Industrial Park had been settled. For details of cash advances made to Industrial Park, please refer to sub-section headed “Advance to and related parties” in the “Financial Information” section of this prospectus.

(vi) *Mortgages provided by Industrial Park for the benefit of Kongyue Information*

Industrial Park has mortgaged a piece of land located in Jinguzhou, Xinhui District, Jiangmen, Guangdong Province with the total area of approximately 91,035 sq.m. and factory and warehouse premises with the total area of approximately 39,198 sq.m. owned by Industrial Park to Bank of China (Jiangmen Branch) as security for the banking facilities granted to Kongyue Information up to the amount of RMB100 million from 4th March, 2005 to 4th September, 2006. Industrial Park has not received any consideration from the Group for the provision of the mortgages. According to the letter issued by Bank of China (Jiangmen Branch) on 31st May, 2005, the bank provided an in-principle approval to Kongyue Information that the bank will release such mortgages upon the successful listing of the Company on the Stock Exchange.

(B) Relationship with the Au Family Shareholders

Upon listing of the Shares, the Au Family Shareholders will hold in aggregate 100% interest in Kytronics Holdings, which will in turn hold 72.84% of the issued share capital of the Company, assuming that the Over-allotment Option is not exercised. Therefore the Au Family Shareholders together are deemed to be controlling shareholder of the Company within the meaning of the Listing Rules.

Apart from their interests in the Company (and indirectly its subsidiaries and associates through their shareholding in the Company), the Au Family Shareholders and their respective associates do not have any interest in any business which compete or is likely to compete, either directly or indirectly, with the business of the Group. Those companies in which they are interested and which previously or are expected to continue to have business dealings with the Group do not actually compete with the Group for reasons stated below.

Connected Distributors

- The Connected Distributors were the regional distributors which assisted the Group to develop its business, instead of the competitors of the Group. Each of them is a domestically owned enterprise in the PRC. For details of the role of the Connected Distributors, please refer to the sub-section headed “Sales and Marketing” in this section.

Having considered the structural efficiency of the Group's operations in the context of the then PRC regulatory environment and the degree of effort to be involved in the Reorganisation (which, if the Connected Distributors were to be included in the Group, would entail time consuming procedures for the conversion of each of them into a foreign investment enterprise ("FIE"), as the Company is a foreign entity for the purposes of PRC laws), the Directors decided that it would be more efficient and cost effective if the Connected Distributors were excluded from the Group and the Group were to centralise management and administration of its distribution operations through its own branches. The Directors consider that the establishment of and operation through its own branches has the following time and cost advantages: (i) no capital commitment as no registered capital is required for the establishment of branches; (ii) the establishment of branches involves much simpler procedures and (iii) the ongoing regulatory compliance to which the branches are subject is less cumbersome. In addition, as advised by the PRC legal advisers of the Company, it would take not less than four months to obtain the relevant approvals and registrations for the conversion of the Connected Distributors from domestic enterprises to FIEs. Besides, according to Management Methodology Regarding Investments in Commercial Aspects by Foreign Enterprises (外商投資商業領域管理辦法) and Index for Investment by Foreign Enterprises (外商投資產業目錄), the Group is required to obtain approvals from and registrations with the relevant PRC authorities of the provinces in which the Connected Distributors were operated. After obtaining the necessary approvals from and registrations with the relevant PRC provincial authorities, the Group is also required to apply for new business licences for the Connected Distributors. The Connected Distributors have now ceased all distribution activities. To avoid any possible competition occurring in the future, each of the Connected Distributors has given a non-compete undertaking in favour of the Group that (1) the Connected Distributors do not and shall not engage in business activities which may conflict with those of the Group; and (2) the Connected Distributors shall cease their entire businesses and operations on or before October 2005. For details of the undertakings given by the Connected Distributors, please refer to the sub-section headed "Relationship with the Au Family Shareholders and the Directors" in this section.

As confirmed by the Directors, the Group had never recognised the advantages of setting up its own branches until they obtained advice from relevant professional advisers after the Group commenced its preparation of listing in early 2004. Having taken such advice, the Directors decided to set up its own branches to replace the Connected Distributors.

Connected Suppliers

- Guangdong Precision (which is wholly owned by the Au Family Shareholders and their associates) and Jiangmen Yida (which is owned as to 40% by the Au Family Shareholders and their associates) are suppliers of the Group. Jiangmen Yida is principally engaged in the manufacture of metal stamped parts (such as supporting frames and metal plates for PCBs). Guangdong Precision is principally engaged in the manufacture of precision plastic parts (such as plastic casings, plastic cogs and wheels and plastic rods). Both are therefore engaged in the production of up-stream parts which are used in the manufacturing of final products but neither of them served the Group exclusively. Furthermore, neither of them has production lines or equipment or operating team engaging in the design, production and/or distribution in the PRC of any products which are similar or compete with the products produced and/or sold by the Group. They do not and could not (unless they change their business) compete with the Group's existing business. As the core businesses of these companies are materially different from that of the Group, they have accordingly not been included as part of the Group.

Connected Purchase Agent

- The Connected Purchase Agent was established in Singapore, and has been assisting the Group in sourcing IC parts and electronic parts from suppliers in Singapore. The Directors consider that its proximity to the Group's suppliers would facilitate liaison with the suppliers in Singapore on behalf of the Group. In this regard, the Group intends to continue to source direct materials from the Connected Purchase Agent after listing of the Shares, which will constitute an ongoing connected transaction under the Listing Rules. For details of the role of the Connected Purchase Agent in direct materials sourcing for the Group and its transaction with the Group after listing of the Shares, please refer to the sub-sections headed "Direct Materials and Sourcing" and "Connected Transactions" in this section of this prospectus.

Apart from sourcing direct materials for the Group, the Connected Purchase Agent has also engaged in trading and investment activities in Singapore for other companies owned by the Au Family Shareholders and their associates which are not included in the Group. These trading and investment activities do not involve the production, design and/or distribution in the PRC of any products which are similar or may compete with the products produced and/or sold by the Group. It therefore, does not and could not (unless it changes its business) compete with the existing business of the Group. As the trading and investment businesses of the Connected Purchase Agent is materially different from the businesses of the Group, the Directors do not consider it appropriate to include the Connected Purchase Agent into the Group.

Connected Logistic Agents

- Kongyue Technology and New Success, both being the Connected Logistic Agents, were responsible for (1) assisting the Group in procuring direct materials in Hong Kong; and (2) providing logistic services to the Group in relation to (a) the import of direct materials from overseas suppliers; and (b) the export of the Group's products to overseas customers during the Track Record Period. For details of The functions of the Connected Logistic Agents, please refer to the sub-section headed "Direct Materials and Sourcing" in this section of this prospectus.

Kongyue Technology (prior to June 2003) and New Success (from July 2003 to December 2004) had been appointed as the Group's logistic agents in Hong Kong as prior to the commencement of operation of Xin Yue in January 2005, the Group did not have any operation in Hong Kong. The Directors considered it efficient to appoint logistic agents in Hong Kong to handle the sourcing and logistic activities in Hong Kong.

Kongyue Technology has ceased serving the Group since June 2003 and its services has been replaced by New Success since July 2003, as the Au Family Shareholders rationalised the business structure of companies owned by the Au Family Shareholders to delineate more clearly the functions of their companies. Kongyue Technology, in addition to holding property investments, engaged in trading activity while New Success' principal business is the provision of logistic services and it had provided logistic services to the Group prior to June 2003. Kongyue Technology and New Success have not been involved in the production, design and/or distribution in the PRC of any products which are similar or compete with the products produced and/or sold by the Group. They do not compete with the Group. As their services are now taken up and replaced by Xin Yue and their businesses are materially different from the core business of the Group, the Company does not consider it desirable or necessary to include these companies in the Group. However, the Connected Logistic Agents have confirmed that they continue to provide procurement and logistics services to companies in which the Au Family Shareholders have interests in, including the Connected Suppliers for whom the Connected

Logistic Agents handle the procurement and sourcing of raw materials and production equipment. The Directors are of the view that the discontinuation of the transactions with the Connected Logistic Agents will not have and has not had any material impact on the business of the Group.

