

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 MONTHS ENDED 31 MARCH 2005

The Board of Directors (the “Board”) of Tencent Holdings Limited (the “Company”) is pleased to announce the unaudited consolidated results of the Company and its subsidiaries (collectively, the “Group”) for the three months ended 31 March 2005. These 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 31 MARCH 2005 AND 31 DECEMBER 2004**

	Unaudited	Audited
	31 March 2005	(as restated)
	RMB'000	(Note)
		31 December 2004
		RMB'000
ASSETS		
Non-current assets		
Fixed assets	151,723	142,080
Held-to-maturity investments	<u>167,374</u>	<u>167,374</u>
	<u>319,097</u>	<u>309,454</u>
Current assets		
Accounts receivable	201,528	192,725
Prepayments, deposits and other receivables	54,012	50,347
Financial assets held for trading	669,948	666,900
Term deposits with initial term of over three months	560,172	784,054
Cash and cash equivalents	<u>1,132,054</u>	<u>859,841</u>
	<u>2,617,714</u>	<u>2,553,867</u>
Total Assets	<u><u>2,936,811</u></u>	<u><u>2,863,321</u></u>
EQUITY		
Shareholders' equity		
Share capital	192	192
Share premium	1,779,769	1,777,721
Share-based compensation reserve	10,120	5,583
Other reserves	52,442	52,442
Retained earnings	<u>913,254</u>	<u>816,300</u>
	<u>2,755,777</u>	<u>2,652,238</u>
LIABILITIES		
Current liabilities		
Accounts payable	2,261	2,506
Other payables and accruals	68,534	79,912
Dividends payable	145	145
Current income tax liabilities	11,944	5,648
Other tax liabilities	16,754	59,650
Deferred revenue	<u>81,396</u>	<u>63,222</u>
	<u>181,034</u>	<u>211,083</u>
Total Equity and Liabilities	<u><u>2,936,811</u></u>	<u><u>2,863,321</u></u>

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 Payments" (see Note 1.1).

**CONDENSED CONSOLIDATED INCOME STATEMENT
FOR THE THREE MONTHS ENDED 31 MARCH 2005**

		Unaudited Three months ended 31 March 2005	Audited (as restated) (Note) Three months ended 31 March 2004
	<i>Note</i>	<i>RMB'000</i>	<i>RMB'000</i>
Revenues			
Internet value-added services		149,064	104,586
Mobile and telecommunications value-added services		134,271	142,817
Online advertising		15,293	8,215
Others		<u>1,843</u>	<u>1,935</u>
		300,471	257,553
Cost of revenues		<u>(101,928)</u>	<u>(87,663)</u>
Gross profit		198,543	169,890
Other gains, net		11,905	867
Selling and marketing expenses		(38,513)	(23,232)
General and administrative expenses		<u>(68,526)</u>	<u>(34,479)</u>
Operating profit		103,409	113,046
Finance (costs)/income, net		<u>(115)</u>	<u>126</u>
Profit before income tax		103,294	113,172
Income tax expenses	5	<u>(6,340)</u>	<u>(6,712)</u>
Profit for the period		<u><u>96,954</u></u>	<u><u>106,460</u></u>
Earnings per share (expressed in RMB per share)			
- basic	6	<u>0.055</u>	<u>0.084</u>
- diluted	6	<u>0.054</u>	<u>0.084</u>

Note: The cost of revenues, selling and marketing expenses and general and administrative expenses for the three months ended 31 March 2004 have been restated as a result of the adoption of IFRS 2 (issued 2004), "Share-based Payments" (see Note 1.1).

NOTES

1 Summary of significant accounting policies

1.1 Basis of preparation and presentation

The condensed consolidated balance sheet as at 31 March 2005 and the condensed consolidated income statement for the three months ended 31 March 2005 (collectively defined as “Interim Financial Information”) of the Company and its subsidiaries (collectively, 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 Group dated 17 March 2005.

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

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

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

The adoption of IAS1, 8, 10, 16, 17, 21, 24, 27, 32, 33, 39 (all revised 2003) and 38 (revised 2004) did not result in substantial changes to the Group’s accounting policies.

