

Tencent 腾讯
TENCENT HOLDINGS LIMITED
騰訊控股有限公司

(Incorporated in the Cayman Islands with limited liability)

(Stock Code: 700)

ANNOUNCEMENT OF THE RESULTS
FOR THE THREE AND SIX MONTHS ENDED 30 JUNE 2006

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 2006. These interim results have been reviewed by PricewaterhouseCoopers, the auditors of the Company (the “Auditors”), in accordance with 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 2006 AND 31 DECEMBER 2005

| | Unaudited | Audited |
|--|-------------------------|-------------------------|
| | 30 June | 31 December |
| | 2006 | 2005 |
| | RMB'000 | RMB'000 |
| ASSETS | | |
| Non-current assets | | |
| Fixed assets | 494,885 | 365,047 |
| Leasehold land payments | 9,908 | — |
| Intangible assets | 216,444 | 21,432 |
| Held-to-maturity investments | 239,868 | 244,581 |
| Deferred tax assets | 91,983 | 96,362 |
| Available-for-sale investments | <u>36,073</u> | <u>36,073</u> |
| | 1,089,161 | 763,495 |
| Current assets | | |
| Inventories | 2,571 | 2,647 |
| Accounts receivable | 381,406 | 222,754 |
| Prepayments, deposits and other receivables | 62,350 | 32,570 |
| Financial assets held for trading | 286,343 | 383,887 |
| Term deposits with initial term of over three months | 711,543 | 445,725 |
| Cash and cash equivalents | <u>1,458,733</u> | <u>1,576,044</u> |
| | 2,902,946 | 2,663,627 |
| Total Assets | <u>3,992,107</u> | <u>3,427,122</u> |

| | Unaudited 30 June 2006 RMB'000 | Audited 31 December 2005 <i>RMB'000</i> |
|--|---|--|
| EQUITY | | |
| Shareholders' equity | | |
| Share capital | 191 | 192 |
| Share premium | 1,439,916 | 1,666,044 |
| Share-based compensation reserve | 73,913 | 40,109 |
| Other reserves | 80,925 | 66,609 |
| Retained earnings | <u>1,513,330</u> | <u>1,155,459</u> |
| | <u>3,108,275</u> | <u>2,928,413</u> |
| LIABILITIES | | |
| Non-current liabilities | | |
| Deferred tax liabilities | 17,532 | 810 |
| Long term payable | <u>106,056</u> | <u>—</u> |
| | <u>123,588</u> | <u>810</u> |
| Current liabilities | | |
| Accounts payable | 50,857 | 25,555 |
| Other payables and accruals | 353,956 | 196,187 |
| Current income tax liabilities | 47,555 | 28,766 |
| Other tax liabilities | 20,199 | 13,256 |
| Deferred revenue | <u>287,677</u> | <u>234,135</u> |
| | <u>760,244</u> | <u>497,899</u> |
| Total Liabilities | <u>883,832</u> | <u>498,709</u> |
| Total Equity and Liabilities | <u>3,992,107</u> | <u>3,427,122</u> |
| Net current assets | <u>2,142,702</u> | <u>2,165,728</u> |
| Total assets less current liabilities | <u>3,231,863</u> | <u>2,929,223</u> |

**CONDENSED CONSOLIDATED INCOME STATEMENT
FOR THE THREE AND SIX MONTHS ENDED 30 JUNE 2006**

| | | Unaudited | | Unaudited | |
|--|-------------|---------------------------|----------------|-------------------------|----------------|
| | | Three months ended | | Six months ended | |
| | | 30 June | | 30 June | |
| | | 2006 | 2005 | 2006 | 2005 |
| | <i>Note</i> | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| Revenues | | | | | |
| Internet value-added services | | 462,260 | 169,883 | 898,798 | 318,947 |
| Mobile and telecommunications value-added services | | 178,355 | 136,498 | 341,781 | 270,769 |
| Online advertising | | 62,972 | 25,170 | 104,742 | 40,463 |
| Others | | 1,394 | 2,114 | 4,965 | 3,957 |
| | 2 | 704,981 | 333,665 | 1,350,286 | 634,136 |
| Cost of revenues | 5 | (199,035) | (108,963) | (374,728) | (210,891) |
| Gross profit | | 505,946 | 224,702 | 975,558 | 423,245 |
| Other gains, net | 4 | 21,357 | 15,148 | 42,893 | 27,053 |
| Selling and marketing expenses | 5 | (74,838) | (45,501) | (154,586) | (84,014) |
| General and administrative expenses | 5 | (142,440) | (75,596) | (272,247) | (144,122) |
| Operating profit | * | 310,025 | 118,753 | 591,618 | 222,162 |
| Finance costs, net | | (6,537) | (51) | (16,632) | (166) |
| Profit before income tax | | 303,488 | 118,702 | 574,986 | 221,996 |
| Income tax (expenses)/benefit | 6 | (35,599) | 68,271 | (57,397) | 61,931 |
| Profit for the period | | 267,889 | 186,973 | 517,589 | 283,927 |
| Earnings per share for profit attributable to the equity holders of the Company during the period (expressed in RMB per share) | | | | | |
| - basic | 7 | 0.151 | 0.106 | 0.290 | 0.161 |
| - diluted | 7 | 0.147 | 0.103 | 0.282 | 0.156 |

* after deduction of share-based compensation charge amounting to RMB19,375,000 (for the three months ended 30 June 2005: RMB5,306,000) for the three months ended 30 June 2006 and RMB33,804,000 (for the six months ended 30 June 2005: RMB9,843,000) for the six months ended 30 June 2006.

**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED 30 JUNE 2006**

| | Unaudited | | | | | | |
|---|---------------------------------|---------------------------------|--|-----------------------------------|--------------------------------------|-------------------------------------|-------------------------|
| | Share capital <i>RMB'000</i> | Share premium <i>RMB'000</i> | Share-based compensation reserve <i>RMB'000</i> | Capital reserve <i>RMB'000</i> | Statutory reserves <i>RMB'000</i> | Retained earnings <i>RMB'000</i> | Total <i>RMB'000</i> |
| Balance at 1 January 2006 | 192 | 1,666,044 | 40,109 | 20,000 | 46,609 | 1,155,459 | 2,928,413 |
| Profit for the period | — | — | — | — | — | 517,589 | 517,589 |
| Employees share option scheme: | | | | | | | |
| - value of employee services | — | — | 33,804 | — | — | — | 33,804 |
| - proceeds from shares issued | 1 | 14,948 | — | — | — | — | 14,949 |
| Repurchase and cancellation of shares | (2) | (241,076) | — | — | — | — | (241,078) |
| Profit appropriations to statutory reserves | — | — | — | — | 14,316 | (14,316) | — |
| Dividend relating to 2005 (note 8) | — | — | — | — | — | (145,402) | (145,402) |
| Balance at 30 June 2006 | <u>191</u> | <u>1,439,916</u> | <u>73,913</u> | <u>20,000</u> | <u>60,925</u> | <u>1,513,330</u> | <u>3,108,275</u> |

