

Tencent 騰訊

Tencent Holdings Limited

騰訊控股有限公司

Incorporated in the Cayman Islands with limited liability

於開曼群島註冊成立的有限公司

smart communication inspires

智慧溝通 靈感無限

2005 Interim Report
二零零五年中期報告



Interim Results

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

Condensed Consolidated Balance Sheet

As at 30 June 2005 and 31 December 2004

		Unaudited 30 June 2005 RMB'000	Audited (as restated) (Note) 31 December 2004 RMB'000
	Note		
ASSETS			
Non-current assets			
Fixed assets	5	190,653	142,080
Intangible assets	6	18,055	—
Held-to-maturity investments		167,358	167,374
Deferred tax assets	13	86,748	—
		462,814	309,454
Current assets			
Accounts receivable	7	232,358	192,725
Prepayments, deposits and other receivables		32,910	50,347
Financial assets held for trading	8	675,200	666,900
Term deposits with initial term of over three months		547,459	784,054
Cash and cash equivalents		1,124,492	859,841
		2,612,419	2,553,867
Total Assets		3,075,233	2,863,321

Condensed Consolidated Balance Sheet (Continued)

As at 30 June 2005 and 31 December 2004

		Unaudited 30 June 2005 RMB'000	Audited (as restated) (Note) 31 December 2004 RMB'000
	Note		
EQUITY			
Shareholders' equity			
Share capital	9	193	192
Share premium	9	1,781,904	1,777,721
Share-based compensation reserve	1, 10	15,426	5,583
Other reserves		66,609	52,442
Retained earnings		954,024	816,300
		2,818,156	2,652,238
LIABILITIES			
Non-current liabilities			
Deferred tax liabilities	13	358	—
Current liabilities			
Accounts payable		1,401	2,506
Other payables and accruals	11	110,006	79,912
Dividends payable		—	145
Current income tax liabilities		18,119	5,648
Other tax liabilities		13,269	59,650
Deferred revenue	12	113,924	63,222
		256,719	211,083
Total Liabilities		257,077	211,083
Total Equity and Liabilities		3,075,233	2,863,321

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

Condensed Consolidated Income Statements

For the three and six months ended 30 June 2005

	Note	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
		2005 RMB'000	(as restated) (Note) 2004 RMB'000	2005 RMB'000	(as restated) (Note) 2004 RMB'000
Revenues					
Internet value-added services		169,883	99,913	318,947	204,499
Mobile and telecommunications value-added services		136,498	156,054	270,769	298,871
Online advertising		25,170	12,847	40,463	21,062
Others		2,114	1,699	3,957	3,634
		333,665	270,513	634,136	528,066
Cost of revenues		(108,963)	(100,652)	(210,891)	(188,315)
Gross profit		224,702	169,861	423,245	339,751
Other gains, net	14	15,148	1,061	27,053	1,928
Selling and marketing expenses		(45,501)	(26,773)	(84,014)	(50,005)
General and administrative expenses		(75,596)	(28,957)	(144,122)	(63,436)
Operating profit		118,753	115,192	222,162	228,238
Finance (costs)/income, net		(51)	(18)	(166)	108
Profit before income tax		118,702	115,174	221,996	228,346
Income tax benefit/(expenses)	16	68,271	(3,293)	61,931	(10,005)
Profit for the period		186,973	111,881	283,927	218,341
Earnings per share for profit attributable to the equity holders of the Company during the period (expressed in RMB per share)					
- basic	17	0.106	0.084	0.161	0.169
- diluted	17	0.103	0.083	0.156	0.168

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

Condensed Consolidated Statement of Changes in Shareholders' Equity

For the six months ended 30 June 2005

	Unaudited						
	Share capital	Share premium	Share-based	Capital reserve	Statutory reserves	Retained earnings	Total
			compensation reserve				
RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	
Balance at 1 January 2005, as previously reported	192	1,777,721	—	20,000	32,442	821,883	2,652,238
Effect of adoption of IFRS 2 (Note 1.1)	—	—	5,583	—	—	(5,583)	—
Balance at 1 January 2005, as restated	192	1,777,721	5,583	20,000	32,442	816,300	2,652,238
Profit for the period	—	—	—	—	—	283,927	283,927
Employees share option scheme:							
- value of employee services	—	—	9,843	—	—	—	9,843
- proceeds from shares issued	1	4,183	—	—	—	—	4,184
Profit appropriations to statutory reserves	—	—	—	—	14,167	(14,167)	—
Dividend relating to 2004 (Note 18)	—	—	—	—	—	(132,036)	(132,036)
Balance at 30 June 2005	193	1,781,904	15,426	20,000	46,609	954,024	2,818,156

	Unaudited (as restated)						
	Share capital	Share premium	Share-based	Capital reserve	Statutory reserves	Retained earnings	Total
			compensation reserve				
RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	
Balance at 1 January 2004	138	15,261	—	20,000	3,653	432,905	471,957
Profit for the period, as restated	—	—	—	—	—	218,341	218,341
Issue of shares in an initial public offering ("IPO")	45	1,656,687	—	—	—	—	1,656,732
Shares issuance expenses	—	(140,262)	—	—	—	—	(140,262)
Employees share option scheme:							
- value of employee services, as restated	—	—	2,252	—	—	—	2,252
Dividend relating to 2003	—	—	—	—	—	(28,935)	(28,935)
Balance at 30 June 2004	183	1,531,686	2,252	20,000	3,653	622,311	2,180,085