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

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

	Three months ended	
	31 March 2005	31 March 2004
	<i>RMB'000</i>	<i>RMB'000</i>
Increase in share-based compensation reserve	10,120	844
Decrease in retained earnings	5,583	—
Increase in cost of revenues	1,074	295
Increase in selling and marketing expenses	886	188
Increase in general and administrative expenses	2,577	361
Decrease in basic earnings per share	RMB0.003	RMB0.001
Decrease in diluted earnings per share	RMB0.003	RMB0.001

1.2 Accounting policies of 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 entity revises its estimates 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.

2 Segment information

Business segment is the Group's primary basis of segment reporting. The business segment information of the Group for the three months ended 31 March 2005 and 2004, respectively, is presented as follows:

	Unaudited				Total
	Three months ended 31 March 2005				
	Internet	Mobile and	Online	Others	
	value-added	telecommunications	advertising	services	services
	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>	<i>RMB'000</i>
Revenues	<u>149,064</u>	<u>134,271</u>	<u>15,293</u>	<u>1,843</u>	<u>300,471</u>
Gross profit/(loss)	<u>106,487</u>	<u>84,205</u>	<u>9,308</u>	<u>(1,457)</u>	198,543
Other gains, net					11,905
Selling and marketing expenses					(38,513)
General and administrative expenses					<u>(68,526)</u>
Operating profit					103,409
Finance costs, net					<u>(115)</u>
Profit before income tax					103,294
Income tax expenses					<u>(6,340)</u>
Profit for the period					<u>96,954</u>

	Audited (as restated) Three months ended 31 March 2004				
	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>104,586</u>	<u>142,817</u>	<u>8,215</u>	<u>1,935</u>	<u>257,553</u>
Gross profit/(loss)	<u>71,856</u>	<u>94,393</u>	<u>4,340</u>	<u>(699)</u>	169,890
Other gains, net					867
Selling and marketing expenses					(23,232)
General and administrative expenses					(34,479)
Operating profit					113,046
Finance income, net					<u>126</u>
Profit before income tax					113,172
Income tax expenses					<u>(6,712)</u>
Profit for the period					<u>106,460</u>

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

3 Share Option Schemes

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

(a) 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.

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, but on the condition that the Company had been listed in a sizeable securities market.

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.

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

The Post-IPO Option Scheme was adopted by the Company on 24 March 2004. The Board 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 listing of the Company’s shares on the Main Board of The Stock Exchange of Hong Kong Limited (“Stock Exchange”).

4 **Expenses by nature**

	Unaudited	Audited
	Three months ended	(as restated)
	31 March 2005	Three months ended
	RMB’000	31 March 2004
		RMB’000
Depreciation of fixed assets (Note)	10,003	5,731
Employee benefits expenses (Note)	61,821	33,122
Mobile and Telecom Charges and bandwidth and server custody fees	66,815	66,277
Operating lease rentals in respect of office buildings	5,357	2,897
Value-added tax paid upon transfer of software within the Group	—	2,102
Travelling and entertainment expenses	10,378	5,988
Promotion and advertising expenses	17,585	11,858
Other expenses	<u>37,008</u>	<u>17,399</u>
Total cost of revenues, selling and marketing expenses and general and administrative expenses	<u>208,967</u>	<u>145,374</u>

Note: Research and development expenses were RMB26,565,000 and RMB12,639,000 for the three months ended 31 March 2005 and 2004 respectively. The expenses included employee benefit expenses and depreciation totalling RMB25,558,000 and RMB6,185,000 for the three months ended 31 March 2005 and 2004 respectively.

The Group had not capitalised any research and development expenses during both periods.

5 Tax expenses

(a) Income tax

(i) *Cayman Islands and British Virgin Islands Profits Tax*

The Group has not been subject to any taxation under these jurisdictions for the three months ended 31 March 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 three months ended 31 March 2005 and 2004, respectively.

(iii) *PRC Enterprise Income Tax*

PRC Enterprise Income Tax (“EIT”) is provided on the assessable income of the Group for the three months ended 31 March 2005 and 2004, respectively, calculated in accordance with the relevant regulations of the PRC after considering the available tax benefits from refunds and allowances.

The table below sets forth the applicable tax rates of four subsidiaries of the Company, namely, Shenzhen Tencent Computer Systems Company Limited (“Tencent Computer”), Tencent Technology (Shenzhen) Company Limited (“Tencent Technology”), Shenzhen Shiji Kaixuan Technology Company Limited (“Shiji Kaixuan”) and Shidai Zhaoyang Technology (Shenzhen) Company Ltd. (“Shidai Zhaoyang”), which were established in the PRC.