| | Unaudited | | | | | | |
|---|---------------------------------|---------------------------------|--|-----------------------------------|--------------------------------------|-------------------------------------|-------------------------|
| | Share capital <i>RMB'000</i> | Share premium <i>RMB'000</i> | Share-based compensation reserve <i>RMB'000</i> | Capital reserve <i>RMB'000</i> | Statutory reserves <i>RMB'000</i> | Retained earnings <i>RMB'000</i> | Total <i>RMB'000</i> |
| 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 share issued | 1 | 4,183 | — | — | — | — | 4,184 |
| Profit appropriations to statutory reserves | — | — | — | — | 14,167 | (14,167) | — |
| Dividend relating to 2004 | — | — | — | — | — | (132,036) | (132,036) |
| Balance at 30 June 2005 | <u>193</u> | <u>1,781,904</u> | <u>15,426</u> | <u>20,000</u> | <u>46,609</u> | <u>954,024</u> | <u>2,818,156</u> |

**CONDENSED CONSOLIDATED CASH FLOW STATEMENT
FOR THE SIX MONTHS ENDED 30 JUNE 2006**

| | Unaudited | |
|---|-------------------------|------------------|
| | Six months ended | |
| | 30 June | |
| | 2006 | 2005 |
| | <i>RMB'000</i> | <i>RMB'000</i> |
| Net cash flows from operating activities | 683,999 | 222,685 |
| Net cash flows (used in)/from investing activities | (421,277) | 169,963 |
| Net cash flows used in financing activities | <u>(371,531)</u> | <u>(127,997)</u> |
| (Decrease)/increase in cash and cash equivalents | (108,809) | 264,651 |
| Cash and cash equivalents at beginning of period | 1,576,044 | 859,841 |
| Exchange losses on cash and cash equivalents | <u>(8,502)</u> | <u>—</u> |
| Cash and cash equivalents at end of period | <u>1,458,733</u> | <u>1,124,492</u> |

Notes

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 (the "Stock Exchange") 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 2006 and related condensed consolidated income statement for the three and six months ended 30 June 2006, condensed consolidated statements of cash flow and changes in shareholders' equity for the six months then ended (collectively defined as the "Interim Financial Statements") 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 Statements should be read in conjunction with the Auditors' report and the audited consolidated financial statements of the Group for the year ended 31 December 2005 (the "2005 Financial Statements") as set out in the 2005 annual report of the Company dated 22 March 2006.

The accounting policies and method of computation used in the preparation of the Interim Financial Statements are consistent with those used in the 2005 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 available-for-sale investments and financial assets held for trading.

Assessment and adoption of revised/new IFRS, interpretations and amendments

The following new standards, amendments and interpretations to existing standards have been published and are mandatory for the financial year ending 31 December 2006.

| | |
|-------------------------------|--|
| IAS 19 (Amendment) | Actuarial Gains and Losses, Group Plans and Disclosures |
| IAS 21 (Amendment) | Net Investment in a Foreign Operation |
| IAS 39 (Amendment) | The Fair Value Option |
| IAS 39 (Amendment) | Cash Flow Hedge Accounting of Forecast Intragroup Transactions |
| IAS 39 and IFRS 4 (Amendment) | Financial Guarantee Contracts |
| IFRIC 4 | Determining whether an Arrangement Contains a Lease |

Management has assessed the relevance of these new standards, interpretations and amendment with respect to the Group's operations and their impact on the Group's accounting policies. In summary:

IAS 19 (Amendment), IAS 39 (Amendment) - Cash Flow Hedge Accounting of Forecast Intragroup Transactions, IAS 39 and IFRS 4 (Amendment) - Financial Guarantee Contracts, are not relevant to the Group's operations.

IAS 39 (Amendment) - The fair value option, IAS 21 (Amendment) — Net Investment in a Foreign Operation and IFRIC 4 did not result in substantial changes to the Group's accounting policies.

2 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 2006 and 2005 are presented as follows:

| | Unaudited Three months ended 30 June 2006 | | | | Total RMB'000 |
|--|--|---|----------------------------------|-------------------|------------------|
| | Internet value-added services RMB'000 | Mobile and telecommunications value-added services RMB'000 | Online advertising RMB'000 | Others RMB'000 | |
| Revenues | <u>462,260</u> | <u>178,355</u> | <u>62,972</u> | <u>1,394</u> | <u>704,981</u> |
| Gross profit/(loss) | <u>356,451</u> | <u>112,581</u> | <u>41,376</u> | <u>(4,462)</u> | <u>505,946</u> |
| Other gains, net | | | | | 21,357 |
| Selling and marketing expenses | | | | | (74,838) |
| General and administrative expenses | | | | | <u>(142,440)</u> |
| Operating profit | | | | | <u>310,025</u> |
| Finance costs, net | | | | | <u>(6,537)</u> |
| Profit before income tax | | | | | <u>303,488</u> |
| Income tax expenses | | | | | <u>(35,599)</u> |
| Profit for the period | | | | | <u>267,889</u> |
| | Unaudited Three months ended 30 June 2005 | | | | |
| | Internet value-added services RMB'000 | Mobile and telecommunications value-added services RMB'000 | Online advertising RMB'000 | Others RMB'000 | Total RMB'000 |
| Revenues | <u>169,883</u> | <u>136,498</u> | <u>25,170</u> | <u>2,114</u> | <u>333,665</u> |
| Gross profit/(loss) | <u>117,108</u> | <u>89,963</u> | <u>18,357</u> | <u>(726)</u> | 224,702 |
| Other gains, net | | | | | 15,148 |
| Selling and marketing expenses | | | | | (45,501) |
| General and administrative expenses | | | | | <u>(75,596)</u> |
| Operating profit | | | | | 118,753 |
| Finance costs, net | | | | | <u>(51)</u> |
| Profit before income tax | | | | | 118,702 |
| Income tax benefit | | | | | <u>68,271</u> |
| Profit for the period | | | | | <u>186,973</u> |

| Unaudited | | | | | |
|--|---|--|---|--------------------------|-------------------------|
| Six months ended 30 June 2006 | | | | | |
| | Internet value-added services <i>RMB'000</i> | Mobile and telecommunications value-added services <i>RMB'000</i> | Online advertising <i>RMB'000</i> | Others <i>RMB'000</i> | Total <i>RMB'000</i> |
| Revenues | <u>898,798</u> | <u>341,781</u> | <u>104,742</u> | <u>4,965</u> | <u>1,350,286</u> |
| Gross profit/(loss) | <u>698,306</u> | <u>216,566</u> | <u>66,380</u> | <u>(5,694)</u> | 975,558 |
| Other gains, net | | | | | 42,893 |
| Selling and marketing expenses | | | | | (154,586) |
| General and administrative expenses | | | | | <u>(272,247)</u> |
| Operating profit | | | | | 591,618 |
| Finance costs, net | | | | | <u>(16,632)</u> |
| Profit before income tax | | | | | 574,986 |
| Income tax expenses | | | | | <u>(57,397)</u> |
| Profit for the period | | | | | <u>517,589</u> |

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

3 Share option

(a) Share option schemes

The Company has adopted two share option schemes for the purpose of providing incentives to its directors, eligible employees and consultants: the Pre-IPO Share Option Scheme and the Post-IPO Share Option Scheme.