Condensed Consolidated Cash Flow Statement

For the six months ended 30 June 2005

	Unaudited	
	Six months ended 30 June	
	2005	2004
	RMB'000	RMB'000
Net cash flows from operating activities	222,685	177,860
Net cash flows from/ (used in) investing activities	169,963	(69,383)
Net cash flows (used in)/ from financing activities	(127,997)	1,516,602
Increase in cash and cash equivalents	264,651	1,625,079
Cash and cash equivalents at beginning of period	859,841	325,586
Cash and cash equivalents at end of period	1,124,492	1,950,665
Analysis of balances of cash and cash equivalents:		
Bank balances and cash	1,124,492	1,950,665

Notes to the Interim Financial Information

1 Summary of significant accounting policies

1.1 General information, basis of preparation and presentation

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

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

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

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

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

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

Notes to the Interim Financial Information (Continued)

1 Summary of significant accounting policies (Continued)

1.1 General information, basis of preparation and presentation (Continued)

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

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

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

Notes to the Interim Financial Information (Continued)

1 Summary of significant accounting policies (Continued)

1.1 General information, basis of preparation and presentation (Continued)

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

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

1.2 Share-based compensation

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

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

Notes to the Interim Financial Information (Continued)

1 Summary of significant accounting policies (Continued)

1.3 Intangible assets

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

1.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group’s entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in Renminbi (“RMB”), which is the Group’s functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies at period end exchange rates are recognised in the income statement.

Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the fair value reserve in equity.

Notes to the Interim Financial Information (Continued)

1 Summary of significant accounting policies (Continued)

1.4 Foreign currency translation (Continued)

(c) Group companies

The results and financial position of all group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency of RMB are translated into the presentation currency as follows:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (ii) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- (iii) all resulting exchange differences are recognised as a separate component of equity.

Upon consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

Notes to the Interim Financial Information (Continued)

2 Critical accounting estimates and judgments

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

2.1 Recognition of Internet value-added services and mobile and telecommunications value-added services

Revenue from Internet value-added services are derived from subscriptions received/receivable from the provision of a comprehensive customer service platform that utilises instant messaging and online entertainment services to create a virtual community over the Internet.

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

Internet value-added services and mobile and telecommunications value-added services are either billed on a monthly subscription basis or a per message basis (the “Internet and Mobile Service Fees”). Certain of these services are delivered to the Group’s customers through the platforms of various subsidiaries of China Mobile Communications Corporation (“China Mobile”) and China United Communications Corporation (“China Unicom”), two mobile phone operators in the PRC, and these two operators also collect the Internet and Mobile Service Fees on behalf of the Group.

Notes to the Interim Financial Information (Continued)

2 Critical accounting estimates and judgments (Continued)

2.1 Recognition of Internet value-added services and mobile and telecommunications value-added services (Continued)

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

The Internet and Mobile Service Fees and the Mobile and Telecom Charges, or the net amount of the two, are confirmed and advised by subsidiaries of China Mobile and China Unicom to the Group on a monthly basis.

For the Internet and Mobile Service Fees not yet confirmed/advised by the operators at the time of reporting the financial results of the Group, management of the Group estimates the amounts receivable based on historical data and developing trends in customer payment delinquencies. Historical data used in estimating revenues include the most recent three-month history of the Internet and Mobile Service Fees actually derived from the operations, the number of subscriptions and the volume of data transmitted between the network gateways of the Group, China Mobile and China Unicom. Adjustments are made in subsequent periods in the event that the actual revenue amounts are different from the original estimates.

The balance of accounts receivable due from China Mobile and China Unicom, which has not been confirmed as at 30 June 2005, was approximately RMB61,819,000 (31 December 2004: RMB66,894,000).

Notes to the Interim Financial Information (Continued)

2 Critical accounting estimates and judgments (Continued)

2.2 Recognition of deferred tax assets

Certain intragroup software sales have been transacted within the Group. The costs of the self-developed software purchased have been amortised by a group company, Shenzhen Tencent Computer Systems Company Limited (“Tencent Computer”), over their contracted useful lives (the “Amortisation”). The Amortisation has been allowed as a deductible expense in ascertaining the assessable profits and income tax of Tencent Computer (the “Tax Deduction Claim”). These have given rise to a potential temporary difference between the accounting base (which is zero) and the tax base (which is the unamortised net book value of these software) of the amounts of software sold in these transactions. In prior periods, no deferred tax assets arising from this potential temporary difference were recognised because there was no reasonable certainty that Tencent Computer would obtain the approval from the local tax bureau for the Tax Deduction Claim. On 8 June 2005, a formal approval document, Shendishuierhan 2005 No.99, was issued by the local tax bureau and deferred tax assets of approximately RMB88,638,000 were recognised by the Group. The amount was calculated based on the unamortised net book value of the software recorded by Tencent Computer at approximately RMB590,918,000 and the enacted enterprise income tax rate for enterprises in Shenzhen of the PRC at 15% (see also Note 13).

2.3 Recognition on share-based compensation expenses

As mention in Note 1.2, the Company has granted share options to its employees. The directors have used the Black-Scholes valuation model (the “BS Model”) to determine the total fair value of the options granted, which is to be expensed over the vesting period. Significant judgement, such as risk free rate, dividend yield, expected volatility and turnover rate of grantees, is required to be made by the directors as factors for applying the BS Model (see also Note 10).

3 Financial risk management

3.1 Foreign exchange risk

The Group mainly operates in the PRC with most of the transactions settled in RMB. The conversion of RMB denominated balances into foreign currencies is subject to the rates and regulations of foreign exchange control promulgated by the PRC government.

The proceeds derived from the IPO are all denominated in Hong Kong Dollars (“HKD”). Certain sum has already been invested into various investments denominated in US Dollars (“USD”). In addition, the Group is required to pay dividends in HKD in the future when dividends are declared.

The Group may experience a loss as a result of any foreign currency exchange rate fluctuations in connection with its deposits and investments. The Group has not used any means to hedge the exposure to foreign exchange risk.

