

The following is the text of a report, prepared for the purpose of inclusion in this prospectus, received from the auditors and reporting accountants of the Company, PricewaterhouseCoopers, Certified Public Accountants, Hong Kong.



羅兵咸永道會計師事務所

PricewaterhouseCoopers
22nd Floor Prince's Building
Central Hong Kong

18th July, 2000

The Directors

FlexSystem Holdings Limited

Vickers Ballas Capital Limited

Deloitte & Touche Corporate Finance Limited

Dear Sirs

We set out below our report on the financial information regarding FlexSystem Holdings Limited (the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") for each of the two years ended 31st March, 2000 (the "Relevant Periods") for inclusion in the prospectus of the Company dated 18th July, 2000 (the "Prospectus").

The Company was incorporated in the Cayman Islands on 8th May, 2000 as an exempted company with limited liability under the Companies Law (2000 Revision) of the Cayman Islands. Pursuant to a group reorganisation (the "Reorganisation"), as detailed in Appendix IV to the Prospectus, which was completed on 15th July, 2000, the Company became the holding company of the subsidiaries set out below.

As at the date of this report, the Company has direct and indirect interests in the following subsidiaries, all of which are private companies (or, if incorporated or established outside Hong Kong, have substantially the same characteristics as a Hong Kong private company). Details of these companies are as follows:

Company	Country/place and date of incorporation/establishment	Issued and fully paid up share capital/registered capital	Attributable equity interest %	Principal activities
<i>Subsidiary held directly:</i>				
SomaFlex International Inc.	British Virgin Islands ("BVI") 8th May, 2000	US\$1 1 ordinary share of US\$1	100	Investment holding

Company	Country/place and date of incorporation/establishment	Issued and fully paid up share capital/registered capital	Attributable equity interest %	Principal activities
<i>Subsidiaries held indirectly:</i>				
FlexSystem Limited	Hong Kong 3rd April, 1987	HK\$120,000 120,000 ordinary shares of HK\$1 each	100	Development and distribution of software and related services
FlexPro Limited	Hong Kong 10th March, 1992	HK\$2 2 ordinary shares of HK\$1 each	100	Development and distribution of software system for manufacturing industries
Danfaith Limited	BVI 21st February, 1995	US\$1 1 ordinary share of US\$1	100	Licensing of computer software
Millenium Magic Sdn Bhd	Malaysia 10th December, 1999	RM2 2 ordinary shares of RM1 each	100	Licensing and distribution of computer software products and technology
Soma Software Services Limited	Hong Kong 6th December, 1999	HK\$100 100 ordinary shares of HK\$1 each	100	Provision of ASP services
Flex System (Shanghai) Co. Ltd. ("Flex System (Shanghai)")	People's Republic of China (the "PRC") 26th February, 1997	Registered capital US\$200,000	100	Development and distribution of FlexAccount products
FlexSystem Software Limited	Macau 24th February, 1999	Registered capital MOP30,000	100	Operation of research and development center

All companies now comprising the Group, except Flex System (Shanghai) and FlexSystem Software Limited, have adopted 31st March as their financial year end date throughout the Relevant Periods. Flex System (Shanghai) and FlexSystem Software Limited have adopted 31st December as their financial year end date for statutory reporting purposes.

We acted as auditors of FlexSystem Limited and FlexPro Limited for the year ended 31st March, 2000. The following statutory accounts were not audited by PricewaterhouseCoopers:—

Name	Financial period		Auditors
	From	To	
FlexSystem Limited	1st April, 1998	31st March, 1999	Y.T. Lo & Co. Certified Public Accountants
FlexPro Limited	1st April, 1998	31st March, 1999	Y.T. Lo & Co. Certified Public Accountants
Flex System (Shanghai)	1st January, 1998	31st December, 1999	Shanghai Gao Ke Certified Public Accountants Co., Ltd.

No audited accounts have been prepared for the Company, SomaFlex International Inc., Danfaith Limited, Millenium Magic Sdn Bhd, Soma Software Services Limited and FlexSystem Software Limited since their respective dates of incorporation or establishment. We have, however, reviewed all significant transactions, as appropriate, of these companies for the Relevant Periods since their respective dates of incorporation or establishment to the date of this report.