KY Import/Export

- KY Import/Export, a PRC company owned by the associates of the Au Family Shareholders, is a licensed import and export company in the PRC. The services of KY Import/Export has been retained by the Group primarily to help enhancing the efficiency of the clearance of the necessary customs documentation. As the Group does not have the right under the PRC laws to import from overseas entities directly for products for domestic sales, it is required to engage licensed import and export companies, for the import of direct materials for production from overseas suppliers for domestic sales. For those PRC domestic sales products, the Group engaged the services of Connected Logistic Agents for direct materials procurement through KY Import/Export. If the products were designated for overseas markets, the Connected Logistic Agents procured the direct materials for the Group without going through KY Import/Export. Since February 2002, under the arrangement between the Group, KY Import/Export and the Connected Logistic Agents, the Connected Logistic Agents have delivered direct materials from Hong Kong to KY Import/Export in Jiangmen. Before the establishment of the import/export business of KY Import/Export in February 2002, the Group has appointed other licensed imports and exports companies in the PRC that were Independent Third Parties for the provision of the above import and export services. The Group's transactions with KY Import/Export will continue after listing of the Shares and will therefore constitute ongoing connected transactions under the Listing Rules. For details of the role of KY Import/Export in importing direct materials for the Group, please refer to the sub-sections headed "Direct Materials and Sourcing" and "Connected Transactions" in this section of this prospectus. During the Track Record Period, KY Import/Export has not provided import and export services to other parties apart from the Group.

Import service

Prior to 2004, the amount billed by KY Import/Export to the Group included (1) a handling fee charged by KY Import/Export; (2) customs tax payable to Jiangmen Customs Department; and (3) the cost of direct materials which was payable to Kongyue Technology and/or New Success. After KY Import/Export received payment from the Group, it would pay (1) the customs tax to Jiangmen Customs Department; and (2) the cost of direct materials to Kongyue Technology and/or New Success, on behalf of the Group, and then retain the balance as the handling fee.

Since January 2004, the Group has started to settle (1) the customs tax directly with Jiangmen Customs Departments; and (2) the cost of direct materials directly with Kongyue Technology and/or New Success. The Group has ceased to purchase direct materials from KY Import/Export since January 2004 and therefore thereafter. KY Import/Export is only entitled to receive a handling fee from the Group (approximately 1% of the total value of goods handled by it) for the provision of import services.

Export service

KY Import/Export also provides export services to the Group. Under normal circumstances, the Group can export the goods by itself without the assistance from KY Import/Export. The Group requires the export services of KY Import/Export only when the Group does not have sufficient time to notify the customs authority for the export of the relevant goods.

KY Import/Export is mainly engaged in the trading and import/export of goods and it has not been involved in the production, design and distribution in the PRC of any products which are similar or compete with the products produced and/or sold by the Group. It does not and could not (unless it changes its business entirely) compete with the Group. As its business is materially different from the core business of the Group, the Company does not consider it desirable or necessary to include KY Import/Export in the Group. In addition, the Company has been advised by its PRC legal advisers that if the KY Import/Export was to be included in the Group, it would become a foreign entity for the purpose of the PRC laws. According to Establishment of Sino-foreign Foreign Trading Equity Joint Ventures Tentative Procedures (關於設立中外合資對外貿易公司暫行辦法), the establishment of a foreign entity which performs import and export activities is subject to certain requirements, such as, a minimum registered share capital of RMB50 million. As the registered share capital of KY Import/Export is less than RMB50 million, new capital has to be injected into KY Import/Export if KY Import/Export is to become a member of the Group. Accordingly, the Directors consider it is not commercially feasible for KY Import/Export to be included in the Group while still maintaining its licensed import/export corporation status.

Industrial Park and Kongyue Technology

- The principal businesses of Industrial Park and Kongyue Technology are to hold property investments made by the Au Family Shareholders and its associates, apart from the occasional trading activities of Kongyue Technology (as described above). Industrial Park is also engaged in property development. They have not been included in the Group because their business activities are materially different from the core business of the Group. They do not compete with the Group.

(C) The Group's ability to operate independent from the Au Family Shareholders' other business interests

The Group operates as an independent business unit from other business interests of the Au Family Shareholders and their associates.

It has historically satisfied its capital requirements primarily through operating cash flow and bank borrowings. On 25th March, 2005, the guarantee of a member of the Group for the benefit of Guangdong Precision (further particulars of which are set out in sub-section headed "Relationship with the Au Family Shareholders and the Directors" in this section) was released.

From an operational perspective, the Group does not share operating facilities or premises with other businesses owned by the Au Family Shareholders and/or their associates. The Connected Suppliers supplies the Group two of the various types of direct materials required for production. Further particulars of transactions with these Connected Suppliers are set out in the sub-section headed "Connected Suppliers" in this section. The Group's business relationship with these Connected Suppliers is no different from other suppliers of direct materials of the Group — if they do not satisfy the Group's requirements as to quality and terms of services, the Group could easily secure alternative suppliers.

BUSINESS

While the Group has historically dealt with some of its customers through the Connected Distributors (further particulars of which are set out in the sub-section headed “Relationship with the Au Family Shareholders and the Directors” in this section), these arrangements have ceased since 1st June, 2004, without any adverse impact on the Group’s business. The Group continues to deal freely with its customers, and enjoys the added benefit of a non-compete undertaking from each of the Connected Distributors which is described in the sub-section headed “Relationship with the Au Family Shareholders and the Directors” in this section.

The Group does not own but instead leases the premises at which its production facilities are situated from Industrial Park on normal commercial terms. Further information regarding such leases are set out in the sub-section headed “Connected Transactions” in this section. As the relevant leases are on normal commercial terms and alternative operating premises are readily available to the Group, the Directors do not consider that the Group is any more reliant on its connected persons with respect to such leased premises than would any other issuer which leases operating premises from third parties. In addition, Industrial Park has granted options in favour of the Group which entitle the Group to purchase those premises from Industrial Park at fair market value as determined by an independent valuer at any time during the terms of the relevant leasing agreements as the Group considers appropriate and beneficial to the Group as a whole, and in such manner as in compliance with the then applicable Listing Rules. The Group has also been granted a first right of refusal over any future sales by Industrial Park (if any) of those premises.

Currently, alternative locations including locations in the vicinity of the Group’s existing facility are readily available and the Directors do not anticipate any difficulty in seeking such alternative locations in the foreseeable future. As the production facilities of the Group are not fixtures and could be disassembled, transported to and installed at a new production site without much difficulty, the Directors do not consider the land and properties leased to the Group by the Industrial Park crucial to the Group’s business operation.

Interests in the Group’s subsidiaries

Apart from the Company, the Au Family Shareholders and their associates have interests in certain members of the Group as follows:

- *Kongyue Information*

Kongyue Information is owned as to 95% indirectly by the Company and 5% by Jiangmen Information which in turn is owned as to 90% by Mr. Ou Guo Liang, a Director and an Au Family Shareholder and 10% by Mr. Ou Bo Chou, an associate of the Au Family Shareholders.

- *Jolimark Tax*

Jolimark Tax is owned as to 95% indirectly by the Company and 5% by Mr. Ou Guo Liang, a Director and an Au Family Shareholder.

- *Jolimark Information*

Jolimark Tax is owned as to 95% indirectly by the Company and 5% by Mr. Ou Guo Liang, a Director and an Au Family Shareholder.

BUSINESS

The shareholding of the Au Family Shareholders and their associates in these non-wholly owned subsidiaries of the Group enable such companies to continue to exist as a sino-foreign enterprise and can thereby enjoy benefits granted to sino-foreign joint ventures under the PRC laws and regulations. The above shareholdings, direct or indirect, of the Group's non-wholly owned subsidiaries, are only investments of Mr. Ou Guo Liang and Mr. Ou Bo Chou and will not be in conflict with the Group's business.

The Directors currently expect that, upon the listing of the Shares, the Group will continue to have a number of transactions with companies owned by the Au Family Shareholders and/or their associates which may constitute connected transactions of the Company for the purposes of Chapter 14A of the Listing Rules. Details of such connected transactions are set out in the sub-section headed "Connected transactions" in this section.

These connected transactions range from leasing arrangement, sourcing services to direct material supply. Whilst the Directors confirm that the Group is able to source such services or direct materials from other third parties, the Directors are of the view that the continuation of these connected transactions on the terms as set out in the sub-section "Connected transactions" in this section of this prospectus would be beneficial to the Group. In particular, the Connected Suppliers will continue be engaged by the Group as the Connected Suppliers are also located in Kong Yue Industrial Park. Their proximity to the Group enable the Group to ensure timely delivery of spare parts ordered and reduce the cost of delivery and transportation. The Directors also confirm nonetheless that such services which will continue to be provided by the Au Family Shareholders and/or their associates could be sourced from or substituted by Independent Third Parties. The Directors therefore confirm that despite the continuing connected transactions, the Group is capable of carrying on its business independently of and will not place undue reliance on, the Au Family Shareholders and their associates after listing.