On 21 July 2005, the PRC government announced that RMB is to be floated in line with a basket of certain selected currencies and not to be pegged with USD on or after that day. As a result, RMB appreciated by approximately 2% as compared to USD based on the exchange rate announced on that day.

Notes to the Interim Financial Information (Continued)

4 Segment information

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

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

Notes to the Interim Financial Information (Continued)

4 Segment information (Continued)

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

Notes to the Interim Financial Information (Continued)

4 Segment information (Continued)

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

Notes to the Interim Financial Information (Continued)

4 Segment information (Continued)

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

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

5 Fixed assets

	Unaudited Six months ended 30 June 2005 RMB'000
Opening net book amount as at 1 January 2005	142,080
Additions	70,063
Disposals	(115)
Depreciation charge	(21,375)
Closing net book amount as at 30 June 2005	190,653

Notes to the Interim Financial Information (Continued)

6 Intangible assets

	Unaudited Six months ended 30 June 2005 RMB'000
Opening net book amount as at 1 January 2005	—
Additions	18,407
Amortisation charge	(352)
Closing net book amount as at 30 June 2005	18,055

7 Accounts receivable

	Unaudited 30 June 2005 RMB'000	Audited 31 December 2004 RMB'000
0 - 30 days	121,621	130,297
31 days - 60 days	54,396	25,340
61 days - 90 days	29,466	15,711
Over 90 days but less than a year	26,875	21,377
	232,358	192,725

The Group has no formal credit periods communicated to its major customers but the customers usually settle the amounts due to it within a period of 30 to 90 days. A substantial balance of the receivable balances as at 30 June 2005 and 31 December 2004 were due from China Mobile, China Unicom and China Telecommunications Corporation and their branches, subsidiaries and affiliates. Management considers that the net book value of the receivable balance approximates its fair value as at 30 June 2005.

8 Financial assets held for trading

Financial assets held for trading represent an investment portfolio held by the Group. The fair values of the respective underlying financial instruments are determined with reference to the respective published price quotations in an active market.

Notes to the Interim Financial Information (Continued)

9 Share capital and share premium

The authorised share capital of the Company as at 1 January 2004 was 53,941,626 shares with no par value each. On 24 March 2004, the Company undertook a share split whereby each then issued ordinary share was split into 70 shares. In addition, the Board also resolved to increase the authorised share capital to 10,000,000,000 ordinary shares and a par value of HKD0.0001 was re-assigned to each share.

The shares and per share information presented in this Interim Financial Information have taken into account the effects of the share split as if they had taken place on 1 January 2004.

Movements of the issued share capital for the year ended 31 December 2004 and for the six months ended 30 June 2005 are as follows:

	Number of ordinary shares	Share capital RMB'000	Share premium RMB'000	Total RMB'000
At 1 January 2004	18,006,868	138	15,261	15,399
Increase in number of shares upon a share split	1,242,473,892	—	—	—
Shares issued during IPO	420,160,500	45	1,516,425	1,516,470
Additional shares issued with respect to over-allotment option of the IPO	63,024,000	7	237,264	237,271
Employees share option scheme: - number of shares issued and proceeds received	21,239,150	2	8,771	8,773
At 31 December 2004/ 1 January 2005	1,764,904,410	192	1,777,721	1,777,913
Employees share option scheme: - number of shares issued and proceeds received (Note)	7,671,936	1	4,183	4,184
At 30 June 2005	1,772,576,346	193	1,781,904	1,782,097

As at 30 June 2005, all issued shares were fully paid.

Note: During the six months ended 30 June 2005, 6,833,200 and 838,736 Pre-IPO options granted under the Pre-IPO Option Scheme (as defined below) were exercised at exercise prices of USD0.0497 and USD0.1967 each, respectively.

Notes to the Interim Financial Information (Continued)

10 Share option

(a) Share option schemes

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

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

Under the Pre-IPO Option Scheme, the Board granted options to eligible employees, including executive directors of the Company, to subscribe for shares in the Company. The Pre-IPO Option Scheme will expire on 31 December 2011.

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

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

10 Share option (Continued)

(a) Share option schemes (Continued)

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

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

(ii) Post-IPO Share Option Scheme (the “Post-IPO Option Scheme”)

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

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

The maximum number of shares in respect of which options may be granted under the Post-IPO Option Scheme, and under any other share option scheme of the Company (including the Pre-IPO Option Scheme), shall not exceed 10% of the relevant class of securities of the Company in issue as at the date of the IPO.

Notes to the Interim Financial Information (Continued)

10 Share option (Continued)

(b) Movements in share options

Movements in the number of share options outstanding and their related weighted average exercise prices are as follows:

	Pre-IPO Option Scheme		Post-IPO Option Scheme		Total number of options
	Average exercise price	No. of options	Average exercise price	No. of options	
At 1 January 2005	USD 0.0849	50,406,917	HKD 3.6650	6,300,961	56,707,878
Granted	—	—	HKD 4.6470	22,491,048	22,491,048
Exercised	USD 0.0658	(7,671,936)	—	—	(7,671,936)
Lapsed	USD 0.2076	(600,850)	HKD 4.0772	(1,649,657)	(2,250,507)
At 30 June 2005	USD 0.0867	42,134,131	HKD 4.5372	27,142,352	69,276,483
At 1 January 2004	USD 0.0497	62,088,600	—	—	62,088,600
Granted	USD 0.2253	10,464,230	—	—	10,464,230
Lapsed	USD 0.1967	(166,460)	—	—	(166,460)
At 30 June 2004	USD 0.0747	72,386,370	—	—	72,386,370

As at 30 June 2005, there had not been any share options granted to the directors of the Company or any consultants.