The accounts of FlexSystem (Shanghai) are prepared in accordance with the applicable accounting principles and relevant financial regulations in the PRC. For the purpose of this report, we have carried out an independent audit of the accounts of FlexSystem (Shanghai) for the Relevant Periods in compliance with generally accepted accounting principles in Hong Kong. We have also examined the audited accounts or, where appropriate, the management accounts of all companies now comprising the Group for the Relevant Periods and have carried out such additional procedures as are necessary in accordance with the Auditing Guideline "Prospectuses and the Reporting Accountant" issued by the Hong Kong Society of Accountants.

The summaries of the combined results of the Group for the Relevant Periods and of the combined net assets of the Group as at 31st March, 2000 (the "Summaries"), have been prepared based on the audited accounts or, where appropriate, management accounts of all companies now comprising the Group, on the basis set out in Section 1 below, after making such adjustments as are appropriate.

The directors of the respective group companies are responsible for preparing these accounts which give a true and fair view. In preparing these accounts, it is fundamental that appropriate accounting policies are selected and applied consistently.

The directors of the Company are responsible for preparing the financial information in sections 1 to 6 below, including the Summaries. It is our responsibility to form an independent opinion on the combined results of the Group for the Relevant Periods and the combined net assets of the Group as at 31st March, 2000.

In our opinion, the Summaries set out below together with the notes thereto, for the purpose of this report, and prepared on the basis set out in section 1 below, give a true and fair view of the combined results of the Group for the Relevant Periods and of the combined net assets of the Group as at 31st March, 2000.

1 BASIS OF PREPARATION

For the purpose of this report, the summary of the combined results, as detailed in section 3 below, includes the results of the companies now comprising the Group as a result of the Reorganisation as if the current group structure had been in existence throughout the Relevant Periods, or since their respective dates of incorporation or establishment, whichever is a shorter period.

The summary of the combined net assets of the Group as at 31st March, 2000, as detailed in section 4 below, has been prepared to present the assets and liabilities of the Group as at that date, as if the current group structure had been in existence at that date.

All significant intra-group transactions and balances have been eliminated on combination.

2 PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies which have been adopted by the Group in arriving at the financial information in this report are set out below. These policies conform with Statements of Standard Accounting Practice issued by the Hong Kong Society of Accountants and accounting principles generally accepted in Hong Kong. The accounts are prepared under the historical cost convention.

(a) Subsidiaries

Subsidiaries are companies in which the Company, directly or indirectly, controls more than half of the voting power or issued share capital or the composition of board of directors.

(b) Investment securities

Investment securities are stated at cost less any provision for diminution in value.

The carrying amounts of individual investment securities are reviewed at each balance sheet date to assess whether the fair values have declined below the carrying amounts. When a decline other than temporary has occurred, the carrying amount of such investment securities should be reduced to its fair value. The amount of the reduction is recognised as an expense in the profit and loss account. Income from investment securities is recognised when the right to receive the income is established.

(c) Fixed assets

Leasehold properties and improvements are stated at cost less accumulated depreciation. Depreciation of leasehold properties and improvements is calculated to write off their cost on a straight-line basis over the unexpired period of lease or their expected useful lives to the Group, whichever is the shorter. The principal annual rate used is 4%.

Other tangible fixed assets are stated at cost less accumulated depreciation. Depreciation of fixed assets is calculated to write off their cost on a reducing balance basis over their expected useful lives to the Group. The principal annual rate used for each of the categories of fixed assets is 20%.

Major costs incurred in restoring fixed assets to their normal working condition are charged to the profit and loss account. Improvements are capitalised and depreciated over their expected useful lives to the Group.

The carrying amounts of fixed assets are reviewed regularly to assess whether their recoverable amounts have declined below their carrying amounts. Recoverable amount is the amount which the Group expects to recover from the future use of the asset, including its residual value on disposal. Expected future cash flows have not been discounted in determining the recoverable amount.

The gain or loss on disposal of a fixed asset is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the profit and loss account at the time of disposal.

(d) Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Rentals applicable to such operating leases are charged to the profit and loss account on a straight-line basis over the lease term.

(e) Accounts receivable

Provision is made against accounts receivable to the extent they are considered to be doubtful. Accounts receivable in the statement of net assets are stated net of such provision.

(f) Deferred taxation

Deferred taxation is accounted for at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts to the extent that a liability or asset is expected to be payable or recoverable in the foreseeable future.

(g) Translation of foreign currencies

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated at the rates of exchange ruling at the balance sheet date. Exchange differences arising in these cases are dealt with in the profit and loss account.

The accounts of subsidiaries expressed in foreign currencies are translated at the rates of exchange ruling at the balance sheet date. Exchange differences are dealt with as a movement in reserves.

(h) Revenue recognition

- (i) Revenue from the sale of goods is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and the title has passed.