	Year ending 31 December 2005	Year ended 31 December 2004
Tencent Computer	15%	7.5%
Tencent Technology (<i>Note (a)</i>)	7.5%	0%
Shiji Kaixuan (<i>Note (b)</i>)	0%	0%
Shidai Zhaoyang	15%	15%

Note:

- (a) Tencent Technology is exempt from EIT for two years commencing from the first year of profitable operations after offsetting prior years’ tax losses, followed by a 50% reduction for the next three years if its annual productive sales income exceeds 50% of its reported total sales income. 2003 is the first profit-making year of Tencent Technology after offsetting all tax losses brought forward from prior years and tax holiday commenced in that year. EIT is levied at 7.5% on its assessable profits for 2005 (2004: Nil).
- (b) Shiji Kaixuan is exempt from EIT for two years commencing from the first year of operations according to the provisions stipulated in the tax circular. 2004 was the first year of operations and thus Shiji Kaixuan is exempt from EIT in 2005 (2004: Nil).

The taxation charges of the Group for the three months ended 31 March 2005 are analysed as follows:

	Unaudited Three months ended 31 March 2005 <i>RMB'000</i>	Audited (as restated) Three months ended 31 March 2004 <i>RMB'000</i>
PRC current tax	6,340	6,349
Deferred tax	<u>—</u>	<u>363</u>
	<u>6,340</u>	<u>6,712</u>

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

	Unaudited Three months ended 31 March 2005 <i>RMB'000</i>	Audited (as restated) Three months ended 31 March 2004 <i>RMB'000</i>
Profit before income tax	<u>103,294</u>	<u>113,172</u>
Tax calculated at a tax rate of 15%	15,494	16,976
Effects of different tax rates available to different companies of the Group	(1,456)	—
Effects of tax holiday on assessable profit of subsidiaries	(4,076)	(21,346)
Expenses not deductible for tax purposes	658	479
Utilisation of previously not recognised tax assets / deferred tax assets not recognised	(5,669)	10,128
Unrecognised tax losses	<u>1,389</u>	<u>475</u>
Tax charge	<u>6,340</u>	<u>6,712</u>

(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

6 Earnings per share

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

	Unaudited Three months ended 31 March 2005	Audited (as restated) Three months ended 31 March 2004
Profit for the period (RMB'000)	<u>96,954</u>	<u>106,460</u>
Weighted average number of ordinary shares in issue (thousand) (Note)	1,765,831	1,260,481
Basic earnings per share (RMB per share) (Note)	<u>0.055</u>	<u>0.084</u>

The diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding by the assumption of the conversion of all potential dilutive ordinary shares. Share options granted are the potential dilutive ordinary shares of the Company. 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).

There were no potential dilutive instruments for the three months ended 31 March 2004 as the Pre-IPO options had not met the pre-condition for their exercisability before the listing of the Company's shares on the Stock Exchange. Accordingly, the diluted earnings per share for the three months ended 31 March 2004 is equal to the basic earnings per share.

	Unaudited Three months ended 31 March 2005	Audited (as restated) Three months ended 31 March 2004
Profit for the period (RMB'000)	<u>96,954</u>	<u>106,460</u>
Weighted average number of ordinary shares in issue (thousand) (Note)	1,765,831	1,260,481
Adjustments for share options (Note)	<u>46,171</u>	<u>—</u>
Weighted average number of ordinary shares for diluted earnings per share (thousand)	1,812,002	1,260,481
Diluted earnings per share (RMB per share) (Note)	<u>0.054</u>	<u>0.084</u>

Note: 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.

7 Dividends

Pursuant to a resolution passed by the Board on 17 March 2005, a final dividend for 2004 of HKD0.07 per share, totalling HKD124,052,000 was proposed, which was approved by the shareholders in the annual general meeting held on 27 April 2005 (2003: USD3,500,000). Such proposed dividend has not been shown as an appropriation and reflected as dividends payable in this Interim Financial Information, but will be accounted for in shareholders' equity as an appropriation of retained earnings during the period the distribution was approved.