Each of the Au Family Shareholders and Kytronics Holdings has confirmed that he/she/it does not have any interests in a business apart from the Group's business which competes or is likely to compete, either directly or indirectly, with the Group's business. In order to eliminate potential competing business with the Group on listing of the Shares, on 13th June, 2005, each of the Au Family Shareholders and Kytronics Holdings has undertaken with the Company (for itself and the Group) that he/she/it:

- (1) shall not either on his/her/its own account or for any other person, firm or company, or as principal, partner, director, employee, consultant or agent through any body corporate, partnership, joint venture or other contractual arrangement, directly or indirectly, solicit, interfere with or endeavour to entice away from any member of the Group any person, firm, company or organisation who to his/her/its knowledge is now or has been a customer, supplier or employee of any member in the Group; and
- (2) shall not either alone or jointly with any other person or entity, or for any person, firm or company or as principal, partner, director, employee, consultant or agent through any body corporate, partnership, joint venture or other contractual arrangement, be engaged invested, or be interested or otherwise involved, directly or indirectly, in any business in any form or manner anywhere in the world that is in competition, directly or indirectly, with or is likely to be in competition, directly or indirectly, with the business from time to time carried out by any members of the Group.

The restrictions mentioned above shall take effect from the Listing Date and the undertaking shall cease to be of any force and effect if:

- (a) any of the Au Family Shareholders or Kytronics Holdings (as the case may) cease(s) to be a controlling shareholder (as defined in the Listing Rules) of the Company; or

- (b) the securities of the Company subsequently cease to be listed on the Stock Exchange (except for temporary suspension of the Shares due to any reason).

For the avoidance of doubt, the following shall not be considered as restrictions as mentioned above:

- (a) holding or being interested in any security in any company which engages or involves in a business which is in competition with or is likely to be in direct or indirect competition with the key business of any of the members of the Group provided such securities are listed on a recognised stock exchange and the amount of such holding does not exceed 1% of the entire share capital of such company; and
- (b) holding any security in any member of the Group.

(C) Interests discloseable under Rule 8.10 of the Listing Rule by Directors

As mentioned above, Mr. Au, Mr. Au Kwok Lun, Mr. Ou Guo Liang being Directors and Au Family Shareholders who together with Ms. Tai Noi Kit and Ms. On Ri Ai hold 100% interest in Kytronics Holdings, which will in turn hold 72.84% of the issued share capital of the Company, assuming that the Over-allotment Option is not exercised. Their shareholding in members of the Group have been disclosed in section headed “History and Development” in this section of this prospectus. In addition to its subsidiaries, as disclosed in the section headed “History and Development” in this section of this prospectus, the Company is also interested in a number of joint ventures which are associates of the Company and which carry on or are intended to carry on the business of manufacture and/or the sale of tax control products. The Group has nominated certain Directors to the board of directors of these joint ventures as well. Mr. Au Kwok Lun has been nominated by the Group to act as director to Shanghai Liang Biao, Hebei Sheng Hong, Shanghai Qijie, Suzhou Jolimark, Beijing Stone and Guangdong Jolimark. Save as disclosed above, the Directors confirm that they are not interested in other companies that may or are likely to compete with the Group under Rule 8.10.

Save as disclosed above in this sub-section (c), the Directors does not have any interests which is discloseable under Rule 8.10 of the Listing Rule in a business apart from the Group’s business which competes or is likely to compete, either directly or indirectly, with the Group’s business.

(D) Certain excluded companies using “Kongyue” as part of their company names

There are 20 companies, which are not members of the Group (the “Excluded Companies”), using “Kongyue” as part of their company names. The Directors do not consider that the use of the name “Kongyue” by these Excluded Companies would mislead the public because of the following:

- The Group’s products have always been, and will continue to be, promoted, advertised and sold under the brand name of “Jolimark” instead of “Kongyue”. The Directors believe that the Group’s customers have always identified the Group as “Jolimark”. The trademark “Jolimark” has been registered by the Group.
- The Group’s businesses are clearly delineated from that of the Excluded Companies and the Excluded Companies will be giving non-compete undertakings in favour of the Company.

In addition, after making enquiries with the Au Family Shareholders, it is the Directors’ understanding that it is unduly cumbersome and practically difficult for certain Excluded Companies to change names because those companies are joint venture companies partly owned by the Au Family Shareholders, for

example, Jiangmen Yida and Guangdong Kong Yue Zhongding Rubber Component Co., Ltd. The Au Family Shareholders cannot change the names of these joint venture companies without the consent from other shareholders of these joint ventures.

CONNECTED TRANSACTIONS

(A) The following continuing connected transactions are exempted under Rule 14A.34 of the Listing Rules from the independent shareholders' approval requirement but are subject to the reporting and announcement requirements

(1) *Property leasing agreements*

(i) Property leasing agreement between Industrial Park and Kongyue Information

On 19th July, 2004, Industrial Park entered into a property leasing agreement (the "Kongyue Information Lease") as landlord with Kongyue Information as tenant under which Industrial Park agreed to let to Kongyue Information premises of a total floor area of 17,027.37 sq.m. situated in Kong Yue Industrial Park, Jiangmen, the PRC for a term of nine years commencing from 1st September, 2000 and ending on 1st September, 2009 for industrial, office, dormitory and other ancillary uses. The Kongyue Information Lease with retrospective effect from September 2000 was entered into by the parties in July 2004 to, among others, record their leasing arrangement with reference to the fair market rental between the period from September 2000 to July 2004. The annual rental under the Kongyue Information Lease is approximately RMB1,303,177 (exclusive of management fees and utilities charges). The rent is determined with reference to the prevailing market rent. During the term of the Kongyue Information Lease, the parties may adjust the rent with reference to, among others, the then prevailing market rate. Based on the Kongyue Information Lease, the annual rental payable by Kongyue Information will be approximately RMB1,303,177 (exclusive of management fees and utilities charges) for each of the five years ending 31st December, 2009.

In addition, pursuant to a supplementary property leasing agreement dated 18th March, 2005, Kongyue Information has been granted an option to renew the Kongyue Information Lease for a further term of 3 years, and for any exercise of a renewal option by Kongyue Information by giving written notice of not less than 3 months before the expiry of the relevant lease to Industrial Park, Industrial Park will be deemed to have granted a new option for a further extension of 3 years, at the then prevailing market rental to be determined by an independent property valuer and subject to compliance with the disclosure and/or other requirements under the Listing Rules then in force. Further, Industrial Park has granted an option in favour of Kongyue Information to purchase such premises from Industrial Park at fair market value as determined by an independent property valuer at any time during the term of the Kongyue Information Lease if the Directors consider that it would be appropriate and beneficial to the Group as a whole to do so and the purchase will be effected in such manner as in compliance with the then applicable Listing Rules. Kongyue Information has also been granted a first right of refusal over any future sales by Industrial Park (if any) of such premises.

Industrial Park is a WFOE whose entire interest is held by Kong Yue Holding Limited which in turn is wholly owned by Mr. Au and associates of the Au Family Shareholders. Therefore, the transaction under the Kongyue Information Lease will constitute a continuing connected transaction for the Company under Chapter 14A of the Listing Rules after the Listing of the Shares on the Stock Exchange.

During the Track Record Period, the annual rental under the Kongyue Information Lease amounted to approximately RMB1,303,177.

(ii) *Property leasing agreement between Industrial Park and Kongyue Jolimark*

On 19th July, 2004, Industrial Park entered into a property leasing agreement (the “Kongyue Jolimark Lease”) as landlord with Kongyue Jolimark as tenant under which Industrial Park agreed to let to Kongyue Jolimark premises of a total floor area of 17,027.37 sq.m. situated in Kong Yue Industrial Park, Jiangmen, the PRC for a term of nine years commencing from 1st May, 2001 and ending on 1st May, 2010 for industrial, office, dormitory and other ancillary uses. The Kongyue Jolimark Lease with retrospective effect from May 2001 was entered into by the parties in July, 2004 to, among others, record their leasing arrangement with reference to the fair market rental between the period from May 2001 to July 2004. The annual rental under the Kongyue Jolimark Lease is approximately RMB1,303,177 (exclusive of management fees and utilities charges). The rent is determined with reference to the prevailing market rent. During the term of the Kongyue Jolimark Lease, the parties may adjust the rent with reference to, among others, the then prevailing market rate. Based on the Kongyue Jolimark Lease, the annual rental payable by Kongyue Jolimark will be approximately RMB1,303,177 (exclusive of management fees and utilities charges) for each of the six years ending 31st December, 2010.