- (ii) Maintenance service income is recognised over the life of the agreement on a straight-line basis. The unearned portion of the maintenance service income received is stated as deferred income in the statement of net assets.
- (iii) Interest income is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

(i) **Retirement benefit costs**

The Group's contributions to the defined contribution retirement scheme are expensed as incurred. The assets of the scheme are held separately from those of the Group in an independently administered fund.

(j) **Research and development costs**

Research and development costs are expensed as incurred except where the technical feasibility of the product under development has been demonstrated, costs are identifiable and a market exists for the product such that it is probable that it will be profitable. Such costs are recognised as an asset and amortised on a straight-line basis over a period of not more than 3 years to reflect the pattern in which the related economic benefits are recognised.

3 RESULTS

The following is a summary of the combined results of the Group for the Relevant Periods, prepared on the basis set out in section 1 above, after making such adjustments as are appropriate:

		Year ended 31st March,	
		1999	2000
	<i>Note</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Turnover	(a)	38,408	44,756
Cost of sales		<u>(5,117)</u>	<u>(5,677)</u>
Gross profit		33,291	39,079
Other revenues	(a)	90	2
Distribution costs		(6,895)	(7,468)
Administrative expenses		(5,083)	(4,081)
Other operating expenses		<u>(9,524)</u>	<u>(8,578)</u>
Operating profit before taxation	(b)	11,879	18,954
Taxation	(c)	<u>(1,962)</u>	<u>(2,760)</u>
Profit after taxation		<u>9,917</u>	<u>16,194</u>
Dividends	(d)	<u>20,000</u>	<u>11,070</u>

Notes:

(a) **Revenues and turnover**

The amounts of each significant category of revenue recognised during the Relevant Periods are as follows:

	Year ended 31st March,	
	1999	2000
	<i>HK\$'000</i>	<i>HK\$'000</i>
Turnover		
Sale of goods	31,049	33,979
Rendering of maintenance services	<u>7,359</u>	<u>10,777</u>
	38,408	44,756
Other revenues		
Interest income	67	2
Others	<u>23</u>	<u>—</u>
	<u>90</u>	<u>2</u>
Total revenues	<u><u>38,498</u></u>	<u><u>44,758</u></u>

(b) **Operating profit before taxation**

Operating profit before taxation is stated after charging the following:

	Year ended 31st March,	
	1999	2000
	<i>HK\$'000</i>	<i>HK\$'000</i>
Staff costs	14,346	16,291
Operating leases in respect of land and buildings	1,226	1,170
Research and development expenses	2,970	1,622
Amortisation of deferred development costs	—	860
Depreciation of fixed assets	295	297
Auditors' remuneration	67	200
Provision for doubtful debts	738	953
Retirement scheme contributions	<u>444</u>	<u>575</u>

(c) Taxation

The taxation charge represents:

	Year ended 31st March,	
	1999	2000
	<i>HK\$'000</i>	<i>HK\$'000</i>
Hong Kong profits tax (i)	1,962	2,774
10% 1997/1998 tax rebate	<u>—</u>	<u>(14)</u>
	<u>1,962</u>	<u>2,760</u>

- (i) Hong Kong profits tax has been provided for at the rate of 16% on the respective estimated assessable profits of FlexSystem Limited, FlexPro Limited and Danfaith Limited during the Relevant Periods.
- (ii) No provision for PRC income tax has been made in the accounts as the Group has no assessable profit for the Relevant Periods.
- (iii) There was no material unprovided deferred taxation for the Relevant Periods.

(d) Dividends

No dividends have been paid or declared by the Company since its incorporation. Dividends amounting to HK\$20,000,000 and HK\$11,070,000 were paid by certain subsidiaries of the Group to its then shareholders prior to the Reorganisation for the years ended 31st March, 1999 and 2000 respectively. The rates of dividend and the number of shares ranking for dividends are not presented as such information is not meaningful having regard to the purpose of the report.

(e) Directors' and senior management's emoluments

- (i) The aggregate amounts of emoluments paid and payable to directors of the Company for the Relevant Periods are as follows:

	Year ended 31st March,	
	1999	2000
	<i>HK\$'000</i>	<i>HK\$'000</i>
Fees	<u>—</u>	<u>—</u>
Basic salaries, allowances and benefits in kind	<u>1,182</u>	<u>1,000</u>
	<u>1,182</u>	<u>1,000</u>

No directors waived any emoluments and no incentive payment or compensation for loss of office was paid or payable to any director during the Relevant Periods.