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 16-day period ended 31 March 2005	For the 16-day period ended 31 December 2004
	<i>(in millions)</i>	
Registered IM user accounts (at end of period)	400.6	369.7
Active user accounts (at end of period)	149.2	134.8
Peak simultaneous online user accounts (for the quarter)	13.2	9.4
Average daily user hours	183.1	114.6
Average daily messages ⁽¹⁾	1,960.6	1,580.2
Fee-based Internet value-added services registered subscriptions (at end of period)	9.6	8.3
Fee-based mobile and telecommunications value-added services registered subscriptions (at end of period) ⁽²⁾	9.1	8.8

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

(2) Includes registered subscriptions for services provided directly by the Group or through mobile operators. Substantially all the decline in fee-based subscriptions was due to termination of the 161 Mobile Chat fee sharing arrangement at the end of December 2004.

The growth in the first 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 increased 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. Peak simultaneous online user accounts and average daily user hours also increased as a result of the increased use of our services by each user account as we introduced a promotional rating system in the fourth quarter of 2004 encouraging our users to spend more time on our network.

FINANCIAL PERFORMANCE HIGHLIGHTS

Our unaudited consolidated revenues for the three months ended 31 March 2005 were RMB300.5 million, an increase of 16.7% over the same period in 2004 and a decrease of 4.5% quarter on quarter.

Profit for the first quarter of 2005 was RMB97.0 million, representing a decrease of 8.9% from the same period in 2004 and a decrease of 16.7% quarter on quarter. As a percentage of revenues, profit for the period accounted for 32.3% for the first quarter of 2005, compared to 41.3% for the same period of 2004 and 37.0% for the fourth quarter of 2004.

MANAGEMENT DISCUSSION AND ANALYSIS

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

First Quarter of 2005 Compared to Fourth Quarter of 2004

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

	Three months ended	
	31 March 2005	31 December 2004
	<i>Unaudited</i>	<i>Audited</i> <i>(as restated*)</i>
	<i>(RMB in thousands)</i>	
Revenues	300,471	314,481
Cost of revenues	<u>(101,928)</u>	<u>(114,626)</u>
Gross profit	198,543	199,855
Other gains, net	11,905	18,366
Selling and marketing expenses	(38,513)	(31,792)
General and administrative expenses	<u>(68,526)</u>	<u>(59,227)</u>
Operating profit	103,409	127,202
Finance costs, net	<u>(115)</u>	<u>(4,455)</u>
Profit before income tax	103,294	122,747
Income tax expenses	<u>(6,340)</u>	<u>(6,407)</u>
Profit for the period	<u>96,954</u>	<u>116,340</u>

* 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 31 December 2004 was reduced by RMB1.8 million. In addition, the adoption of IFRS 2 has resulted in the reduction of profit by RMB4.5 million for the three months ended 31 March 2005.

Revenues. Revenues decreased by 4.5% to RMB300.5 million for the first quarter of 2005 from RMB314.5 million for the fourth quarter of 2004. The following table sets forth our revenues by lines of business for the first quarter of 2005 and the fourth quarter of 2004:

	Three months ended			
	31 March 2005		31 December 2004	
	Amount	% of total revenues	Amount	% of total revenues
	<i>(RMB in thousands, except percentages)</i>			
Internet value-added services	149,064	49.6%	125,149	39.8%
Mobile and telecommunications value-added services	134,271	44.7%	168,664	53.6%
Online advertising	15,293	5.1%	17,744	5.6%
Others	1,843	0.6%	2,924	1.0%
Total revenues	<u>300,471</u>	<u>100.0%</u>	<u>314,481</u>	<u>100.0%</u>

Revenues from our Internet value-added services increased by 19.1% to RMB149.1 million for the first quarter of 2005 from RMB125.1 million for the fourth quarter of 2004. The increase mainly reflected the continuing success of avatars and the significant growth in our online games. Revenues from avatars also benefited from a seasonal increase in the first quarter of 2005 as usage increased during the Chinese New Year holidays. Revenues from our fairly new products and services also grew. These increases, however, were partially offset by a decrease in revenues from Premium QQ, which were affected by the “cleaning up” of customer accounts undertaken by mobile operators.