Out of the 69,276,483 options outstanding as at 30 June 2005 (30 June 2004: 72,386,370 options), 19,833,494 options (30 June 2004: 31,044,300 options) were currently exercisable. Options exercised during the six months ended 30 June 2005 resulted in the issuance of 6,833,200 ordinary shares and 838,736 ordinary shares at exercise prices of USD0.0497 and USD0.1967 each, respectively. The related weighted average price at the time of exercise was HKD 5.4089 (equivalent to approximately RMB 5.7534) per share.

Notes to the Interim Financial Information (Continued)

10 Share option (Continued)

(c) Outstanding share options

Numbers of share options outstanding as at 30 June 2005 and 2004 have the following expiry dates and exercise prices:

Expiry Date	Range of Exercise Price	30 June 2005	30 June 2004
31 December 2011 (Pre-IPO options)	USD0.0497	33,407,000	62,088,600
	USD0.1967-	8,727,131	10,297,770
	USD0.4396		
10 years commencing from the adoption date of 24 March 2004 (Post-IPO options)	HKD3.665- HKD5.67	27,142,352	—
		69,276,483	72,386,370

Notes to the Interim Financial Information (Continued)

10 Share option (Continued)

(d) Fair values of options

The fair values of the options granted to the employees, determined using the BS Model since 1 January 2004 are as follows:

Date of grant	10/2/2004	24/3/2004	14/9/2004	26/1/2005	3/2/2005	23/3/2005	6/4/2005	19/5/2005
Fair value of options (RMB'000)	31,741	3,723	10,279	29,567	8,871	1,579	2,073	1,297
No. of options granted	8,730,960	1,733,270	6,311,520	16,006,530	4,513,600	660,000	810,918	500,000
Exercise price	USD 0.1967	USD 0.1967 or 0.4396	HKD 3.6650	HKD 4.4850	HKD 4.8000	HKD 5.5500	HKD 5.6700	HKD 5.6000
Closing share price at date of grant	HKD 4.3235 (Note (i))	HKD 3.4292 (Note (i))	HKD 3.6000	HKD 4.4750	HKD 4.8000	HKD 5.5500	HKD 5.5500	HKD 5.6000
Risk free rate (Note (ii))	4.43%	3.300%	3.633%	3.305%	3.349%	4.199%	4.0860%	3.7930%
Dividend yield (Note (iii))	0.6%	1.4%	1.4%	1.4%	1.4%	1.4%	1.4%	1.4%
Expected volatility (Note (iv))	62.75%	80%	60%	55%	55%	55%	55%	55%
Exercisable date	Based on the grant date (Note (vi))	Based on the commencement date of employment (Note (vi))	Based on the commencement date of employment or based on option grant date (Note (v) &(vi))	Based on the commencement date of employment or based on option grant date (Note (v) &(vi))	Based on the grant date (Note (vi))	500,000 options are based on grant date (note (vi)). The remaining 160,000 options are based on the commencement date of employment (Note(v)).	Based on the commencement date of employment (Note(v)).	Based on the commencement date of employment (Note(v)).

10 Share option (Continued)

(d) Fair values of options (Continued)

Note:

- (i) The fair values of the shares of the Company, determined by a third party valuer, have been used in the BS Model adopted in order to determine the fair values of the options granted before the IPO on 16 June 2004.
- (ii) The risk free rate for the options granted on 10 February 2004 was determined based on the yield of the Chinese Government International Bond maturing in 2011 as at the date of valuation. The risk free rate for the options granted after February 2004 was determined based on the yield to maturity of Hong Kong Government Bonds with maturity in June 2012 as at the date of valuation.
- (iii) Dividend yield is calculated using the average price to earnings ratio of 17 of comparable companies and dividend payout ratio ranging from 10% to 25%.
- (iv) Volatility measured as the standard deviation of expected share price returns is determined based on the average daily trading price volatility of the shares of the Company and comparable companies since their IPO to the valuation date.
- (v) For options granted with exercisable date determined based on the commencement date of employment, the first 25% of the options can be exercised two years after the commencement date, and 25% each of the total options will become exercisable in each subsequent year.
- (vi) For options granted with exercisable date determined based on the grant date of the options, the first 25% of the option can be exercised one year after the grant date, and 25% each of the total options will become exercisable in each subsequent year.

(e) Expected turnover rate of grantees

The expected percentage of employees that will stay within the Group at the end of the vesting period is calculated based on the historical employee information, which is assessed to be 60%. The rate has been used to determine the amount of share-based compensation expenses reported during the reporting period.

Notes to the Interim Financial Information (Continued)

11 Other payables and accruals

	Unaudited 30 June 2005 RMB'000	Audited 31 December 2004 RMB'000
Staff costs and welfare accruals	49,642	42,944
Marketing and administrative expenses accruals	20,783	13,452
Prepayments received from customers	10,928	4,007
Professional fees accruals	6,618	6,360
Others	22,035	13,149
	110,006	79,912

12 Deferred revenue

Deferred revenue mainly represents prepaid service fees made by customers for certain Internet value-added services in the forms of pre-paid cards and tokens of which the related services have not been rendered.