In addition, pursuant to a supplementary property leasing agreement dated 18th March, 2005, Kongyue Jolimark has been granted an option to renew the Kongyue Jolimark Lease for a further term of 3 years, and for any exercise of a renewal option by Kongyue Jolimark by giving a written notice of not less than 3 months before the expiry of the relevant lease to Industrial Park, Industrial Park will be deemed to have granted a new option for a further extension of 3 years, at the then prevailing market rental to be determined by an independent property valuer and subject to compliance with the disclosure and/or other requirements under the Listing Rules then in force. Further, Industrial Park has granted an option in favour of Kongyue Jolimark to purchase such premises from Industrial Park at fair market value as determined by an independent property valuer at any time during the term of the Kongyue Jolimark Lease if the Directors consider that it would be appropriate and beneficial to the Group as a whole to do so and the purchase will be effected in such manner as in compliance with the then applicable Listing Rules. Kongyue Jolimark has also been granted a first right of refusal over any future sales by Industrial Park (if any) of such premises.

Industrial Park is a WFOE whose entire interest is held by Kong Yue Holding Limited which in turn is wholly owned by Mr. Au and associates of the Au Family Shareholders. Therefore, the transaction under the Kongyue Jolimark Lease will constitute a continuing connected transaction for the Company under Chapter 14A of the Listing Rules after the listing of the Shares on the Stock Exchange.

During the Track Record Period, the annual rental under the Kongyue Jolimark Lease amounted to approximately RMB1,303,177.

(iii) *Storage leasing agreement between Industrial Park and Kongyue Jolimark*

On 19th July, 2004, Industrial Park entered into a property leasing agreement (the “Storage Lease”) as landlord with Kongyue Jolimark as tenant under which Industrial Park agreed to let to Kongyue Jolimark premises of a total floor area of 5,143.4 sq.m. situated in Kong Yue Industrial Park, Jiangmen, the PRC for a term of nine years commencing from 1st November, 2003 and ending on 1st November, 2012 for storage and office uses. The storage lease with

retrospective effect from November 2003 was entered into by the parties in July 2004 to, among others, record their leasing arrangement with reference to the fair market rental between the period from November 2003 to July 2004. The annual rental under the Storage Lease is RMB393,646 (exclusive of management fees and utilities charges). The rent is determined with reference to the prevailing market rent. During the term of the Storage Lease, the parties may adjust the rent with reference to, among others, the then prevailing market rate. Based on the Storage Lease, the annual rental payable by Kongyue Jolimark will be RMB393,646 (exclusive of management fees and utilities charges) for each of the eight years ending 31st December, 2012.

In addition, pursuant to a supplementary property leasing agreement dated 18th March, 2005, Kongyue Jolimark has been granted an option to renew the Storage Lease for a further term of 3 years, and for any exercise of a renewal option by Kongyue Jolimark by giving a written notice of not less than 3 months before the expiry of the relevant lease to Industrial Park, Industrial Park will be deemed to have granted a new option for a further extension of 3 years, at the then prevailing market rental to be determined by an independent property valuer and subject to compliance with the disclosure and/or other requirements under the Listing Rules then in force. Further, Industrial Park has granted an option in favour of Kongyue Jolimark to purchase such premises from Industrial Park at fair market value as determined by an independent property valuer at any time during the term of the Storage Lease if the Directors consider that it would be appropriate and beneficial to the Group as a whole to do so and the purchase will be effected in such manner as in compliance with the then applicable Listing Rules. Kongyue Jolimark has also been granted a first right of refusal over any future sales by Industrial Park (if any) of such premises.

Industrial Park is a WFOE whose entire interest is held by Kong Yue Holding Limited which in turn is wholly owned by Mr. Au and associates of the Au Family Shareholders. Therefore, the transaction under the Storage Lease will constitute a continuing connected transaction for the Company under Chapter 14A of the Listing Rules after the listing of the Shares on the Stock Exchange.

During the two years ended 31st December, 2004, the annual rental under the Storage Lease amounted to RMB65,608 and RMB393,646 respectively.

The Group engaged an independent property valuer in July 2004 to determine the fair market rental in respect of the properties that are the subject matter of the Kongyue Information Lease, the Kongyue Jolimark Lease and the Storage Lease. It was then noted that the rental paid by the Group for these properties was lower than the fair market rental confirmed by the independent property valuer, and the previous leasing agreements between the parties did not reflect the parties' intention that the rental was to be determined with reference to the fair market rental of the properties. The Group therefore entered into new leasing agreements with the landlord on 19th July, 2004 in order to record their leasing arrangement with reference to the fair market rental of the properties for the whole term of the leases.

(iv) *Dormitory leasing agreement between Industrial Park and Kongyue Information*

On 13th December, 2004 and 6th June, 2005, Industrial Park entered into a property leasing agreement and a supplemental property leasing agreement respectively (collectively the "Information Dormitory Lease") as landlord with Kongyue Information as tenant under which Industrial Park agreed to let to Kongyue Information premises of a total floor area of 3,438.03 sq.m. situated in Kong Yue Industrial Park, Jiangmen, the PRC, for a term of nine years

commencing from 1st January, 2005 and ending on 31st December, 2013 as dormitory. The annual rental under the Information Dormitory Lease is RMB294,840 (exclusive of management fees and utilities charges). The rent is determined with reference to the prevailing market rent. During the term of the Information Dormitory Lease, the parties may adjust the rent with reference to, among others, the then prevailing market rate. Based on the Information Dormitory Lease, the annual rental payable by Kongyue Information will be RMB294,840 (exclusive of management fees and utilities charges) for each of the nine years ending 31st December, 2013.

Industrial Park is a WFOE whose entire interest is held by Kong Yue Holding Limited which in turn is wholly owned by Mr. Au and associates of the Au Family Shareholders. Therefore, the transaction under the Information Dormitory Lease will constitute a continuing connected transaction for the Company under Chapter 14A of the Listing Rules after the listing of the Shares on the Stock Exchange.

(v) *Dormitory leasing agreement between Industrial Park and Kongyue Jolimark*

On 13th December, 2004 and 6th June, 2005, Industrial Park entered into a property leasing agreement and a supplemental property leasing agreement respectively (collectively the “Jolimark Dormitory Lease”) as landlord with Kongyue Jolimark as tenant under which Industrial Park agreed to let to Kongyue Jolimark premises of a total floor area of 933.02 sq.m. situated in Kong Yue Industrial Park, Jiangmen, the PRC for a term of nine years commencing from 1st January, 2005 and ending on 31st December, 2013 as dormitory. The annual rental under the Jolimark Dormitory Lease is RMB90,564 (exclusive of management fees and utilities charges). The rent is determined with reference to the prevailing market rent. During the term of the Jolimark Dormitory Lease, the parties may adjust the rent with reference to, among others, the then prevailing market rate. Based on the Jolimark Dormitory Lease, the annual rental payable by Kongyue Jolimark will be RMB90,564 for each of the nine years ending 31st December, 2013.

Industrial Park is a WFOE whose entire interest is held by Kong Yue Holding Limited which in turn is wholly owned by Mr. Au and associates of the Au Family Shareholders. Therefore, the transaction under the Jolimark Dormitory Lease will constitute a continuing connected transaction for the Company under Chapter 14A of the Listing Rules after the listing of the Shares on the Stock Exchange.

(vi) *Property leasing agreement between the Company and Kongyue Technology*

On 13th June, 2005, Kongyue Technology entered into a property leasing agreement (the “Lippo Lease”) as landlord with the Company as tenant under which Kongyue Technology agreed to let to the Company premises of a lettable floor area of 36 sq.m. being portion of Unit 3701, 37th Floor, Tower Two, Lippo Centre, 89 Queensway, Admiralty, Hong Kong for a term commencing on the Listing Date and ending on 31st December, 2007 at the rent of HK\$93,120 per annum (inclusive of rates, Government rent, management charges and utilities charges) for office use. The rent is determined with reference to the prevailing market rent. Based on the Lippo Lease, the annual rental payable by the Company will be HK\$93,120 for each of the three years ending 31st December, 2007.