As at the listing date of the Company on 16 June 2004, all options under the Pre-IPO Share Option Scheme had been granted. The maximum number of shares in respect of which options may be granted under the Post-IPO Share Option Scheme, and under any other share option scheme of the Company (including the Pre-IPO Share Option Scheme), shall not exceed 10% of the relevant class of securities of the Company in issue as at the date of the IPO.

(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 Share Option Scheme | | Post-IPO Share Option Scheme | | Total |
|--------------------------|--------------------------------|--------------------------|---------------------------------|--------------------------|--------------------------|
| | Average exercise price | No. of options | Average exercise price | No. of options | No. of options |
| At 1 January 2005 | USD0.0849 | 50,406,917 | HKD3.6650 | 6,300,961 | 56,707,878 |
| Granted | — | — | HKD4.6470 | 22,491,048 | 22,491,048 |
| Exercised | USD0.0658 | (7,671,936) | — | — | (7,671,936) |
| Lapsed | USD0.2076 | <u>(600,850)</u> | HKD4.0772 | <u>(1,649,657)</u> | <u>(2,250,507)</u> |
| At 30 June 2005 | USD0.0867 | <u>42,134,131</u> | HKD4.5372 | <u>27,142,352</u> | <u>69,276,483</u> |
| At 1 January 2006 | USD0.0933 | 31,574,357 | HKD6.1627 | 51,293,646 | 82,868,003 |
| Granted | — | — | HKD11.5500 | 10,950,000 | 10,950,000 |
| Exercised | USD0.0852 | (8,233,043) | HKD4.2807 | (2,069,812) | (10,302,855) |
| Lapsed | USD0.1967 | <u>(156,940)</u> | HKD4.7605 | <u>(1,408,776)</u> | <u>(1,565,716)</u> |
| At 30 June 2006 | USD0.0955 | <u>23,184,374</u> | HKD7.2664 | <u>58,765,058</u> | <u>81,949,432</u> |

During the six months ended 30 June 2006, no share options were granted to the directors of the Company or any consultants.

Out of the 81,949,432 options outstanding as at 30 June 2006 (30 June 2005: 69,276,483 options), 21,470,156 options (30 June 2005: 19,833,494) were exercisable. Options exercised during the six months ended 30 June 2006 resulted in 10,302,855 ordinary shares issued. The weighted average price of the shares at the time these options were exercised was HKD 12.9647 (equivalent to approximately RMB 13.3459) per share.

4 **Other gains, net**

| | Unaudited | | Unaudited | |
|---|--------------------|---------------|------------------|---------------|
| | Three months ended | | Six months ended | |
| | 30 June | | 30 June | |
| | 2006 | 2005 | 2006 | 2005 |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| Interest income | 18,302 | 9,165 | 35,637 | 18,022 |
| Fair value gains on financial assets held for trading | 3,055 | 5,252 | 7,256 | 8,300 |
| Others | — | 731 | — | 731 |
| | <u>21,357</u> | <u>15,148</u> | <u>42,893</u> | <u>27,053</u> |

5 **Expenses by nature**

| | Unaudited | | Unaudited | |
|--|--------------------|----------------|------------------|----------------|
| | Three months ended | | Six months ended | |
| | 30 June | | 30 June | |
| | 2006 | 2005 | 2006 | 2005 |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| Employee benefits expenses (<i>Note</i>) | 144,758 | 72,278 | 270,635 | 134,099 |
| Mobile and telecom charges and bandwidth and server custody fees | 113,214 | 66,101 | 211,900 | 132,916 |
| Promotion and advertising expenses | 40,650 | 22,062 | 82,905 | 39,647 |
| Travelling and entertainment expenses | 17,607 | 12,361 | 35,433 | 22,739 |
| Depreciation of fixed assets (<i>Note</i>) | 25,588 | 11,372 | 47,597 | 21,375 |
| Amortisation of intangible assets | 6,773 | 352 | 12,016 | 352 |
| Operating lease rentals in respect of office buildings | 9,123 | 6,717 | 15,984 | 12,074 |
| Value-added tax paid upon transfer of software within the Group | — | — | 1,500 | — |
| Other expenses | <u>58,600</u> | <u>38,817</u> | <u>123,591</u> | <u>75,825</u> |
| Total cost of revenues, selling and marketing expenses and general and administrative expenses | <u>416,313</u> | <u>230,060</u> | <u>801,561</u> | <u>439,027</u> |

Note:

Research and development expenses were RMB72,356,000 (for the three months ended 30 June 2005: RMB32,527,000) and RMB135,276,000 (for the six months ended 30 June 2005: RMB59,092,000) for the three and six months ended 30 June 2006, respectively. The expenses included employee benefit expenses of RMB61,241,000 and depreciation of fixed assets of RMB9,449,000 (for the three months ended 30 June 2005: RMB26,510,000 and RMB4,423,000, respectively) for the three months ended 30 June 2006 and employee benefit expenses of RMB113,164,000 and depreciation of fixed assets of RMB17,963,000 (for the six months ended 30 June 2005: RMB48,766,000 and RMB7,725,000, respectively) for the six months ended 30 June 2006. The Group had not capitalised any research and development expenses for the six months ended 30 June 2006 (for the six months ended 30 June 2005: Nil).

6 Income tax (expenses)/benefit

(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 2006 and 2005, 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 2006 and 2005, respectively.

(iii) PRC Enterprise Income Tax

PRC Enterprise Income Tax ("EIT") has been provided on the assessable income of entities within the Group incorporated in the PRC for the six months ended 30 June 2006 and 2005, calculated in accordance with the relevant regulations of the PRC after considering the available tax benefits from refunds and allowances.

Certain direct and indirect subsidiaries of the Company are registered in the PRC. The EIT tax rates applicable to these companies for the six months ended 30 June 2006 range from 0% to 15%.