Notes to the Interim Financial Information (Continued)

13 Deferred income taxes

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

The gross movement on the deferred tax account is as follows:

	Unaudited 30 June 2005 RMB'000	Audited 31 December 2004 RMB'000
At beginning of period/year	—	—
Credited to income statement (see below)	(88,638)	—
Charged to income statement	2,248	—
At end of period/year	(86,390)	—

As mentioned in Note 2.2, the Group recognised the deferred tax assets in respect of the temporary difference arising from certain intragroup software sales transactions. The movements during the six months ended 30 June 2005 were as follows:

Deferred tax assets:

	Unaudited 30 June 2005 RMB'000	Audited 31 December 2004 RMB'000
At beginning of period/year	—	—
Credited to income statement (Note 2.2)	(88,638)	—
Charged to income statement	1,890	—
At end of period/year	(86,748)	—

Notes to the Interim Financial Information (Continued)

13 Deferred income taxes (Continued)

The Group recognised deferred tax liabilities in respect of the relevant taxes that may arise from the transfer of profits derived from Tencent Computer and Shenzhen Shiji Kaixuan Technology Company Limited (“Shiji Kaixuan”), subsidiaries in which the Company has direct or indirect legal equity interests, to the Company. The movements of deferred tax liabilities were as follows:

Deferred tax liabilities:

	Unaudited 30 June 2005 RMB'000	Audited 31 December 2004 RMB'000
At beginning of period/year	—	988
Credited to income statement	—	(988)
Charged to income statement	358	—
At end of period/year	358	—

14 Other gains, net

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2005 RMB'000	(as restated) 2004 RMB'000	2005 RMB'000	(as restated) 2004 RMB'000
Financial assets held for trading				
- Fair value gains (realised and unrealised)	5,252	—	8,300	—
Interest income	9,165	1,061	18,022	1,910
Others	731	—	731	18
	15,148	1,061	27,053	1,928

Notes to the Interim Financial Information (Continued)

15 Expenses by nature

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

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

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

Notes to the Interim Financial Information (Continued)

16 Tax expenses

(a) Income tax

(i) Cayman Islands and British Virgin Islands Profits Tax

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

(ii) Hong Kong Profits Tax

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

(iii) PRC Enterprise Income Tax

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

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

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

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

Notes to the Interim Financial Information (Continued)

16 Tax expenses (Continued)

(a) Income tax (Continued)

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

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2005 RMB'000	(as restated) 2004 RMB'000	2005 RMB'000	(as restated) 2004 RMB'000
Profit before income tax	118,702	115,174	221,996	228,346
Tax calculated at a tax rate of 15%	17,805	17,276	33,299	34,252
Effects of different tax rates available to different companies of the Group	(1,497)	—	(2,953)	—
Effects of tax holiday on assessable profit of subsidiaries	3,097	(30,912)	(979)	(52,258)
Expenses not deductible for tax purposes	794	441	1,452	920
Utilisation of previously unrecognised deferred tax assets/deferred tax assets not recognised	(1,091)	16,667	(6,760)	26,795
Recognition of previously unrecognised deferred tax assets (Notes 2.2 and 13)	(88,638)	—	(88,638)	—
Utilisation of previously unrecognised tax losses	—	(230)	—	(230)
Unrecognised tax losses	1,259	51	2,648	526
Tax (credit)/charge	(68,271)	3,293	(61,931)	10,005

Notes to the Interim Financial Information (Continued)

16 Tax expenses (Continued)

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

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

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

17 Earnings per share

Basic

Basic earnings per share ("EPS") are calculated by dividing the profit for the periods by the weighted average number of ordinary shares in issue during each period.

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2005 (as restated) 2004		2005 (as restated) 2004	
Profit attributable to the equity holders of the Company for the period (RMB'000) (Note a)	186,973	111,881	283,927	218,341
Weighted average number of ordinary shares in issue (thousands) (Note b)	1,771,925	1,329,738	1,768,895	1,295,109
Basic EPS (RMB per share)	0.106	0.084	0.161	0.169

Notes to the Interim Financial Information (Continued)

17 Earnings per share (Continued)

Diluted

Diluted EPS is calculated by adjusting the weighted average number of ordinary shares outstanding by the assumption of the conversion of all potential dilutive ordinary shares arising from share options granted by the Company (collectively forming the denominator for computing the diluted EPS). A calculation is done to determine the number of shares that could have been acquired at fair value (determined as to be the average market price of the Company's shares during the periods) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares so calculated is compared against the number of shares that would have been issued assuming the exercise of the share options. The difference is added to the denominator as an issue of ordinary shares for no consideration. No adjustment is made to earnings (numerator).

	Unaudited Three months ended 30 June		Unaudited Six months ended 30 June	
	2005	(as restated) 2004	2005	(as restated) 2004
Profit attributable to the equity holders of the Company for the period (RMB'000) (Note a)	186,973	111,881	283,927	218,341
Weighted average number of ordinary shares in issue (thousands) (Note b)	1,771,925	1,329,738	1,768,895	1,295,109
Adjustments for share options (thousands) (Note b)	43,718	10,306	45,540	5,154
Weighted average number of ordinary shares for the calculation of diluted earnings per share (thousands)	1,815,643	1,340,044	1,814,435	1,300,263
Diluted EPS (RMB per share)	0.103	0.083	0.156	0.168

Note a: Profit attributable to the equity holders of the Company for 2004 has been restated to reflect the retrospective adjustments on the effects of share-based payment by the adoption of IFRS 2.

Note b: All per share information has been adjusted retrospectively as if the effect of a split of the Company's shares had taken place on 1 January 2004 (see Note 9).

Notes to the Interim Financial Information (Continued)

18 Dividends

A final dividend for 2004 of HKD0.07 per share, totalling approximately HKD124,052,000 (equivalent to RMB132,036,000) (2003: USD3,500,000), was proposed pursuant to a resolution passed by the Board on 17 March 2005, and was approved by the shareholders in the annual general meeting held on 27 April 2005. The full amount has been distributed up to 30 June 2005.