Kongyue Technology is wholly owned by Mr. Au and associates of the Au Family Shareholders. Therefore, the transaction under the Lippo Lease will constitute a continuing connected transaction for the Company under Chapter 14A of the Listing Rules after the listing of the Shares on the Stock Exchange.

(vii) *Property leasing agreement between Jolimark China and Mr. Ou Guo Liang*

On 4th March, 2005, Mr. Ou Guo Liang entered into a property leasing agreement (the “Beijing Office Lease”) as landlord with Jolimark China as tenant under which Mr. Ou Guo Liang agreed to let to Jolimark China premises of a total floor area of 1,274.99 sq.m. situated in Shuangqiao Building, No. 68 North 4th Ring West Road, Haidian District, Beijing, the PRC, for a term of six years commencing from 1st January, 2005 and ending on 31st December, 2010 for office use.

The annual rental under the Beijing Office Lease is RMB1,650,852 (exclusive of management fees and utilities charges). The rent is determined with reference to the prevailing market rent. During the term of the Beijing Office Lease, the parties may adjust the rent with reference to, among others, the then prevailing market rate. Based on the Beijing Office Lease, the annual rental payable by Jolimark China will be RMB1,650,852 for each of the six years ending 31st December, 2010.

Mr. Ou Guo Liang is a Director and an Au Family Shareholder. Therefore, the transaction under the Beijing Office Lease will constitute a continuing connected transaction for the Company under Chapter 14A of the Listing Rules after the listing of the Shares on the Stock Exchange.

(viii) *Property leasing agreement between Shenzhen Jolimark and Industrial Park*

On 4th March, 2005, Industrial Park entered into a property leasing agreement (the “Shenzhen Jolimark Lease”) as landlord with Shenzhen Jolimark as tenant under which Industrial Park agreed to let to Shenzhen Jolimark premises of a total floor area of 261.07 sq.m. situated in Units 2408-10, 24th Floor, Dongfang Plaza, Jianshe Road, Luohu District, Shenzhen, the PRC, for a term of six years commencing from 1st January, 2005 and ending on 31st December, 2010 for office use.

The annual rental under the Shenzhen Jolimark Lease is RMB109,644 (exclusive of management fees and utilities charges). The rent is determined with reference to the prevailing market rent. During the term of the Shenzhen Jolimark Lease, the parties may adjust the rent with reference to, among others, the then prevailing market rate. Based on the Shenzhen Jolimark Lease, the annual rental payable by Shenzhen Jolimark will be RMB109,644 for each of the six years ending 31st December, 2010.

Industrial Park is a WFOE whose entire interest is held by Kong Yue Holding Limited which in turn is wholly owned by Mr. Au and associates of the Au Family Shareholders. Therefore, the transactions under the Shenzhen Jolimark Lease will constitute a continuing connected transaction for the Company under Chapter 14A of the Listing Rules after the listing of the Shares on the Stock Exchange.

(ix) *Property leasing agreement between Xin Yue and Kongyue Technology*

On 13th June, 2005, Kongyue Technology entered into a property leasing agreement (the “Xin Yue Lease”) as landlord with Xin Yue as tenant under which Kongyue Technology agreed to let to Xin Yue warehouse premises of a total gross floor area of 95.86 sq.m. situated in Workshop B5, 13th Floor, Block B, Kailey Industrial Centre, 12 Fung Yip Street, Chai Wan, Hong Kong for a term of five years commencing from 1st January, 2005 and ending on 31st December, 2009 as warehouse.

The annual rental under the Xin Yue Lease is HK\$55,200 (inclusive of rates, government rent and utilities charges (other than telephone and electricity charges) but exclusive of management fees). The rent is determined with reference to the prevailing market rent. Based on the Xin Yue Lease, the annual rental payable by Xin Yue will be HK\$55,200 for each of the five year ending 31st December, 2009.

Kongyue Technology is wholly owned by Mr. Au and associates of the Au Family Shareholders. Therefore, the transaction under the Xin Yue lease will constitute a continuing connected transaction for the Company under Chapter 14A of the Listing Rules after the Listing of the Shares on the Stock Exchange.

DTZ Debenham Tie Leung Limited, an independent property valuer, has confirmed that the current rental payable under each of the Kongyue Information Lease, the Kongyue Jolimark Lease, the Storage Lease, the Information Dormitory Lease, the Jolimark Dormitory Lease, the Lippo Lease, the Beijing Office Lease, the Shenzhen Jolimark Lease and the Xin Yue Lease is comparable to the current market rental. The Directors have confirmed that the amount agreed under each of such leases is fair and reasonable, was negotiated on an arm's length basis and constitutes normal commercial terms. The Sponsor has confirmed that the transactions under each of such leases are on normal commercial terms.

(2) *Import and Export Agency Agreement with KY Import/Export*

During the Track Record Period, KY Import/Export served as an interface between the Group and its overseas suppliers and purchase agents (including Kongyue Technology and New Success) to import direct materials from overseas countries and Hong Kong.

Because (1) the terms offered by KY Import/Export are comparable to those offered by other independent PRC licensed import and export companies; (2) during the process of settlement for the imported goods in the PRC, the Group is required to transfer the monies for the purchases to the authorised export/import companies; and (3) the staff of KY Import/Export are familiar with the details and specifications of the direct materials purchased by the Group from overseas suppliers, the Directors consider that the appointment of KY Import/Export can minimise the credit risk of the Group and through its accommodation in allowing the Group to settle direct with Jiangmen customs authorities and the Group's Hong Kong logistics agent for imports and improve the efficiency of the clearance of the necessary customs documentation, and therefore the Directors consider that KY Import/Export is one of its preferred import/export services providers.

Kongyue Information and KY Import/Export entered into an agreement dated 19th July, 2004 (as amended by the supplemental agreement dated 13th June, 2005) (the "Import and Export Agency Agreement") on normal commercial terms in their respective ordinary course of business. The agreement is for a period commencing on the Listing Date until 31st December, 2007. Pursuant to the Import and Export Agency Agreement, KY Import/Export agreed to provide import services relating to the Group's direct materials and equipment and export services relating to the Group's products. The terms of the Import and Export Agency Agreement were negotiated on an arm's length basis.

KY Import/Export is wholly owned by the Au Family Shareholders and their associates. Therefore, the transactions under the Import and Export Agency Agreement will constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules after the listing of the Shares on the Stock Exchange.

(a) *Handing fees for import services*

For the three years ended 31st December, 2004, the service fees in respect of import services charged by KY Import/Export to the Group amounted to approximately RMB1.9 million, RMB3.5 million and RMB1.7 million respectively. The Group has only started to engage KY Import/Export in provision of import services in 2002. The service fees to be charged by KY Import/Export in relation to the direct materials imported are charged in a “mark-up” equal to approximately 1% on the contract price of the materials imported, which have been included in the total amounts billed by KY Import/Export to the Group presented as purchase from KY Import/Export in the accountants report for the two years ended 31st December, 2003. The rate of such service fees charged by KY Import/Export is comparable to those charged by Independent Third Parties. As the Group is going to expand its EMS/ODM/OEM business and internal sales of Jolimark branded products as part of its future plans, it is expected that demand for direct materials, for example electronic components, will be increased. Such direct materials will be best purchased from overseas suppliers.

(b) *Export sales*

The Group has only started to engage KY Import/Export in provision of export services in 2002. The Group’s exports made with the assistance of KY Import/Export for the three years ended 31st December, 2004 amounted to approximately RMB3.1 million, RMB5.9 million and RMB41.2 million respectively, of which the service fees in respect of export services provided by KY Import/Export accounted for approximately RMB31,000, RMB59,000 and RMB412,000 respectively. The rate of such service fees charged by KY Import/Export is comparable to those charged by Independent Third Parties.

The service fee in relation to the products exported represent approximately 1% of the contract price of such products. The amount of sales to KY Import/Export presented in the accountants’ report set out in Appendix I of this prospectus represents the reduced amount of sales (after deduction of the service fee).

The increase in the export sales through KY Import/ Export from approximately RMB5.9 million in 2003 to approximately RMB41.2 million in 2004 was mainly due to the export sales of around RMB30 million printer products which were originally intended for domestic sales. The Group had paid the relevant import tax for such products in accordance with the applicable customs regulation. Since the Group received purchase orders from overseas customers for such products, the Group decided to sell such products to its overseas customers instead of for domestic sales. According to the practice of customs authority, the Group is entitled to receive an import tax rebate from Jiangmen customs authorities if it exported such products through KY Import/Export by sale to KY Import/Export and resale to the overseas customers.