Revenues from our mobile and telecommunications value-added services decreased by 20.4% to RMB134.3 million for the first quarter of 2005 from RMB168.7 million for the fourth quarter of 2004. The decrease mainly reflected the significant decline in revenues from our mobile chat services resulting from termination of the 161 Mobile Chat fee sharing arrangement with China Mobile. The “cleaning up” of customer accounts undertaken by mobile operators also impacted some of our services. In addition, MMS related revenues were negatively affected due to the overall change in China Mobile’s billing policy with respect to MMS, including the new requirement that a MMS may not be charged to a user unless it is delivered to a user’s mobile phone while the user’s mobile phone is active and capable of receiving MMS, rather than simply delivering it to the user’s mobile phone MMS mailbox to be later retrieved by the user.

Revenues from online advertising decreased by 13.8% to RMB15.3 million for the first quarter of 2005 from RMB17.7 million for the fourth quarter of 2004. The decrease mainly reflected the seasonality of our online advertising business, which generally shows a particularly low level of sales in the first quarter of each year due to the New Year holidays in China.

Cost of revenues. Cost of revenues decreased by 11.1% to RMB101.9 million for the first quarter of 2005 from RMB114.6 million for the fourth quarter of 2004. The decrease principally reflected the decrease in the amount of telecommunications operators’ revenue share and imbalance fees. Content subscription costs and staff costs, however, increased as

we offered richer content and a broader range of products and services. As a percentage of revenues, cost of revenues decreased to 33.9% in the first quarter of 2005 from 36.4% in the fourth quarter of 2004. The following table sets forth our cost of revenues by lines of business for the first quarter of 2005 and the fourth quarter of 2004:

	Three months ended		Three months ended	
	31 March 2005	% of	31 December 2004	% of
	Amount	segment	Amount	segment
	<i>(RMB in thousands, except percentages)</i>			
Internet value-added services	42,577	28.6%	37,920	30.3%
Mobile and telecommunications value-added services	50,066	37.3%	68,448	40.6%
Online advertising	5,985	39.1%	5,243	29.5%
Others	3,300	179.1%	3,015	103.1%
Total cost of revenues	<u>101,928</u>		<u>114,626</u>	

Cost of revenues for our Internet value-added services increased by 12.3% to RMB42.6 million for the first quarter of 2005 from RMB37.9 million for the fourth quarter of 2004. The increase mainly reflected the increased content sharing costs in relation to various new content services. In addition, expenses associated with our bandwidth capacity and servers increased as we supported more bandwidth intensive services, and our staff costs also increased as we recruited additional staff to develop and support new products and services. These increases were partially offset by the lower amount of telecommunications operators' revenue share and imbalance fees as we gradually diversified some of our collection channels into non-mobile channels.

Cost of revenues for our mobile and telecommunications value-added services decreased by 26.9% to RMB50.1 million for the first quarter of 2005 from RMB68.4 million for the fourth quarter of 2004. The decrease mainly reflected the lower amount of fees retained by mobile operators for their share of revenues due to termination of the 161 Mobile Chat fee sharing arrangement with China Mobile, which had a comparatively higher revenue sharing ratio than our other services. The decrease was partially offset by increased content sharing costs as we offered a broader range of products.

Cost of revenues for our online advertising increased by 14.2% to RMB6.0 million for the first quarter of 2005 from RMB5.2 million for the fourth quarter of 2004. The increase reflected the increased staff costs as we increased the number of staff to drive the growth of our online advertising business. Sales commission paid to advertising agencies, however, decreased in line with reduced online advertising business volume due to seasonality factors.

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. In addition, financial subsidies that we may receive from time to time are recognized as other gains. Other gains decreased by 35.2% to RMB11.9 million for the first quarter of 2005 from RMB18.4 million for the fourth quarter of 2004. Other gains for the

fourth quarter of 2004 were higher due to a financial subsidy of RMB7.2 million received from the local government as part of the local government's efforts to promote development of high-tech and software industries. Interest income, however, increased in the first quarter of 2005 as interest rates in general increased at the end of 2004.

Selling and marketing expenses. Selling and marketing expenses increased by 21.1% to RMB38.5 million for the first quarter of 2005 from RMB31.8 million for the fourth quarter of 2004. The increase principally reflected higher marketing staff costs and increased promotional and advertising expenses. These expenses were incurred in relation to our broader products and services portfolio and our efforts to diversify our revenue collection channels. As a percentage of revenues, selling and marketing expenses increased to 12.8% in the first quarter of 2005 from 10.1% in the fourth quarter of 2004.