The taxation charges of the Group for the six months ended 30 June 2006 and 2005 are analysed as follows:

| | Unaudited | | Unaudited | |
|-----------------|-------------------------------|------------------------|-----------------------------|------------------------|
| | Three months ended 30 June | | Six months ended 30 June | |
| | 2006 | 2005 | 2006 | 2005 |
| | <i>RMB'000</i> | <i>RMB'000</i> | <i>RMB'000</i> | <i>RMB'000</i> |
| PRC current tax | 24,830 | 18,119 | 47,476 | 24,459 |
| Deferred tax | 10,769 | (86,390) | 9,921 | (86,390) |
| | <u>35,599</u> | <u>(68,271)</u> | <u>57,397</u> | <u>(61,931)</u> |

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 applicable in Shenzhen and High Technology Zone in Beijing, the PRC, where the principal activities of the Group are conducted. The difference is analysed as follows:

| | Unaudited | | Unaudited | |
|---|--------------------|-----------------|------------------|-----------------|
| | Three months ended | | Six months ended | |
| | 30 June | | 30 June | |
| | 2006 | 2005 | 2006 | 2005 |
| | RMB'000 | RMB'000 | RMB'000 | RMB'000 |
| Profit before income tax | <u>303,488</u> | <u>118,702</u> | <u>574,986</u> | <u>221,996</u> |
| Tax calculated at a tax rate of 15% | 45,523 | 17,805 | 86,248 | 33,299 |
| Effects of different tax rates available to different companies of the Group | 6,182 | (1,497) | 10,734 | (2,953) |
| Effects of tax holiday on assessable profit of subsidiaries | (23,854) | 3,097 | (52,764) | (979) |
| Expenses not deductible for tax purposes | 7,748 | 794 | 13,179 | 1,452 |
| Utilisation of previously unrecognised tax assets/ deferred tax assets not recognised | — | (1,091) | — | (6,760) |
| Recognition of previously unrecognised deferred tax assets | — | (88,638) | — | (88,638) |
| Unrecognised tax losses | — | <u>1,259</u> | — | <u>2,648</u> |
| Tax charge/(credit) | <u>35,599</u> | <u>(68,271)</u> | <u>57,397</u> | <u>(61,931)</u> |

7 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 | | Unaudited | |
|---|--------------------|----------------|------------------|----------------|
| | Three months ended | | Six months ended | |
| | 30 June | | 30 June | |
| | 2006 | 2005 | 2006 | 2005 |
| Profit attributable to the equity holders of the Company for the period (RMB'000) | <u>267,889</u> | <u>186,973</u> | <u>517,589</u> | <u>283,927</u> |
| Weighted average number of ordinary shares in issue (thousand shares) | 1,771,006 | 1,771,925 | 1,781,989 | 1,768,895 |
| Basic EPS (RMB per share) | <u>0.151</u> | <u>0.106</u> | <u>0.290</u> | <u>0.161</u> |

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 the average

market price of the Company's shares during the periods) based on the monetary value of the subscription rights attached to the 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 | | Unaudited | |
|--|---------------------------|----------------|-------------------------|----------------|
| | Three months ended | | Six months ended | |
| | 30 June | | 30 June | |
| | 2006 | 2005 | 2006 | 2005 |
| Profit attributable to the equity holders of the Company for the period (RMB'000) | <u>267,889</u> | <u>186,973</u> | <u>517,589</u> | <u>283,927</u> |
| Weighted average number of ordinary shares in issue (thousand shares) | 1,771,006 | 1,771,925 | 1,781,989 | 1,768,895 |
| Adjustments for share options (thousand shares) | <u>56,093</u> | <u>43,718</u> | <u>52,840</u> | <u>45,540</u> |
| Weighted average number of ordinary shares for the calculation of diluted earnings per share (thousand shares) | 1,827,099 | 1,815,643 | 1,834,829 | 1,814,435 |
| Diluted EPS (RMB per share) | <u>0.147</u> | <u>0.103</u> | <u>0.282</u> | <u>0.156</u> |

8 Dividends

A final dividend for 2005 of HKD0.08 per share, totalling approximately HKD140,635,000 (equivalent RMB145,402,000) (2004: HKD124,052,000 (equivalent RMB132,036,000)), was proposed pursuant to a resolution passed by the Board on 22 March 2006, and was approved by the shareholders in the annual general meeting held on 24 May 2006. Such dividends have been shown as an appropriation in these Interim Financial Statements and been paid as at 30 June 2006.

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 2006 | For the 16- day period ended 31 March 2006 | Percentage change |
|---|--|---|------------------------------|
| | <i>(in millions)</i> | | |
| Registered IM user accounts (at end of period) | 549.0 | 531.5 | 3.3% |
| Active user accounts (at end of period) | 224.2 | 220.5 | 1.7% |
| Peak simultaneous online user accounts (for the quarter) | 20.1 | 19.6 | 2.6% |
| Average daily user hours | 301.7 | 272.2 | 10.8% |
| Average daily messages ⁽¹⁾ | 3,334.1 | 2,883.8 | 15.6% |
| Fee-based Internet value-added services registered subscriptions (at end of period) | 14.7 | 13.5 | 8.9% |
| Fee-based mobile and telecommunications value-added services registered subscriptions (at end of period) ⁽²⁾ | 10.1 | 9.5 | 6.3% |

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

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

Our IM platform generally showed healthy growth in the second quarter of 2006. The growth in user accounts, both registered IM user accounts and active user accounts, mainly reflected the continuing organic growth of our services, partly reduced by our increased effort in limiting the activity of certain accounts which were used for spamming other users. The growth in fee-based registered subscriptions resulted from our focus to enhance user experience for our services, our targeted marketing and our efforts to cross-market our value-added services to the users of our Internet platforms such as IM, QQ Game portal and QQ.com portal.

FINANCIAL PERFORMANCE HIGHLIGHTS

First Half of 2006

The following table sets forth the figures for the first half of 2006 and the first half of 2005:

| | Unaudited | |
|-------------------------------------|---------------------------|------------------|
| | Six months ended | |
| | 30 June | |
| | 2006 | 2005 |
| | <i>(RMB in thousands)</i> | |
| Revenues | 1,350,286 | 634,136 |
| Cost of revenues | <u>(374,728)</u> | <u>(210,891)</u> |
| Gross profit | 975,558 | 423,245 |
| Other gains, net | 42,893 | 27,053 |
| Selling and marketing expenses | (154,586) | (84,014) |
| General and administrative expenses | <u>(272,247)</u> | <u>(144,122)</u> |
| Operating profit | 591,618 | 222,162 |
| Finance costs, net | <u>(16,632)</u> | <u>(166)</u> |
| Profit before income tax | 574,986 | 221,996 |
| Income tax (expenses)/benefit | <u>(57,397)</u> | <u>61,931</u> |
| Profit for the period | <u>517,589</u> | <u>283,927</u> |

Revenues. Revenues increased by 112.9% to RMB1,350.3 million for the first half of 2006 from RMB634.1 million for the first half of 2005.