The Directors confirm that KY Import/Export is not responsible for procuring customers and negotiating the terms of sales. Its functions are (1) to handle the customs documentation in the PRC for the Group; and (2) to assist the Group in necessary foreign currency conversions to settle the trade payables due to the overseas suppliers. In respect of exports, the transactions between the Group and KY Import/Export relate to export of certain products through KY Import/Export, which are effected by sale to KY Import/Export and resale to the ultimate customers in order to comply with customs regulations.

During the Track Record Period, other than KY Import/Export, the Group has also appointed other independent licensed import and export companies for the provision of import services.

Each of (1) the aggregate annual rental payable under the above property leasing agreements; and (2) the import and export agency agreement will exceed HK\$1,000,000 and each of the percentage ratio (other than the profits ratio) under Chapter 14 of the Listing Rules, where applicable, in respect of these continuing connected transactions is, on an annual basis, expected to be less than 2.5%. The transactions under the above transactions will constitute continuing connected transactions for the Company and fall under Rule 14A.34 of the Listing Rules. They will be exempted from the independent shareholders' approval requirement but will be subject to the reporting and announcement requirements set out in Rules 14A.45 to 14A.47 of the Listing Rules.

(B) The following continuing connected transactions are subject to the reporting, announcement and independent shareholders' approval requirements as required under Rule 14A.35 of the Listing Rules.

(i) *Supply agreements with Guangdong Precision*

Guangdong Precision, a manufacturer of plastic parts, was established in 2002 in Kong Yue Industrial Park. Currently, the Group has adopted the policy of having not less than two preferred suppliers for each type of key direct materials. The Directors consider that Guangdong Precision is one of the preferred suppliers of precision plastic parts because (1) it satisfies the Group's quality requirement as a preferred supplier; (2) the quotations given by Guangdong Precision are comparable to those offered by other independent suppliers; and (3) the vicinity of Guangdong Precision, which translates into (i) simpler logistic requirements and shorter delivery time; and (ii) greater ease in monitoring product quality of precision plastic parts supplied by Guangdong Precision. Since the second half of 2003, the Group has been purchasing precision plastic components (such as plastic casing) from Guangdong Precision.

Two agreements (the "Precision Agreements"), both dated 19th July, 2004 (as amended by two supplemental agreements both dated 13th June, 2005), were entered into on normal commercial terms in the ordinary course of business between (i) Kongyue Information and Guangdong Precision; and (ii) Kongyue Jolimark and Guangdong Precision under which Guangdong Precision agreed to supply precision plastic parts to the Group from time to time as requested by the Group. The plastic parts supplied by Guangdong Precision to Kongyue Information and Kongyue Jolimark are used for manufacturing and new product development purpose respectively. Each of the Precision Agreements is for a period commencing on the Listing Date until 31st December, 2007. The terms of the two agreement were negotiated on an arm's length basis and the sale prices of the products offered by Guangdong Precision are determined with reference to the prevailing market price that are comparable to those offered by independent suppliers.

Guangdong Precision is a WFOE held by Dinomax on trust for the Au Family Shareholders. Therefore, the transactions under the Precision Agreements will continuing constitute connected transactions of the Company under Chapter 14A of the Listing Rules once the Shares are listed on the Stock Exchange.

For the two years ended 31st December, 2004, the aggregate sales value of the products supplied by Guangdong Precision to the Group, which were based on the then prevailing market price, amounted to approximately RMB938,000 and RMB6.7 million respectively.

(ii) Supply agreement with Jiangmen Yida

Jiangmen Yida, a manufacturer of metal stamped parts, was established in 2003 also in Kong Yue Industrial Park. Currently, the Group has adopted the policy of having not less than two preferred suppliers for each type of key direct materials. The Directors consider that Jiangmen Yida is one of the preferred suppliers of metal stamped parts because (1) it satisfies the Group's quality requirement as a preferred supplier; (2) the quotations given by Jiangmen Yida are comparable to those offered by other independent suppliers; and (3) the vicinity of Jiangmen Yida, which translates into (i) simpler logistic requirements and shorter delivery time; and (ii) greater ease in monitoring product quality of metal stamped supplied by Jiangmen Yida. Since the second half 2003, the Group has been purchasing metal components from Jiangmen Yida.

Kongyue Information and Jiangmen Yida entered into an agreement dated 19th July, 2004 (as amended by a supplemental agreement dated 13th June, 2005) (the "Yida Agreement") on normal commercial terms and in their respective ordinary course of business. The Yida Agreement is for a period commencing on the Listing Date until 31st December, 2007. Pursuant to the Yida Agreement, Jiangmen Yida agreed to supply metal stamped parts to the Group for printer manufacturing from time to time as requested by the Group. The terms of the Yida Agreement were negotiated on an arm's length basis and the sale prices of the products offered by Jiangmen Yida are determined with reference to the prevailing market price that are comparable to those offered by independent suppliers.

Jiangmen Yida is held as to 35% by Dinomax on trust for the Au Family Shareholders. Therefore, the transactions under the Yida Agreement will constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules once the Shares are listed on the Stock Exchange.

For the two years ended 31st December, 2004, the sales value of the products supplied by Jiangmen Yida to the Group, which were based on the then prevailing market price, amounted to approximately RMB479,000 and RMB5.2 million respectively.

The transactions under the Precision Agreements and the Yida Agreement will constitute non-exempt continuing connected transactions for the Company under Rule 14A.35 of the Listing Rules and will be subject to the reporting and announcement requirements set out in Rules 14A.45 to 14A.47 of the Listing Rules and the independent shareholders' approval requirement set out in Rule 14A.48 of the Listing Rules.

(C) Waivers from the Stock Exchange in respect of the continuing connected transaction

Rule 14A.35(1) of the Listing Rules requires that the term of an agreement governing continuing connected transactions of an issuer must not exceed three years except in special circumstances. The remaining term of each of the Kongyue Information Lease, the Kongyue Jolimark Lease, the Storage Lease, the Information Dormitory Lease, the Jolimark Dormitory Lease, the Beijing Office Lease, the Shenzhen Jolimark Lease and the Xin Yue Lease will exceed three years following the Listing.

The Directors are of the view that there are special circumstances in the present case that warrant a longer term for each of the Kongyue Information Lease, the Kongyue Jolimark Lease, the Storage Lease, the Information Dormitory Lease, the Jolimark Dormitory Lease, the Beijing Office Lease, the Shenzhen Jolimark Lease and the Xin Yue Lease. The production facilities of the Group are located at the premises which are subject to the Kongyue Information Lease, the Kongyue Jolimark Lease and the Storage Lease. The premises subject to the Information Dormitory Lease and the Jolimark Dormitory Lease provide accommodation for the staff and employees of the Group whereas the premises subject to the Beijing Office Lease and the Shenzhen Jolimark Lease have been used as the Group's offices in Beijing and Shenzhen

respectively. In addition, the warehouse premises subject to the Xin Yue Lease have been used as Xin Yue's warehouse in Hong Kong. It will be in the interest of the Company and its shareholders for the Company to have a longer term of the relevant leases to ensure continuity and stability of the operations of the Group.

DTZ has confirmed that the current amount payable under each of the Kongyue Information Lease, the Kongyue Jolimark Lease, the Storage Lease, the Information Dormitory Lease, the Jolimark Dormitory Lease, the Beijing Office Lease, the Shenzhen Jolimark Lease and the Xin Yue Lease is comparable to the prevailing market rate. The Sponsor and DTZ have confirmed that it is normal business practice for such kind of leasing agreements to have a term of more than three years. Based on the above, the Sponsor concurs with the view of the Directors that it is in the interest of the Company and its Shareholders for the relevant members of the Group to enjoy leases of a longer term to help ensure continuity and stability of the operations of the Group.

The transactions under each of the Kongyue Information Lease, the Kongyue Jolimark Lease, the Storage Lease, the Information Dormitory Lease, the Jolimark Dormitory Lease, the Lippo Lease, the Beijing Office Lease, the Shenzhen Jolimark Lease, the Xin Yue Lease and the Import and Export Agency Agreement (the "Exempt Transactions") constitute continuing connected transactions of the Company under Rule 14A.34 of the Listing Rules and are subject to the reporting and announcement requirements set out in Rule 14A.35(3) of the Listing Rules following the Proposed Listing.