General and administrative expenses. General and administrative expenses increased by 15.7% to RMB68.5 million for the first quarter of 2005 from RMB59.2 million for the fourth quarter of 2004. The increase was mainly attributable to increased research and development expenses as we increased our research and development staff with an emphasis on online games, web portal and IM functionalities. As a percentage of revenues, general and administrative expenses increased to 22.8% in the first quarter of 2005 from 18.8% in the fourth quarter of 2004.

Income tax expenses. We recorded profit taxes of RMB6.3 million for the first quarter of 2005 compared to RMB6.4 million for the fourth quarter of 2004. The decrease in profit taxes mainly reflected the decrease in our profit before income tax. The effective tax rate applicable for the first quarter of 2005 was slightly higher than that for the fourth quarter of 2004 because the tax rates applicable to some of our subsidiaries are higher in 2005.

Profit for the period. As a result of the factors discussed above, net profit decreased by 16.7% to RMB97.0 million for the first quarter of 2005 from RMB116.3 million for the fourth quarter of 2004. Net margin for the period was 32.3% for the first quarter of 2005 compared to 37.0% for the fourth quarter of 2004.

First Quarter of 2005 Compared to First Quarter of 2004

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

	Three months ended	
	31 March 2005	31 March 2004
	<i>Unaudited</i>	<i>Audited</i> <i>(as restated*)</i>
	<i>(RMB in thousands)</i>	
Revenues	300,471	257,553
Cost of revenues	<u>(101,928)</u>	<u>(87,663)</u>
Gross profit	198,543	169,890
Other gains, net	11,905	867
Selling and marketing expenses	(38,513)	(23,232)
General and administrative expenses	<u>(68,526)</u>	<u>(34,479)</u>
Operating profit	103,409	113,046
Finance (costs)/income, net	<u>(115)</u>	<u>126</u>
Profit before income tax	103,294	113,172
Income tax expenses	<u>(6,340)</u>	<u>(6,712)</u>
Profit for the period	<u><u>96,954</u></u>	<u><u>106,460</u></u>

* 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 31 March 2004 was reduced by RMB0.8 million. In addition, the adoption of IFRS 2 has resulted in the reduction of profit by RMB4.5 million for the three months ended 31 March 2005.

Revenues. Revenues increased by 16.7% to RMB300.5 million for the first quarter of 2005 from RMB257.6 million for the first quarter of 2004, as a result of a 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 lines of business for the first quarter of 2005 and the first quarter of 2004:

	Three months ended			
	31 March 2005		31 March 2004	
	Amount	% of total revenues	Amount	% of total revenues
	<i>(RMB in thousands, except percentages)</i>			
Internet value-added services	149,064	49.6%	104,586	40.6%
Mobile and telecommunications value-added services	134,271	44.7%	142,817	55.4%
Online advertising	15,293	5.1%	8,215	3.2%
Others	<u>1,843</u>	<u>0.6%</u>	<u>1,935</u>	<u>0.8%</u>
Total revenues	<u><u>300,471</u></u>	<u><u>100.0%</u></u>	<u><u>257,553</u></u>	<u><u>100.0%</u></u>

Revenues from our Internet value-added services increased by 42.5% to RMB149.1 million for the first quarter of 2005 from RMB104.6 million for the first 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 and the development of new fee collection channels also contributed to the increase in revenues from Internet value-added services. These increases, however, were partially offset by a decrease in revenues from Premium QQ, which was negatively impacted by the “cleaning up” of customer accounts undertaken by mobile operators, and other more mature products such as online dating.

Revenues from our mobile and telecommunications value-added services decreased by 6.0% to RMB134.3 million for the first quarter of 2005 from RMB142.8 million for the first quarter of 2004. The decrease was mainly attributable to the significant decrease in revenues from mobile chat services due to termination of the 161 Mobile Chat fee sharing arrangement with China Mobile and the “cleaning up” of customer accounts undertaken by mobile operators. These decreases were partially offset by increases in revenues from mobile content services and mobile voice value-added services, comprising ringback tones and mobile IVR. Revenues from 2.5G-related services also increased significantly due to the increased popularity of 2.5G services offered by mobile operators.

Revenues from online advertising increased by 86.2% to RMB15.3 million for the first quarter of 2005 from RMB8.2 million for the first quarter of 2004. The increase in revenues reflected our growing customer base. In addition, our QQ.com portal started to generate more revenues.