| | Six months ended | | | |
|--|---|----------------------|---------------------|-----------------|
| | 30 June 2006 | | 30 June 2005 | |
| | % of total | | % of total | |
| | Amount | revenues | Amount | revenues |
| | <i>(RMB in thousands, except percentages)</i> | | | |
| Internet value-added services | 898,798 | 66.6% | 318,947 | 50.3% |
| Mobile and telecommunications value-added services | 341,781 | 25.3% | 270,769 | 42.7% |
| Online advertising | 104,742 | 7.8% | 40,463 | 6.4% |
| Others | <u>4,965</u> | <u>0.3%</u> | <u>3,957</u> | <u>0.6%</u> |
| Total revenues | <u>1,350,286</u> | <u>100.0%</u> | <u>634,136</u> | <u>100.0%</u> |

Cost of revenues. Cost of revenues increased by 77.7% to RMB374.7 million for the first half of 2006 from RMB210.9 million for the first half of 2005.

| | Six months ended | | Six months ended | |
|--|---|-----------------------|------------------|-----------------------|
| | 30 June 2006 | | 30 June 2005 | |
| | Amount | % of segment revenues | Amount | % of segment revenues |
| | <i>(RMB in thousands, except percentages)</i> | | | |
| Internet value-added services | 200,492 | 22.3% | 95,352 | 29.9% |
| Mobile and telecommunications value-added services | 125,215 | 36.6% | 96,601 | 35.7% |
| Online advertising | 38,362 | 36.6% | 12,798 | 31.6% |
| Others | 10,659 | 214.7% | 6,140 | 155.2% |
| Total cost of revenues | <u>374,728</u> | | <u>210,891</u> | |

Second Quarter of 2006

Our unaudited consolidated revenues for the second quarter of 2006 were RMB705.0 million, an increase of 111.3% over the same period in 2005 and an increase of 9.2% from the first quarter of 2006.

Revenues from our Internet value-added services for the second quarter of 2006 were RMB462.3 million, an increase of 172.1% over the same period in 2005 and an increase of 5.9% from the first quarter of 2006.

Revenues from our mobile and telecommunications value-added services for the second quarter of 2006 were RMB178.4 million, an increase of 30.7% over the same period in 2005 and an increase of 9.1% from the first quarter of 2006.

Revenues from online advertising for the second quarter of 2006 were RMB63.0 million, an increase of 150.2% over the same period in 2005 and an increase of 50.8% from the first quarter of 2006.

Cost of revenues for the second quarter of 2006 were RMB199.0 million, an increase of 82.7% over the same period in 2005 and an increase of 13.3% from the first quarter of 2006.

Selling and marketing expenses for the second quarter of 2006 were RMB74.8 million, an increase of 64.5% over the same period in 2005 and a decrease of 6.2% from the first quarter of 2006.

General and administrative expenses for the second quarter of 2006 were RMB142.4 million, an increase of 88.4% over the same period in 2005 and an increase of 9.7% from the first quarter of 2006.

Operating profit for the second quarter of 2006 was RMB310.0 million, representing an increase of 161.1% over the same period in 2005 and an increase of 10.1% quarter on quarter. As a percentage of revenues, operating profit represented 44.0% for the second quarter of 2006, compared to 35.6% for the same period of 2005 and 43.6% for the first quarter of 2006.

Profit for the second quarter of 2006 was RMB267.9 million, representing an increase of 43.3% over the same period in 2005 and an increase of 7.3% from the first quarter of 2006. As a percentage of revenues, profit for the period represented 38.0% for the second quarter of 2006, compared to 56.0% for the same period of 2005 and 38.7% for the first quarter of 2006.

MANAGEMENT DISCUSSION AND ANALYSIS

Second Quarter of 2006 Compared to First Quarter of 2006

The following table sets forth the figures for the second quarter of 2006 and the first quarter of 2006:

| | Unaudited | |
|-------------------------------------|--|--------------------------|
| | Three months ended 30 June 2006 | 31 March 2006 |
| | <i>(RMB in thousands)</i> | |
| Revenues | 704,981 | 645,305 |
| Cost of revenues | <u>(199,035)</u> | <u>(175,693)</u> |
| Gross profit | 505,946 | 469,612 |
| Other gains, net | 21,357 | 21,536 |
| Selling and marketing expenses | (74,838) | (79,748) |
| General and administrative expenses | <u>(142,440)</u> | <u>(129,807)</u> |
| Operating profit | 310,025 | 281,593 |
| Finance costs, net | <u>(6,537)</u> | <u>(10,095)</u> |
| Profit before income tax | 303,488 | 271,498 |
| Income tax expenses | <u>(35,599)</u> | <u>(21,798)</u> |
| Profit for the period | <u><u>267,889</u></u> | <u><u>249,700</u></u> |

Revenues. Revenues increased by 9.2% to RMB705.0 million for the second quarter of 2006 from RMB645.3 million for the first quarter of 2006. The following table sets forth our revenues by line of business for the second quarter of 2006 and the first quarter of 2006:

| | Three months ended | | | |
|--|---|----------------------------|-----------------------|----------------------------|
| | 30 June 2006 | | 31 March 2006 | |
| | Amount | % of total revenues | Amount | % of total revenues |
| | <i>(RMB in thousands, except percentages)</i> | | | |
| Internet value-added services | 462,260 | 65.6% | 436,538 | 67.6% |
| Mobile and telecommunications value-added services | 178,355 | 25.3% | 163,426 | 25.3% |
| Online advertising | 62,972 | 8.9% | 41,770 | 6.5% |
| Others | 1,394 | 0.2% | 3,571 | 0.6% |
| Total revenues | <u>704,981</u> | <u>100.0%</u> | <u>645,305</u> | <u>100.0%</u> |

Revenues from our Internet value-added services increased by 5.9% to RMB462.3 million for the second quarter of 2006 from RMB436.5 million for the first quarter of 2006. Our online identity and community business, including QQ Show, QQ Pet, an Internet-based virtual pet, and Qzone, a personal homepage that bundles avatars, blog, photo album and online music, continued to grow. We also benefited from the growth of our online games. In addition, Premium QQ grew as we began to bundle some of our other value-added services, including QQ Magic, E-cards, self-defined personal icons and QQ Ring into its service package during the second quarter of 2006.

Revenues from our mobile and telecommunications value-added services increased by 9.1% to RMB178.4 million for the second quarter of 2006 from RMB163.4 million for the first quarter of 2006. This increase reflected the growth in our content-based services, as well as the revenues attributable to Joymax group, which was acquired in late January 2006, being reflected for the full quarter. In addition, revenues from our 2.5G services grew as a result of increased promotion for both WAP and MMS. Revenues from mobile voice value-added services comprising ringback tones and mobile IVR also grew. Such increase in revenues were partially offset by the slight decrease in revenues from our communication-based SMS services. For a detailed description of policy changes announced in July 2006 that will affect our wireless services on China Mobile's Monternet platform, please refer to "Business Outlook" below.

Revenues from online advertising increased by 50.8% to RMB63.0 million for the second quarter of 2006 from RMB41.8 million for the first quarter of 2006. The increase was mainly attributable to one significantly large order for a special cross-marketing promotion campaign with a consumer product customer, increased volume through agency sales and the increase in advertising on our QQ Game portal. Advertising revenues relating to the Internet searching functions also grew.