The transactions under the Precision Agreements and the Yida Agreement (the "Non-Exempt Transactions") constitute continuing connected transactions of the Company and are subject to the reporting and announcement requirements and the independent shareholders' approval requirement set out in Rule 14A.35(3) and (4) of the Listing Rules following the Proposed Listing.

The Exempt Transactions and the Non-Exempt Transactions will be entered into and conducted in the ordinary and usual course of business of the Company on normal commercial terms and on arm's length basis in accordance with the pricing bases as set out in the relevant written agreements between the connected parties as mentioned above.

Pursuant to Rule 14A.42(3) of the Listing Rules, the Company has applied for, and the Stock Exchange has agreed to grant (i) an one-off waiver from strict compliance with the announcement requirement under Rule 14A.47 of the Listing Rules at the time of the listing of the Shares on the Stock Exchange in respect of the Exempt Transactions; and (ii) an one-off waiver from strict compliance with the announcement requirement under Rule 14A.47 of the Listing Rules and the independent shareholders' approval requirement under Rule 14A.48 of the Listing Rules at the time of the listing of the Shares on the Stock Exchange in respect of the Non-Exempt Transactions.

BUSINESS

The aggregate annual amounts of the Exempt Transactions and the Non-Exempt Transactions for the three years ending 31st December, 2007 shall not exceed the following annual caps:

Type of transaction	Annual Cap for the year ending		
	31st December,		
	2005	2006	2007
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Exempted Transactions			
— Leasing agreements including the Kongyue Information Lease, the Kongyue Jolimark Lease, the Storage Lease, the Information Dormitory Lease, the Jolimark Dormitory Lease, the Lippo Lease, the Beijing Office Lease, the Shenzhen Jolimark Lease and the Xin Yue Lease (<i>Note 1</i>)	5,500	5,500	5,500
— Import and Export Agency Agreement			
(a) Handling fees for import services (<i>Note 2</i>)	2,181	2,836	3,686
(b) Export sales amount (<i>Note 3</i>)	6,000	6,000	6,000
Non-Exempt Transactions			
— Yida Agreement (<i>Note 2</i>)	6,553	8,518	11,074
— Precision Agreements (<i>Note 2</i>)	8,319	10,814	14,059

Notes:

- (1) The aggregate historical amount of the Kongyue Information Lease, the Kongyue Jolimark Lease and the Storage Lease during the Track Record Period amounted to approximately RMB2.6 million, RMB2.7 million and RMB3.0 million respectively. The Information Dormitory Lease, the Jolimark Dormitory Lease, the Beijing Office Lease, the Shenzhen Jolimark Lease and the Xin Yue Lease commenced on 1st January, 2005 while the Lippo Lease will commence from the Listing Date.
- (2) The proposed caps for transactions under the Yida Agreement, the Precision Agreements and the Import and Export Agency Agreement (handling fees for import services) are based on the historical amounts of the relevant transactions and the Company's assumptions of increase in the Group's turnover of 25%, 30% and 30% from 2004 to 2007 respectively (which assumptions were made for the sole purpose of calculation of the caps for the Yida Agreement, the Precision Agreements and the Import and Export Agency Agreement (handling fees for import services)). The assumed rates of increase have been determined by the Directors with reference to the historical growth in the Group's turnover during the Track Record Period and their expectations of organic growth in the Group's business, in particular, expected increase in demand for the Group's products stimulated by the implementation of the third phase of the "Golden Tax Project" and the commencement of mass production of the Group's owned branded digital display products. Based on the assumptions described above, the aggregate annual caps stated above for the transactions under the Yida Agreement and the Precision Agreements amount to approximately 1.6% of the total purchases of the Group for each of the three years ending 31st December, 2007.
- (3) Currently, the Group is allowed to export products without engaging the services of a licensed import/export company for goods which have been notified by the Group to the customs authorities in advance.

As advised by the Directors, they understand that Jiangmen customs authorities will gradually computerize its customs documentation system in 2005 which shorten the necessary notification time from 10 working days to 2 working days. Taking into account the above proposed change, the Directors expect that, save for the parts and components of the product which the Group is not allowed to export without engaging the services of a licensed import/export company, the Group intends to carry out most of its export sales itself from 2005 to 2007. Currently, the Group expects the export sales of such parts and components will be no more than HK\$6 million in each of the three years ending 31st December, 2007.

BUSINESS

The Company will comply with the provisions in Chapter 14A of the Listing rules governing continuing connected transactions from time to time.

The Directors (including the independent non-executive Directors) and the Sponsor are of the opinion that the Exempt Transactions and the Non-Exempt Transactions are in the ordinary and usual course of the Group's business, on normal commercial terms, and are fair, reasonable and in the interests of the Shareholders as a whole. They are also of the view that the annual caps as set out above are fair and reasonable.

(D) Exempt Continuing Connected Transactions

The following transactions are exempted under Rule 14A.33(3)(b) or Rule 14A.65(4) of the Listing Rules from the reporting, announcement and independent shareholders' approval requirements.

(i) *Supply Agreement with the Connected Purchase Agent*

The Group has sourced certain direct materials, in particular, IC parts and electronic parts, from overseas suppliers mostly in Singapore. Such suppliers were considered by the Group for their quality of work and pricing. In view of local vicinity to such local suppliers in Singapore, the Group has, during the Track Record Period, engaged the Connected Purchase Agent, to help source electronic direct materials mainly for its own branded products.

Kongyue Information and the Connected Purchase Agent entered into an agreement (the "Singapore Agreement") on 19th July, 2004 on normal commercial terms in their respective ordinary course of business. The Singapore Agreement is for a period commencing on the Listing Date until 31st December, 2007. Pursuant to Singapore Agreement, the Connected Purchase Agent agreed to source certain parts and components and raw materials mainly electronic components such as IC parts and power supply unit for the Group. The terms of the Singapore Agreement were negotiated on an arm's length basis. The fees charged by the Connected Purchase Agent in relation to the materials sourced are reflected as a "mark-up" equal to approximately 1% on the contract price of such materials agreed between the Group and the relevant supplier. The materials procured through Connected Purchase Agent were delivered to the Group through Connected Logistic Agents and the service fees charged by the Connected Purchase Agent have been included in the total amounts charged by the Connected Logistic Agents to the Group.

The Connected Purchase Agent is wholly owned by the Au Family Shareholders. Therefore, the transactions under the Singapore Agreement with the Connected Purchase Agent will constitute continuing connected transactions of the Company under Chapter 14A of the Listing Rules once the Shares are listed on the Stock Exchange.

For each of the three years ended 31st December, 2004, the fees charged by the Connected Purchase Agent in relation to its sourcing of materials for the Group amounted to approximately RMB94,000, RMB67,000 and RMB117,000 respectively.

For the annual transaction amount under the Singapore Agreement will be less than HK\$1,000,000 and each of the percentage ratios (other than profits ratio) under Chapter 14 of the Listing Rules, where applicable, in respect of the continuing connected transactions to be conducted under the Singapore Agreement is, on an annual basis, expected to be less than 2.5%. The transactions under the Singapore Agreement will constitute continuing connected transactions for the Company and fall under Rule 14A. 33(3)(b) of the Listing Rules. They will be exempted from the reporting, announcement and independent shareholders' approval requirements set out in Rule 14A.45 to 14A.48

of the Listing Rules. The Directors (including independent non-executive Directors) consider that the transactions contemplated under the Singapore Agreement are in the ordinary and normal course of business of the Group and on normal commercial term which are fair and reasonable and in the interests of the Company and the Shareholders as a whole.

(ii) Provision of incentive subsidies by Industrial Park

As tenants of the Kong Yue Industrial Park, Kongyue Information and Kongyue Jolimark have been receiving incentive subsidies from Industrial Park in accordance with a preferential agreement entered into by Jingu Zhou Economic Development Testing Zone Management Committee (今古州經濟開發試驗區管理委員會), Xin Hui City Finance Bureau (新會市財政局) and Industrial Park on 29th September, 2001 (amended by supplemental agreements dated 16th October, 2001 and 16th October, 2003). Pursuant to the agreement, the local government in Xin Hui City would provide incentive subsidies to Industrial Park until 31st December, 2006, the amount of which is to be calculated and determined with reference to the tax payable by all the tenants situated in the Kong Yue Industrial Park. The incentive subsidies would be distributed by Industrial Park from time to time to the tenants in accordance with their respective investment amount and contribution.