19 Commitments

(a) Capital commitments

Capital expenditure contracted for at the balance sheet date but not yet incurred is as follows:

	Unaudited	Audited
	30 June	31 December
	2005	2004
	RMB'000	RMB'000
Purchase of fixed assets	28,538	12,150

(b) Operating lease commitments

The future aggregate minimum lease payments committed or authorised under operating leases in respect of buildings are as follows:

	Unaudited	Audited
	30 June	31 December
	2005	2004
	RMB'000	RMB'000
Not later than one year	22,199	17,328
Later than one year and not later than five years	17,010	15,713
	39,209	33,041

Notes to the Interim Financial Information (Continued)

19 Commitments (Continued)

(c) Other commitments

The future aggregate authorised minimum lease payments under bandwidth and server custody leases are as follows:

	Unaudited	Audited
	30 June	31 December
	2005	2004
	RMB'000	RMB'000
Contracted:		
Not later than one year	22,955	14,616
Later than one year and not later than five years	—	3,250
	22,955	17,866
Authorised but not contracted:		
Not later than one year	63,019	48,035
	85,974	65,901

20 Related parties transactions

No material related parties transactions occurred during the three months and six months ended 30 June 2005.

21 Comparatives

As mentioned in Note 1.1, the comparative figures have been restated as a result of the adoption of IFRS 2, "Share-based Payment". In addition, interest income previously included under "finance (costs)/income, net" is now presented as part of "other gains, net" in the income statement of the Group.

22 Approval of Interim Financial Information

The Interim Financial Information has been approved by the Board on 24 August 2005.

Review Report of Auditors

TO THE BOARD OF DIRECTORS OF TENCENT HOLDINGS LIMITED

(Incorporated in Cayman Islands with limited liability)

We have reviewed the accompanying condensed consolidated interim balance sheet of Tencent Holdings Limited (the “Company”) and its subsidiaries (collectively, the “Group”) as at 30 June 2005 and the related condensed consolidated interim statements of income for the three and six months then ended, cash flow and changes in shareholders’ equity for the six months then ended (collectively defined as “Interim Financial Information”) set out on pages 1 to 36.

This Interim Financial Information is the responsibility of the Company’s management. Our responsibility is to issue a report on this Interim Financial Information based on our review. We conducted our review in accordance with the International Standard on Review Engagements 2400 “Engagements to Review Financial Statements” (the “Standard”). This Standard requires that we plan and perform the review to obtain moderate assurance about whether the Interim Financial Information is free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the accompanying Interim Financial Information has not been properly prepared, in all material respects, in accordance with International Accounting Standard 34 “Interim Financial Reporting”.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, 24 August 2005

Operating Information

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

	For the 15-day period ended 30 June 2005	For the 16-day period ended 31 March 2005
	(in millions)	
Registered IM user accounts (at end of period)	438.4	400.6
Active user accounts (at end of period)	173.1	149.2
Peak simultaneous online user accounts (for the quarter)	16.2	13.2
Average daily user hours	265.4	183.1
Average daily messages ⁽¹⁾	2,551.3	1,960.6
Fee-based Internet value-added services registered subscriptions (at end of period)	9.4	9.6
Fee-based mobile and telecommunications value-added service registered subscriptions (at end of period) ⁽²⁾	9.2	9.1

(1) Average daily messages include messages exchanged between PCs only and exclude messages exchanged with mobile handsets.

(2) Includes registered subscriptions for services provided directly by us or through mobile operators.

The growth in the second quarter of 2005 of our user accounts, both registered IM user accounts and active user accounts, mainly reflects an increase in our Internet-based service accounts as we continued to increase the functionality of our services and as our services became increasingly popular. The growth in our user account base in turn, increased the overall use of our platform as reflected in the increase in peak simultaneous online user accounts, average daily user hours and average daily messages. In addition, our ranking system encouraged users to increase their usage of our services.

Financial Performance Highlights

First Half of 2005

The following table sets forth the comparative figures for the first half of 2005 and the first half of 2004:

	Unaudited	
	Six months ended 30 June	
	2005	(Restated*) 2004
	(RMB in thousands)	
Revenues	634,136	528,066
Cost of revenues	(210,891)	(188,315)
Gross profit	423,245	339,751
Other gains, net	27,053	1,928
Selling and marketing expenses	(84,014)	(50,005)
General and administrative expenses	(144,122)	(63,436)
Operating profit	222,162	228,238
Finance (costs)/income, net	(166)	108
Profit before income tax	221,996	228,346
Income tax benefit /(expenses)	61,931	(10,005)
Profit for the period	283,927	218,341

* The adoption of IFRS 2 "Share-based Payment" requires retrospective application of all share options granted to employees after 7 November 2002 and not vested as at 1 January 2005. As a result, profit for the six months ended 30 June 2004 was reduced by RMB2.3 million.

Financial Performance Highlights (Continued)

First Half of 2005 (Continued)

Revenues. Revenues increased by 20.1% to RMB634.1 million for the first half of 2005 from RMB528.1 million for the first half of 2004.

	Six months ended 30 June			
	2005		2004	
	Amount	% of total revenues	Amount	% of total revenues
(RMB in thousands, except percentages)				
Internet value-added services	318,947	50.3%	204,499	38.7%
Mobile and telecommunications value-added services	270,769	42.7%	298,871	56.6%
Online advertising	40,463	6.4%	21,062	4.0%
Others	3,957	0.6%	3,634	0.7%
Total revenues	634,136	100.0%	528,066	100.0%

Cost of revenues. Cost of revenues increased by 12.0% to RMB210.9 million for the first half of 2005 from RMB188.3 million for the first half of 2004.

	Six months ended 30 June			
	2005		2004	
	Amount	% of segment revenues	Amount	% of segment revenues
(RMB in thousands, except percentages)				
Internet value-added services	95,352	29.9%	66,850	32.7%
Mobile and telecommunications value-added services	96,601	35.7%	108,523	36.3%
Online advertising	12,798	31.6%	7,238	34.4%
Others	6,140	155.2%	5,704	157.0%
Total cost of revenues	210,891		188,315	

Financial Performance Highlights (Continued)

Second Quarter of 2005

Our unaudited consolidated revenues for the second quarter of 2005 were RMB333.7 million, an increase of 23.3% over the same period in 2004 and an increase of 11.0% quarter on quarter.