Cost of revenues. Cost of revenues increased by 13.3% to RMB199.0 million for the second quarter of 2006 from RMB175.7 million for the first quarter of 2006. The increase principally reflected increase in bandwidth and server custody fees as our business volume

expanded, an increase in telecommunications operators' revenue share and increased staff costs. As a percentage of revenues, cost of revenues increased to 28.2% for the second quarter of 2006 from 27.2% for the first quarter of 2006. The following table sets forth our cost of revenues by line of business for the second quarter of 2006 and the first quarter of 2006:

| | Three months ended | | Three months ended | |
|--|---|-----------------------|--------------------|-----------------------|
| | 30 June 2006 | % of segment revenues | 31 March 2006 | % of segment revenues |
| | Amount | | Amount | |
| | <i>(RMB in thousands, except percentages)</i> | | | |
| Internet value-added services | 105,809 | 22.9% | 94,683 | 21.7% |
| Mobile and telecommunications value-added services | 65,774 | 36.9% | 59,441 | 36.4% |
| Online advertising | 21,596 | 34.3% | 16,766 | 40.1% |
| Others | 5,856 | 420.1% | 4,803 | 134.5% |
| Total cost of revenues | <u>199,035</u> | | <u>175,693</u> | |

Cost of revenues for our Internet value-added services increased by 11.8% to RMB105.8 million for the second quarter of 2006 from RMB94.7 million for the first quarter of 2006. The increase reflected higher expenses associated with our bandwidth capacity and servers as usage increased and as we supported more bandwidth intensive services, such as Qzone and online games. The increase also reflected higher staff costs. We also recognized higher amounts of telecommunications operators' revenue share as the volume of our Internet value-added services increased.

Cost of revenues for our mobile and telecommunications value-added services increased by 10.7% to RMB65.8 million for the second quarter of 2006 from RMB59.4 million for the first quarter of 2006. The increase mainly reflected the higher amounts of telecommunications operators' revenue share, an increase in sharing and subscription costs relating to our content services as the volume of our mobile and telecommunications value-added services increased and higher staff costs.

Cost of revenues for our online advertising increased by 28.8% to RMB21.6 million for the second quarter of 2006 from RMB16.8 million for the first quarter of 2006. The increase mainly reflected higher staff costs as well as the increased amount of sales commission paid to advertising agencies as the scale of our advertising business grew.

Other gains, net. Other gains during the reported periods reflected primarily the interest income generated from bank deposits and other interest-earning financial assets and fair value gains on financial instruments. Other gains decreased slightly by 0.8% to RMB21.4 million for the second quarter of 2006 from RMB21.5 million for the first quarter of 2006. During the second quarter of 2006, interest rates, particularly on US dollar-denominated financial instruments, generally increased. Our average balance of cash and financial instruments, however, was lower than that for the first quarter of 2006 as a result of our share repurchase during the second quarter of 2006.

Selling and marketing expenses. Selling and marketing expenses decreased by 6.2% to RMB74.8 million for the second quarter of 2006 from RMB79.7 million for the first quarter of 2006. Although we continued to actively promote our Internet value-added services and products through mid-May 2006, we reduced our selling and marketing spending during the low season period from mid-May to mid-June. As a percentage of revenues, selling and marketing expenses decreased to 10.6% in the second quarter of 2006 from 12.4% in the first quarter of 2006 as we reduced our selling and marketing expenses and also spread the expenses over a larger revenue base.

General and administrative expenses. General and administrative expenses increased by 9.7% to RMB142.4 million for the second quarter of 2006 from RMB129.8 million for the first quarter of 2006. The increase was mainly due to the continuing expansion of our strategic research and development staff as we focused on our various products and services, including IM functionalities, online games and our web portals. It was also attributable to the increased staff expenses, as the scope and scale of our business increased, and increased lease expenses relating to our rental of additional branch premises. As a percentage of revenues, general and administrative expenses increased to 20.2% in the second quarter of 2006 from 20.1% in the first quarter of 2006.

Finance costs, net. Finance costs represent foreign exchange loss and interest expenses. We recorded finance costs of RMB6.5 million for the second quarter of 2006 compared to RMB10.1 million for the first quarter of 2006. Foreign exchange loss for the second quarter of 2006 relating to our US dollar-denominated cash and investments was lower compared to that for the first quarter of 2006 when the appreciation of Renminbi had a significant impact. This improvement was partially offset by the amortization costs on the payables attributable to the Joymax group acquisition.

Income tax expenses. We recorded income tax expenses of RMB35.6 million for the second quarter of 2006 compared to RMB21.8 million for the first quarter of 2006. The increase mainly reflected the increase in our profit before tax. In addition, in the first quarter of 2006, we had a tax credit related to deferred tax assets attributable to the sales of self-developed software and technology among our group companies.

Profit for the period. As a result of the factors discussed above, profit for the period increased by 7.3% to RMB267.9 million for the second quarter of 2006 from RMB249.7 million for the first quarter of 2006. Net margin was 38.0% for the second quarter of 2006 compared to 38.7% for the first quarter of 2006.

Second Quarter of 2006 Compared to Second Quarter of 2005

The following table sets forth the figures for the second quarter of 2006 and the second quarter of 2005:

| | Unaudited | |
|-------------------------------------|---------------------------|------------------|
| | Three months ended | |
| | 30 June | |
| | 2006 | 2005 |
| | <i>(RMB in thousands)</i> | |
| Revenues | 704,981 | 333,665 |
| Cost of revenues | <u>(199,035)</u> | <u>(108,963)</u> |
| Gross profit | 505,946 | 224,702 |
| Other gains, net | 21,357 | 15,148 |
| Selling and marketing expenses | (74,838) | (45,501) |
| General and administrative expenses | <u>(142,440)</u> | <u>(75,596)</u> |
| Operating profit | 310,025 | 118,753 |
| Finance costs, net | <u>(6,537)</u> | <u>(51)</u> |
| Profit before income tax | 303,488 | 118,702 |
| Income tax (expenses)/benefit | <u>(35,599)</u> | <u>68,271</u> |
| Profit for the period | <u>267,889</u> | <u>186,973</u> |

Revenues. Revenues increased by 111.3% to RMB705.0 million for the second quarter of 2006 from RMB333.7 million for the second quarter of 2005, as a result of a significant increase in revenues from Internet value-added services. The following table sets forth our revenues by line of business for the second quarter of 2006 and the second quarter of 2005:

| | Three months ended | | | |
|--|---|----------------------|---------------------|-----------------|
| | 30 June 2006 | | 30 June 2005 | |
| | <i>% of total</i> | | <i>% of total</i> | |
| | Amount | revenues | Amount | revenues |
| | <i>(RMB in thousands, except percentages)</i> | | | |
| Internet value-added services | 462,260 | 65.6% | 169,883 | 50.9% |
| Mobile and telecommunications value-added services | 178,355 | 25.3% | 136,498 | 40.9% |
| Online advertising | 62,972 | 8.9% | 25,170 | 7.6% |
| Others | <u>1,394</u> | <u>0.2%</u> | <u>2,114</u> | <u>0.6%</u> |
| Total revenues | <u>704,981</u> | <u>100.0%</u> | <u>333,665</u> | <u>100.0%</u> |

Revenues from our Internet value-added services increased by 172.1% to RMB462.3 million for the second quarter of 2006 from RMB169.9 million for the second quarter of 2005. Revenues from our various online games and online identity and community services increased significantly as we continued to enhance our existing services such as our QQ Game portal and QQ Show and built on the success of relatively new products such as QQ Fantasy, QQ Pet and Qzone.