For each of the three years ended 31st December, 2004, the aggregate amount of incentive subsidies received by the Group from the Industrial Park amounted to approximately RMB3.6 million, RMB4.3 million and RMB3.2 million respectively.

Industrial Park is a WFOE whose entire interest is held by Kong Yue Holding Limited which in turn is wholly owned by Mr. Au and associates of the Au Family Shareholders. Hence, Industrial Park is a connected person of the Company. From the Group's perspective, the provision of incentive subsidies by Industrial Park represents financial assistance provided by Industrial Park to Kongyue Information and Kongyue Jolimark on normal commercial terms (or better to the Group) where no security over the assets of the Group is granted in respect of such financial assistance. It is therefore exempted from the reporting, announcement and independent shareholders' approval requirements pursuant to Rule 14A.65(4) of the Listing Rules.

PROPERTY INTERESTS

The Group leases properties for industrial, office, dormitory and warehouse use in various jurisdictions as follows:

(A) PRC

(i) Industrial Park

The Group leases five properties with an aggregate floor area of 43,569.19 sq.m. in Kong Yue Industrial Park from Industrial Park, a connected person to the Group. In connection with three of such leases (in respect of properties numbered 3, 6 and 7 in the valuation report set out in Appendix III to this prospectus), Industrial Park has granted to the Group options to renew the leases for a further term of three years and for any exercise of a renewal option by the Group, Industrial Park will be deemed to have granted a new option for a further extension of three years at the then prevailing market rentals to be determined by an independent property valuer and subject to compliance with the disclosure and/or other requirements under the Listing Rules. With such arrangement, the Group has been effectively granted perpetual options to renew such leases. In addition, the Group has obtained from Industrial Park options to purchase from it those three leased properties. The options are exercisable by the Group during the terms of the relevant

leases as the Group considers appropriate and beneficial to the Group as a whole, at such price as determined by an independent property valuer to reflect the fair market value of the properties, and in such manner as in compliance with the then applicable Listing Rules. The Group has also been granted a first right of refusal over any future sales by Industrial Park (if any) of such properties. Those three properties are currently subject to mortgage in favour of Bank of China (Jiangmen Branch) to secure 18-month banking facilities of RMB100 million. These five properties form the operation base of the Group comprising office, dormitory, warehouse and factory. The Group does not have realty title certificate in respect of its sole operation base in Kong Yue Industrial Park. The only reason for this is because the Group does not wish to make the capital commitment which ownership of property entails and wishes to have the flexibility to seek alternative premises. It is not because title to property owned by the landlord, Industrial Park, is not good. If the landlord, Industrial Park, breaches the leases, as confirmed by the PRC legal advisers of the Company, the Group will be entitled as a matter of PRC laws to seek damages for such breach. In view of the above, the controlling Shareholders have not given and will not give indemnity for any lack of the long term title certificate to the sole operation base of the Group and the Directors do not consider there to be any commercial reason for requiring such indemnity from the controlling Shareholders. For details of the leases, please refer to the section headed “Connected Transactions” in the Business section of this prospectus.

As the Group’s sole industrial, storage, office and staff dormitory premises are leased from Industrial Park, if the leases are terminated early without cause, the Group will be required to relocate its industrial, storage, office and staff dormitory premises. However, the Group could easily relocate its production facilities to other sites and continue its operations without material adverse impact, except for incurring necessary costs involved for relocation and arrangements which need to be made to reduce the impact on production and business operations during the relocation period. Based on the Group’s previous experience in relocating its production facilities from Xinhui City Xiaogang Town to its existing production base in 2000, the Directors are of the view that the expected time for relocation is less than one month.

Since the landlord of the premises is Industrial Park, a WFOE whose entire interest is held by Kong Yue Holding Limited which in turn is wholly owned by Mr. Au and associates of the Au Family Shareholders, the Group considers the possibility of termination of the leases without cause (which could amount to a breach by the landlord of the terms of the leases) to be remote.

As tenants of the Industrial Park, Kongyue Information and Kongyue Jolimark are entitled to subsidies granted by Industrial Park in accordance with a preferential agreement entered into by Jingu Zhou Economic Development Testing Zone Management Committee (今古州經濟開發試驗區管理委員會), Xin Hui City Finance Bureau (新會市財政局) and Industrial Park on 29th September, 2001 (amended by supplemental agreements dated 16th October, 2001 and 16th October 2003 which has been approved by the people’s government in Xin Hui (新會市人民政府)). Based on the above, the PRC legal advisers of the Company is of the view that the granting of subsidies from Industrial Park to Kongyue Information and Kongyue Jolimark in accordance with the preferential agreement is legal under the PRC laws.

During the three years ended 31st December, 2004, the aggregate amount of subsidies received by the Group from the Industrial Park amounted to approximately RMB3.6 million, RMB4.3 million and RMB3.2 million respectively, which represented approximately 0.64%, 0.53% and 0.33% of the Group’s turnover during the same period respectively. Such payments are recognised as continuing related party transactions in the accountants’ report, the text of

which is set out in Appendix I to this prospectus. The grant of incentive subsidies are exempted from reporting, announcement and shareholders' approval requirements under Rule 14A.65(4) of the Listing Rules.

As confirmed by the Directors, the method of calculation for such subsidies as proposed and adopted by the local government in Xinhui City, is based on the amount of tax payment made by the Group during the corresponding periods. The entitlement period of subsidies will end on 31st December, 2006.

The Directors consider it is in the interest of the Group to exclude Industrial Park from the Group because the principal business of Industrial Park is property investment and development, which is not the core business of the Group, and the major assets of Industrial Park are the parcel of land and the buildings located at Kong Yue Industrial Park. If Industrial Park is included in the Group, it will end up with an even larger number of connected transactions as part of the land and buildings of Industrial Park are leased to connected persons and other third parties.

(ii) *Other properties*

The Group also leases a property with a floor area of 261.07 sq.m. in Shenzhen from Industrial Park, a connected person to the Group.

Other than those leased from Industrial Park, the Group also leases 19 properties in Shenyang, Beijing, Guangzhou, Xian, Wuhan, Shanghai, Chengdu, Shenzhen and Jiangmen in the PRC with an aggregate floor area of approximately 3,715.195 sq.m. Of these rented properties, 7 are used for storage, one is vacant and the others are for office use. The landlord of 5 out of these 19 leases are entitled to lease the property and the lease agreements are legally valid and binding. For the remaining 14 of the 19 leases, the landlords failed to provide document of title or information to prove their title to such properties or to show that they are entitled to lease such properties to the Group. In the absence of such documents, the PRC legal advisers to the Company cannot confirm whether the relevant lease agreements are valid and enforceable against third parties. If the relevant lease agreement is invalid or unenforceable against third parties, the relevant member of the Group may be evicted from the leased premises although such member shall have the right to claim damages from the landlord. Please also refer to the property valuation in Appendix III to this prospectus. The Directors do not consider these 14 properties essential to the production activities of the Group and adverse impact on the Group resulting from any termination of these 14 leases would be minimal.

(B) Hong Kong

The Group leases portion of Unit 3701, 37th Floor, Tower Two, Lippo Centre, 89 Queensway Admiralty, Hong Kong, having lettable floor area of 36 sq.m., as office from Kongyue Technology, a connected person to the Group, for a term from the Listing Date to 31st December, 2007 at monthly rent of HK\$7,760. The Group also leases Workshop B5, 13th Floor, Block B, Kailey Industrial Centre, 12 Fung Yip Street, Chai Wan, Hong Kong, having a gross floor area of 95.86 sq.m. for storage use from Kongyue Technology for a term from 1st January, 2005 to 31st December, 2009 at monthly rent of HK\$4,600. For details please refer to the sub-section headed "Connected Transactions" in the "Business" section of this prospectus.

(C) Japan

The Group leases Unit 508, 5th Floor, West Block, Kanagawa Science Park, 3-2-1 Sakato, Takatsu-ku, Kawasaki-shi, Kanagawa Prefecture 213-0012, Tokyo, Japan, having a gross floor area of 94.92 sq.m., for office use from an Independent Third Party for a term from 17th April, 2004 to 30th April, 2006 at a monthly rent of JPY303,744. For details please refer to the property valuation in Appendix III to this prospectus.