Cost of revenues. Cost of revenues increased by 16.3% to RMB101.9 million for the first quarter of 2005 from RMB87.7 million for the first 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 subscription costs as we offered richer content. These increases were partially offset by the lower telecommunications operators’ revenue share and imbalance fees due to diversification of some of our fee collection channels to non-mobile operators and due to 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 33.9% in the first quarter of 2005 from 34.0% in the first quarter of 2004. The following table sets forth our cost of revenues by lines of business for the first quarter of 2005 and the first quarter of 2004:

	Three months ended		Three months ended	
	31 March 2005	% of	31 March 2004	% of
	Amount	segment	Amount	segment
	<i>(RMB in thousands, except percentages)</i>			
Internet value-added services	42,577	28.6%	32,730	31.3%
Mobile and telecommunications value-added services	50,066	37.3%	48,424	33.9%
Online advertising	5,985	39.1%	3,875	47.2%
Others	<u>3,300</u>	179.1%	<u>2,634</u>	136.1%
Total cost of revenues	<u>101,928</u>		<u>87,663</u>	

Cost of revenues for our Internet value-added services increased by 30.1% to RMB42.6 million for the first quarter of 2005 from RMB32.7 million for the first quarter of 2004. The increase mainly reflected increased expenses associated with our bandwidth capacity and servers increased as we supported more bandwidth intensive services and increased content sharing costs as we offered richer content services. These increases were partially offset by a decrease in the amount of fees retained by mobile operators for their share of revenues and imbalance fees as a result of a gradual diversification of some of our collection channels into non-mobile based channels.

Cost of revenues for our mobile and telecommunications value-added services increased by 3.4% to RMB50.1 million for the first quarter of 2005 from RMB48.4 million for the first quarter of 2004. The increase mainly reflected the increase in the amount of content subscription fees as we enriched our content. Staff costs also increased as we increased the number of staff to support our various new products and services. The fees retained by mobile operators for their share of revenues and imbalance fees, however, decreased significantly due to termination of the 161 Mobile Chat fee sharing arrangement with China Mobile, which had a comparatively high revenue sharing ratio than our other services.

Cost of revenues for our online advertising increased by 54.5% to RMB6.0 million for the first quarter of 2005 from RMB3.9 million for the first quarter of 2004. The increase mainly reflected increased staff costs as we increased the number of staff to drive the growth of our online advertising business. The amount of sales commissions paid to advertising agencies and bandwidth charges also increased as the volume of advertising contracts increased.

Other gains, net. We recorded other gains of RMB11.9 million for the first quarter of 2005 compared to RMB0.9 million for the first quarter of 2004. The increase mainly reflected the interest income generated from depositing the cash proceeds from our initial public offering completed in mid-2004 into interest-earning financial assets and fair value gains on financial instruments.

Selling and marketing expenses. Selling and marketing expenses increased by 65.8% to RMB38.5 million for the first quarter of 2005 from RMB23.2 million for the first quarter of 2004. The increase principally reflected increased promotional and advertising activities and higher staff costs as we launched and began marketing several new products and as we established new distribution channels. In addition, we increased our outsourcing as we expanded our customer support activities.

General and administrative expenses. General and administrative expenses increased by 98.7% to RMB68.5 million for the first quarter of 2005 from RMB34.5 million for the first 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 in particular online games, web portal and IM functionalities. Staff cost also increased significantly as a result of a higher number of staff and increased salary. Increased office lease rental payments relating to our relocated Shenzhen headquarters and expenses relating to being a listed company also contributed to the increase in general and administrative expenses.

Income tax expenses. We recorded profit taxes of RMB6.3 million for the first quarter of 2005 compared to RMB6.7 million for the first quarter of 2004. The decrease in profit taxes mainly reflected the decrease in our profit before income tax. Since 2003, Tencent Technology has been selling self-developed software to Tencent Computer under our structural contracts. Upon obtaining a formal approval from the local tax bureau in the PRC, the cost of the software, which is amortised as expenses at Tencent Computer over its estimated contractual useful lives, will be allowed for income tax deduction claims in ascertaining the assessable profits of Tencent Computer. Accordingly, these intra-group arrangements have 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. The related potential deferred tax assets, estimated to be in the amount of RMB92.4 million as at 31 March 2005 based on the enacted tax rate of 15% applicable to enterprises based in Shenzhen, have not been recognized in our consolidated financial statements because there is no reasonable certainty that Tencent Computer will obtain the necessary approval from the local tax bureau. Management lodged an application with the relevant authorities in 2004, but has not received any affirmative confirmation to date.