Operating profit for the second quarter of 2005 was RMB118.8 million, representing an increase of 3.1% over the same period in 2004 and an increase of 14.8% quarter on quarter.

Profit for the second quarter of 2005 was RMB187.0 million, representing an increase of 67.1% from the same period in 2004 and an increase of 92.8% quarter on quarter. As a percentage of revenues, profit for the period accounted for 56.0% for the second quarter of 2005, compared to 41.4% for the same period of 2004 and 32.3% for the first quarter of 2005.

Management Discussion and Analysis

Effective from 1 January 2005, we have adopted International Financial Reporting Standard (IFRS) 2 “Share-based Payment” which resulted in a change in our accounting policy with respect to share option grants made to employees. The adoption of IFRS 2 requires a retrospective adjustment to the financial information for 2004. Accordingly, our financial information for the second quarter of 2004 set forth below has been restated.

Second Quarter of 2005 Compared to First Quarter of 2005

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

	Unaudited	
	Three months ended	
	30 June	31 March
	2005	2005
	(RMB in thousands)	
Revenues	333,665	300,471
Cost of revenues	(108,963)	(101,928)
Gross profit	224,702	198,543
Other gains, net	15,148	11,905
Selling and marketing expenses	(45,501)	(38,513)
General and administrative expenses	(75,596)	(68,526)
Operating profit	118,753	103,409
Finance costs, net	(51)	(115)
Profit before income tax	118,702	103,294
Income tax benefit/(expenses)	68,271	(6,340)
Profit for the period	186,973	96,954

Management Discussion and Analysis (Continued)

Second Quarter of 2005 Compared to First Quarter of 2005 (Continued)

Revenues. Revenues increased by 11.0% to RMB333.7 million for the second quarter of 2005 from RMB300.5 million for the first quarter of 2005. The following table sets forth our revenues by line of business for the second quarter of 2005 and the first quarter of 2005:

	Three months ended			
	30 June 2005		31 March 2005	
	Amount	% of total revenues	Amount	% of total revenues
	(RMB in thousands, except percentages)			
Internet value-added services	169,883	50.9%	149,064	49.6%
Mobile and telecommunications value-added services	136,498	40.9%	134,271	44.7%
Online advertising	25,170	7.6%	15,293	5.1%
Others	2,114	0.6%	1,843	0.6%
Total revenues	333,665	100.0%	300,471	100.0%

Revenues from our Internet value-added services increased by 14.0% to RMB169.9 million for the second quarter of 2005 from RMB149.1 million for the first quarter of 2005. The increase mainly reflected the continuing success of our online identity business, the significant growth of Premium QQ offered through fixed-line operators' channels and the growth in our online games. Revenues from fairly new services, such as our online reminder service and personalized icon services, also contributed to the increase in revenues.

Revenues from our mobile and telecommunications value-added services increased by 1.7% to RMB136.5 million for the second quarter of 2005 from RMB134.3 million for the first quarter of 2005. Revenues from ringback tones and mobile IVR increased significantly in the second quarter of 2005 due to an overall growth in popularity of these services. The increase, however, was partially offset by the continuing decline in revenues relating to our mobile communication-based and content-based SMS services. In addition, the continuing "cleaning up" of customer accounts undertaken by mobile operators negatively affected our revenues derived from mobile and telecommunications value-added services. In the second quarter of 2005, we were in the final stages of winding-down the settlement of fees relating to the 161 Mobile Chat arrangement with China Mobile, which was terminated in late 2004.

Management Discussion and Analysis (Continued)

Second Quarter of 2005 Compared to First Quarter of 2005 (Continued)

Revenues from online advertising increased by 64.6% to RMB25.2 million for the second quarter of 2005 from RMB15.3 million for the first quarter of 2005. The change was mainly attributable to the seasonal pick-up of our online advertising business and increased marketing of our advertising services. The increase in revenues also reflected some new advertising revenues relating to the Internet searching functions that we initiated in early 2005.

Cost of revenues. Cost of revenues increased by 6.9% to RMB109.0 million for the second quarter of 2005 from RMB101.9 million for the first quarter of 2005. The increase principally reflected the increase in content costs and bandwidth and server custody fees as we offered richer content and a broader range of products and services. On the other hand, telecommunications operators' revenue share and imbalance fees decreased as we finalized the settlement of our fee sharing arrangements with certain provincial operators of China Mobile relating to 161 Mobile Chat, which was terminated in late 2004. As a percentage of revenues, cost of revenues decreased to 32.7% in the second quarter of 2005 from 33.9% in the first quarter of 2005. The following table sets forth our cost of revenues by line of business for the second quarter of 2005 and the first quarter of 2005:

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

Management Discussion and Analysis (Continued)

Second Quarter of 2005 Compared to First Quarter of 2005 (Continued)

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

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

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

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

Management Discussion and Analysis (Continued)

Second Quarter of 2005 Compared to First Quarter of 2005 (Continued)

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

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

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

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

Management Discussion and Analysis (Continued)

Second Quarter of 2005 Compared to Second Quarter of 2004

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

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

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

Management Discussion and Analysis (Continued)

Second Quarter of 2005 Compared to Second Quarter of 2004 (Continued)

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

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

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

Management Discussion and Analysis (Continued)

Second Quarter of 2005 Compared to Second Quarter of 2004 (Continued)

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

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

Management Discussion and Analysis (Continued)

Second Quarter of 2005 Compared to Second Quarter of 2004 (Continued)

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

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

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

Management Discussion and Analysis (Continued)

Second Quarter of 2005 Compared to Second Quarter of 2004 (Continued)