Revenues from our mobile and telecommunications value-added services increased by 30.7% to RMB178.4 million for the second quarter of 2006 from RMB136.5 million for the second quarter of 2005. The increase mainly reflected revenues from Joymax, which we acquired in January 2006. The increase also reflected an increase in revenues from content-based SMS and an increase in revenues from 2.5G related services. Revenues from mobile voice value-added services comprising ringback tones and mobile IVR also contributed to the increase. The increase was slightly offset by the termination of the 161 Mobile Chat fee sharing arrangement with China Mobile at the end of 2004, for which revenues were recognized up through the second quarter of 2005. For a detailed description of policy changes announced in July 2006 that will affect our wireless services on China Mobile's Monternet platform, please refer to "Business Outlook" below.

Revenues from online advertising increased by 150.2% to RMB63.0 million for the second quarter of 2006 from RMB25.2 million for the second quarter of 2005. The increase in revenues reflected the growth in reach and traffic on our primary advertising platforms, QQ IM and QQ.com, our growing customer base, and some new advertising revenues relating to Internet searching functions and advertising on our game portal. The increase was also attributable to one significantly large order for a special cross-marketing promotion campaign with a consumer product customer.

Cost of revenues. Cost of revenues increased by 82.7% to RMB199.0 million for the second quarter of 2006 from RMB109.0 million for the second quarter of 2005. The increase principally reflected higher amounts of telecommunications operators' revenue share, increased bandwidth and server custody fees as we supported more bandwidth intensive services, increased sharing costs due to increases in revenues and enrichment of content and increased staff costs as we increased the number of employees to support our various services

and products. As a percentage of revenues, cost of revenues decreased to 28.2% in the second quarter of 2006 from 32.7% in the second quarter of 2005. The following table sets forth our cost of revenues by line of business for the second quarter of 2006 and the second quarter of 2005:

| | Three months ended | | Three months ended | |
|--|---|---------------|--------------------|---------------|
| | 30 June 2006 | % of | 30 June 2005 | % of |
| | Amount | segment | Amount | segment |
| | <i>(RMB in thousands, except percentages)</i> | | | |
| Internet value-added services | 105,809 | 22.9% | 52,775 | 31.1% |
| Mobile and telecommunications value-added services | 65,774 | 36.9% | 46,535 | 34.1% |
| Online advertising | 21,596 | 34.3% | 6,813 | 27.1% |
| Others | <u>5,856</u> | <u>420.1%</u> | <u>2,840</u> | <u>134.3%</u> |
| Total cost of revenues | <u>199,035</u> | | <u>108,963</u> | |

Cost of revenues for our Internet value-added services increased by 100.5% to RMB105.8 million for the second quarter of 2006 from RMB52.8 million for the second quarter of 2005. The increase mainly reflected increased telecommunications operators' revenue share, expenses incurred to support more bandwidth intensive services, such as Qzone and online games, and increased staff costs to support our growing range of Internet value-added services. In addition, sharing and subscription costs associated with the offering of richer content services, such as our avatars and music offerings, increased.

Cost of revenues for our mobile and telecommunications value-added services increased by 41.3% to RMB65.8 million for the second quarter of 2006 from RMB46.5 million for the second quarter of 2005. The increase was due mainly to increased telecommunications operators' revenue share, an increase in sharing and subscription costs as we enriched our content and an increase in staff costs as we increased the number of employees to support our various services and products. In addition, increased telecommunications operators' revenue share and other costs relating to the services of Joymax group, which we acquired in late January 2006, contributed to the increase.

Cost of revenues for our online advertising increased by 217.0% to RMB21.6 million for the second quarter of 2006 from RMB6.8 million for the second quarter of 2005. The increase mainly reflected the increased sales commissions paid to advertising agencies as the volume of our advertising contracts increased and as we increased our usage of advertising agencies to help sell our advertising services. In addition, we continued to increase the number of staff on our online advertising sales team, and incurred further expenses to offer Internet searching functions.

Other gains, net. We recorded other gains of RMB21.4 million for the second quarter of 2006 compared to RMB15.1 million for the second quarter of 2005. The increase mainly reflected additional interest income due to the increase in US dollar-denominated interest rates and fair value gains generated from increased cash investments into interest-earning financial assets.

Selling and marketing expenses. Selling and marketing expenses increased by 64.5% to RMB74.8 million for the second quarter of 2006 from RMB45.5 million for the second quarter of 2005. The increase principally reflected increased promotional and advertising activities, higher staff costs and greater travel costs as we continued marketing several new products and established new distribution channels. In addition, we continued to increase our outsourcing as we expanded our customer support activities.

General and administrative expenses. General and administrative expenses increased by 88.4% to RMB142.4 million for the second quarter of 2006 from RMB75.6 million for the second quarter of 2005. 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 costs also increased as a result of a higher number of staff employed to support our business expansion.

Finance costs, net. Finance costs represent foreign exchange loss and interest expenses. We recorded finance costs of RMB6.5 million for the second quarter of 2006 compared to RMB51,000 for the second quarter of 2005. The increase in finance costs recorded was due to foreign exchange loss relating to our US dollar-denominated cash and investments in connection with the appreciation of Renminbi. A significant portion of our cash and investments, consisting primarily of the proceeds from our initial public offering in 2004, is subject to the same risk, and if Renminbi continues to appreciate, we may incur further foreign exchange losses. Amortization costs on the payables attributable to the Joymax group acquisition also contributed to the increase.

Income tax benefit (expenses). We recorded income tax expenses of RMB35.6 million for the second quarter of 2006 compared to a net tax credit of RMB68.3 million for the second quarter of 2005. The net tax credit recorded in the second quarter of 2005 related to the recognition of deferred tax assets attributable to the sales of self-developed software and technology among our group companies.

Profit for the period. Profit for the period increased by 43.3% to RMB267.9 million for the second quarter of 2006 from RMB187.0 million for the second quarter of 2005. Net margin was 38.0% for the second quarter of 2006 compared to 56.0% for the second quarter of 2005.