Profit for the period. As a result of the factors discussed above, net profit decreased by 8.9% to RMB97.0 million for the first quarter of 2005 from RMB106.5 million for the first quarter of 2004. Net margin was 32.3% for the first quarter of 2005 compared to 41.3% for the first quarter of 2004.

Liquidity and Financial Resources

As at 31 March 2005 and 31 December 2004, we had the following cash and investments:

	31 March 2005	31 December 2004
	<i>Unaudited</i>	<i>Audited</i>
	<i>(RMB in thousands)</i>	
Cash and cash equivalents	1,132,054	859,841
Term deposits with initial term of over three months	560,172	784,054
Financial assets held for trading	669,948	666,900
Held-to-maturity investments	<u>167,374</u>	<u>167,374</u>
Total	<u>2,529,548</u>	<u>2,478,169</u>

A large portion of our cash 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 31 March 2005.

Business Outlook

The first quarter was a rewarding yet challenging quarter for us. On the one hand, we were encouraged by the growth of our Internet platforms including our IM platform, QQ.com portal and QQ Game Portal and by the increased revenues from our Internet value-added services. On the other hand, our mobile and telecommunications value-added services revenues were negatively impacted by the termination of the 161 Mobile Chat fee sharing arrangement with China Mobile, and the continued volatility in the mobile value-added services industry.

Despite the challenges, we strongly believe in the long-term opportunities in Internet and telecommunications value-added service market in China. As such, we have continued and are committed to invest in the strengthening of our Internet platforms, the developing of new products and services and the building up of our research and development capabilities to capture such opportunities.

We have strengthened our core IM platform, as demonstrated in the rapid growth in both our active user accounts and peak simultaneous user accounts. Our QQ.com portal has also seen continued rapid growth in its traffic. We will continue to invest in enriching the functionalities and content of these platforms to attract users to our platform.

In our Internet value-added services, we are working to enhance the features of existing products and services. For example, we have developed flash-based avatars that offer better user experience than the static avatars that we currently offer. In addition, we have also released our new online identities business such as Q-Zone and QQ Pet for close-beta testing in the first quarter of 2005. We expect them to provide incremental revenue in the second half of 2005.

In our online game business, we have further extended the leadership of our QQ Game Portal as demonstrated by its strong growth in peak concurrent user accounts in the first quarter of 2005. We have also started to monetize such leadership by increasing paid-subscriptions and game item purchases for our casual games. We have further refined our advanced casual game, QQTang, during the open-beta testing in the first quarter of 2005. We have also launched our MMOG, QQ Fantasy, for close-beta testing in the first quarter of 2005. We are targeting to generate incremental revenues from these two games in the later part of 2005.

In our mobile and telecommunications value-added services, we expect continued volatility as industry policies and environment continue to evolve. We will strive to actively promote our Mobile QQ and other existing services.

In our online advertising business, we expect to see strong growth in our online advertising business in the second quarter of 2005 as we step out of the weak season for the year.

Other Information

Employee and Remuneration Policies

As at 31 March 2005, the Group had 1,311 employees (31 March 2004: 700), most of whom are based in the Company's head office in Shenzhen, 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 three months ended 31 March 2005 was RMB61.8 million (2004: RMB33.1 million).

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

During the three months ended 31 March 2005, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's listed securities.

Corporate Governance

The Audit Committee, 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 quarterly financial statements for the three months ended 31 March 2005.

Compliance with the Code on Corporate Governance Practices

Save for the deviation from code provision A.2.1 of Appendix 14 to the Listing Rules in respect of the segregation of the role of the chairman and chief executive officer, 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 three months ended 31 March 2005, complied with the codes set out in 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 chairman and chief executive officer should be separate and should not be performed by the same individual. The division of responsibilities between the chairman and chief executive officer should be clearly established and set out in writing.

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

Appreciation

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

By Order of the Board
Ma Huateng
Chairman

Hong Kong, 18 May 2005

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

Executive Directors:

Ma Huateng and Zhang Zhidong;

Non-Executive Directors:

Antonie Andries Roux and Charles St Leger Searle; and

Independent Non-Executive Directors:

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

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

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