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

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

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

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

Management Discussion and Analysis (Continued)

Second Quarter of 2005 Compared to Second Quarter of 2004 (Continued)

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

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

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

Management Discussion and Analysis (Continued)

Liquidity and Financial Resources

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

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

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

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

Business Outlook

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

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

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

Business Outlook (Continued)

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

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

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

Directors' Interests in Securities

As at 30 June 2005, the interests and short positions of the directors and the chief executive of the Company in the shares, underlying shares and debentures of the Company or its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinance (“SFO”)) which (a) were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which they have taken, or are deemed to have taken, under such provisions of the SFO); or (b) were required, pursuant to section 352 of the SFO, to be recorded in the register required to be kept by the Company; or (c) were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Companies in the Listing Rules, to be notified to the Company and the Stock Exchange were as follows:

(A) LONG POSITION IN THE SHARES OF THE COMPANY

Name of Director	Nature of interest	Number of shares held	Percentage of issued share capital
Ma Huateng	Corporate (Note 1)	242,483,080	13.68%
Zhang Zhidong	Corporate (Note 2)	108,085,530	6.10%

Notes:

- 1 These shares are held by Advance Data Services Limited, a BVI company wholly owned by Ma Huateng.
- 2 These shares are held by Best Update International Limited, a BVI company wholly owned by Zhang Zhidong.

Directors' Interests in Securities (Continued)

(B) LONG POSITION IN THE SHARES OF ASSOCIATED CORPORATIONS

Name of Director	Name of associated corporation	Nature of interest	Number of shares and class of shares held	Percentage of issued share capital
Ma Huateng	Shenzhen Tencent Computer Systems Company Limited	Personal	RMB9,500,000 (registered capital)	47.5%
	Shenzhen Shiji Kaixuan Technology Company Limited	Personal	RMB5,225,000 (registered capital)	47.5%
Zhang Zhidong	Shenzhen Tencent Computer Systems Company Limited	Personal	RMB4,000,000 (registered capital)	20%
	Shenzhen Shiji Kaixuan Technology Company Limited	Personal	RMB2,200,000 (registered capital)	20%

Save as disclosed above, none of the directors or chief executive and their associates, had interests or short positions in any shares, underlying shares or debentures of the Company and its associated corporations as at 30 June 2005.

Share Option Schemes

The Company has adopted two share option schemes, namely, the Pre-IPO Option Scheme and the Post-IPO Option Scheme, under which the directors may, at their discretion, grant options to employees, including any directors, of the Company or its subsidiaries to subscribe for shares in the Company, subject to the terms and conditions stipulated therein. No further options will be granted under the Pre-IPO Option Scheme. Movements of the options under the Pre-IPO Option Scheme and the Post-IPO Option Scheme are detailed in Note 10 to the Interim Financial Information as included in this interim report. As at 30 June 2005, there were no outstanding share options granted to the directors of the Company.

Substantial Shareholders

As at 30 June 2005, the following persons, other than the directors or chief executive of the Company, had an interest or short position in the shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO as recorded in the register required to be kept by the Company under section 336 of the SFO, or who was, directly or indirectly, interested in 5% or more of the issued share capital of the Company:

Long position in the shares of the Company

Name of shareholder	Nature of interest	Number of shares held	Percentage of issued share capital
MIH QQ (BVI) Limited	Corporate (Note 1)	630,240,380	35.56%
Advance Data Services Limited	Corporate (Note 2)	242,483,080	13.68%
Best Update International Limited	Corporate (Note 3)	108,085,530	6.10%

Notes:

- 1 As MIH QQ (BVI) Limited is wholly owned by Naspers Limited through its intermediary companies MIH (BVI) Limited, MIH Holdings Limited and MIH Investments (Pty) Ltd, Naspers Limited, MIH (BVI) Limited, MIH Holdings Limited and MIH Investments (Pty) Ltd are deemed to be interested in the same block of 630,240,380 shares under Part XV of the SFO.
- 2 As Advance Data Services Limited is wholly owned by Ma Huateng, Mr. Ma has interest in these shares as disclosed under the section headed "Directors' Interests in Securities".
- 3 As Best Update International Limited is wholly owned by Zhang Zhidong, Mr. Zhang has interest in these shares as disclosed under the section headed "Directors' Interests in Securities".

Saved as disclosed above, the Company had not been notified of any other persons (other than a director or chief executive of the Company) who, as at 30 June 2005, had an interest or short position in the shares and underlying shares in the Company as recorded in the register required to be kept under section 336 of the SFO.

Employee and Remuneration Policies

As at 30 June 2005, the Group had 1,648 employees (30 June 2004: 804), most of whom are based in the Company's head office in Shenzhen, the PRC. The number of employees employed by the Group varies from time to time depending on needs and they are remunerated based on industry practice.

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

The total remuneration cost incurred by the Group for the six months ended 30 June 2005 was RMB134 million (2004: RMB67 million).

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

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

Audit Committee

The Audit Committee, which comprises two independent non-executive directors and one non-executive director of the Company, has reviewed the accounting principles and practices adopted by the Company and discussed auditing, internal control and financial reporting matters. The Audit Committee, together with the Auditors, has reviewed the Group's unaudited interim financial statements for the three and six months ended 30 June 2005.

Adoption of Code of Conduct regarding Directors' Securities Transactions

The Company has adopted a code of conduct regarding directors' securities transactions on terms no less exacting than the required standard set out in Appendix 10 - Model Code for Securities Transactions by Directors of Listed Companies under the Listing Rules. The directors of the Company have complied with such code of conduct throughout the accounting periods covered by this interim report.

Compliance with the Code on Corporate Governance Practices

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

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

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

Appreciation

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

By Order of the Board

Ma Huateng

Chairman

Hong Kong, 24 August 2005

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