LIQUIDITY AND FINANCIAL RESOURCES

As at 30 June 2006 and 31 March 2006, we had the following major financial resources in the form of cash and investments:

| | Unaudited | |
|---|---------------------------|------------------|
| | 30 June | 31 March |
| | 2006 | 2006 |
| | <i>(RMB in thousands)</i> | |
| Cash and cash equivalents | 1,458,733 | 1,679,200 |
| Term deposits with original maturities of over three months | 711,543 | 511,587 |
| Financial assets held for trading | 286,343 | 335,487 |
| Held-to-maturity investments | <u>239,868</u> | <u>241,386</u> |
| Total | <u>2,696,487</u> | <u>2,767,660</u> |

A large portion of our financial resources represents non-Renminbi denominated proceeds raised from our initial public offering in 2004, and is held in deposits and investments denominated in US dollars. As there are no cost-effective hedges against the appreciation of Renminbi, we have not used any means to hedge our exposure to foreign exchange risk. In addition, generally there is no effective manner to convert a significant amount of US dollars into Renminbi, which is not a freely exchangeable currency. Therefore, 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 2006.

During the six months ended 30 June 2006, we repurchased 18,357,000 of our ordinary shares for approximately HKD232,141,000. Such ordinary shares were subsequently cancelled. From the time of our initial public offering through 30 June 2006, we have repurchased 32,623,000 of our ordinary shares for an aggregate amount of HKD350,121,000.

BUSINESS OUTLOOK

In July 2006, we issued a press release describing a number of policy changes for all wireless value-added services on China Mobile's Monternet platform including SMS, MMS and WAP services. Firstly, starting in July 2006, new subscribers have been given month-long free trials; after registration they are asked to confirm their subscriptions; and at the end of the trial period they are reminded of the subscription and cancellation procedures. Secondly, during August and September 2006, existing subscribers will receive SMS reminders about active subscriptions, fees being charged and cancellation procedures. China Mobile provincial subsidiaries are also expected to cancel existing WAP subscriptions that have been inactive for more than four months. In addition, we also understand that wireless service providers who are currently providing mobile chat services on the Monternet platform would have their service contracts extended until 31 December 2006 only. We are engaging in a constructive dialogue with China Mobile to discuss the possible options thereafter. We anticipate that these policies will have a negative impact on our mobile and telecommunication services as they will reduce the number of new subscribers, reduce

revenues due to the free trial period and increase the churn of existing monthly subscriptions for our wireless value-added services and certain Internet services that offer wireless functionalities. To manage the challenging and uncertain operating environment around our mobile and telecommunication services, we will focus on closely interacting with China Mobile, improving our services to increase user stickiness and product differentiation, and exploring alternative ways of promoting our services under the new policies.

As we proactively manage the challenges in the wireless sector, we believe our diversified revenue model will offer an important source of stability. We will continue to invest in R&D, operations and strategic marketing to strengthen our Internet platforms and various online services.

In our core IM platform, we have implemented a number of operational measures to eliminate spam messages and enhance user password protection with good initial results. Although these measures partially offset the increase in the number of peak concurrent user accounts and active user accounts, we believe that these efforts will foster a healthy long-term growth for our platforms.

With respect to our QQ.com portal platform, we have achieved a historical milestone in its development. According to Alexa.com, our QQ.com portal has become the number 1 portal in China in terms of traffic. Alexa.com also currently ranks QQ.com as the number 5 website in the world in terms of traffic. We believe the rapid growth of QQ.com since its launch in the end of 2003 is yet another demonstration of the strength of our Internet platforms. We believe the position of QQ.com will allow us to increase our advertising revenue and contribute to the growth of our other Internet services through cross-marketing.

In our Internet value-added services, our online identities business benefited from growth in our Qzone and QQ Pet products. We are continuing to improve system performance and product experience for these products. With respect to online games, we are focusing on expanding the content of QQ Fantasy following a successful commercialization of the MMOG in the first quarter of 2006. We launched a major expansion pack in August which aimed to increase the stickiness of the game. We also launched our second advanced casual game, R2Beat, in July for open beta testing and are actively looking for new games to expand our portfolio of advanced casual games. Owing to seasonal factors, our mini casual game registered a small decline in peak concurrent users. After a period of heavy focus on building monetization mechanisms into our casual games portal, we are now shifting more of our attention to building new games and enhancing basic user experience in order to reinforce our market leadership.

Our advertising business continued to grow at a fast pace during the second quarter as we have been able to leverage the significant traffic on our IM and portal platforms. With a focus on team development, product innovation and client servicing, we believe we are well poised to capitalize on the secular growth trend in the online advertising industry in China.

OTHER INFORMATION

Employee and Remuneration Policies

As at 30 June 2006, the Group had 2,443 employees (30 June 2005: 1,648), most of whom are based in the Company's head office in Shenzhen, the PRC. The number of employees employed by the Group varies from time to time depending on needs and they are remunerated based on industry practice.

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

The total remuneration cost incurred by the Group for the six months ended 30 June 2006 was RMB 270.6 million (30 June 2005: RMB134.1 million).

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

During the six months ended 30 June 2006, the Company repurchased 18,357,000 shares on the Stock Exchange for an aggregate consideration of HKD232,141,000 before expenses. The repurchased shares were subsequently cancelled. The repurchases were effected by the Board for the enhancement of shareholder value in the long term. Details of the shares repurchased are as follows:

| Month of purchase on the Stock Exchange for the six months ended 30 June 2006 | Number of shares repurchased | Purchase consideration per share | | Aggregate consideration paid HKD |
|--|-------------------------------------|---|------------------------------|---|
| | | Highest price paid HKD | Lowest price paid HKD | |
| January | 4,584,000 | 9.75 | 9.50 | 44,227,000 |
| February | 3,471,000 | 9.95 | 9.80 | 34,242,000 |
| April | <u>10,302,000</u> | 15.10 | 14.05 | <u>153,672,000</u> |
| Total | <u>18,357,000</u> | | | <u>232,141,000</u> |

Save as disclosed above, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares during the period.

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 2006.

Compliance with the Code on Corporate Governance Practices

Save as disclosed in the 2005 annual report of the Company which was the position as at 31 December 2005, 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 2006, complied with the code provisions of the Code on Corporate Governance Practices as set out in Appendix 14 to the Listing Rules, which became effective from 1 January 2005.

As to the deviation from code provision A.2.1 of Appendix 14 to the Listing Rules, the Board will continue to review the current structure from time to time and shall make necessary changes when appropriate and inform the shareholders accordingly.

Appreciation

The dedication of the staff of the Group is the most important ingredient of our success and its continuation is critical for the Group 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, 23 August 2006

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

Executive Directors:

Ma Huateng and Zhang Zhidong;

Non-Executive Directors:

Antonie Andries Roux and Charles St Leger Searle; and

Independent Non-Executive Directors:

Li Dong Sheng, Iain Ferguson Bruce and Ian Charles Stone.

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

Please also refer to the published version of this announcement in The Standard.