The number of directors whose emoluments fall within the following bands is as follows:—

	Year ended 31st March,	
	1999	2000
Nil to HK\$1,000,000	<u>2</u>	<u>2</u>

These two directors received individual emoluments of approximately HK\$920,000 (1999: HK\$720,000) and HK\$80,000 (1999: HK\$462,000) respectively for the year ended 31st March, 2000.

(ii) The five individuals whose emoluments were the highest in the Group are as follows:

	Year ended 31st March,	
	1999	2000
Director	1	1
Employees	<u>4</u>	<u>4</u>
	<u>5</u>	<u>5</u>

Details of the emoluments of employees as mentioned above are as follows:

	Year ended 31st March,	
	1999	2000
	<i>HK\$'000</i>	<i>HK\$'000</i>
Basic salaries, allowances and benefits in kind	2,431	2,318
Pension scheme contributions	<u>51</u>	<u>70</u>
	<u>2,482</u>	<u>2,388</u>

The number of employees whose emoluments fall within the following bands is as follows:—

	Year ended 31st March,	
	1999	2000
Nil to HK\$ 1,000,000	<u>4</u>	<u>4</u>

(iii) During the Relevant Periods, no emoluments have been paid by the Group to the directors and the highest paid employees mentioned above as an inducement to join the Group or as compensation for loss of office.

(f) **Retirement scheme**

The Group contributed to a defined contribution retirement scheme for its employees in Hong Kong during the Relevant Periods. Contributions to the scheme by the Group are calculated at 5% of the employees' basic salaries.

The PRC subsidiary of the Company has participated in an employees' retirement scheme implemented by the Shanghai Municipal Government. Contributions are made to the scheme based on 31.5% of the applicable basic payroll costs.

The Group has no other obligations other than the above-mentioned contributions.

(g) **Earnings per share**

No earnings per share information is presented as this would be hypothetical due to the Reorganisation and preparation of the results on a combined basis, as disclosed in section 1 of this report.

(h) **Related party transactions**

Save as disclosed elsewhere in this report, the following significant related party transactions have been entered into by the Group during the Relevant Periods:

		Year ended 31st March,	
		1999	2000
	<i>Note</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
Sales to FlexCorp Limited	(i)	4,930	4,347
Property rental, management fees and related expenses paid to Oriental Palace Limited ("Oriental Palace")	(ii)	805	817

(i) Mr. Lok Wai Man and Mr. So Yiu King, both directors and shareholders of the Company, each has a 45% interest in FlexCorp Limited. The sales made to FlexCorp Limited are conducted in the normal course of business at prices and terms comparable with those charged to and contracted with independent third party customers of the Group. The Directors of the Company have confirmed that these transactions will be terminated following the listing of the Company's shares on the Growth Enterprise Market ("GEM") of The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

(ii) A license agreement granting the Group the exclusive rights and occupation in relation to the offices of the Group in Hong Kong was made on 7th July, 2000 between FlexSystem Limited and Oriental Palace. The license agreement is for the remaining and unexpired term of the respective tenancy agreements between Oriental Palace as tenant and an independent third party as landlord in relation to the offices mentioned above. Mr. Lok Wai Man and Mr. So Yiu King, directors and shareholders of the Company, each has a 50% interest in Oriental Palace. The rental, management fees and related expenses reimbursed to Oriental Palace are the same as that charged by the landlord of the premises to Oriental Palace. The Directors of the Company have confirmed that these transactions will continue until the expiry of the rental agreements entered into by Oriental Palace and the landlord.

The directors of the Company are of the opinion that the above transactions were conducted based on normal commercial terms in the normal course of the Group's business.

4 NET ASSETS

The following is a summary of the combined net assets of the Group as at 31st March, 2000, prepared on the basis set out in section 1 above and after making such adjustments as are appropriate:

	<i>Note</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
FIXED ASSETS	(a)		1,621
INVESTMENT SECURITIES	(b)		1,605
CURRENT ASSETS			
Amount due from a director	(c)	5,469	
Amount due from a related company	(d)	2,871	
Trade receivables		6,965	
Other receivables and prepayments		1,811	
Bank and cash balances	(e)	<u>1,020</u>	
			18,136
CURRENT LIABILITIES			
Trade payables and other payables		1,418	
Deferred income	2(h)(ii)	3,940	
Deposits received from customers		3,717	
Tax payable		<u>6,695</u>	
			<u>15,770</u>
NET CURRENT ASSETS			<u>2,366</u>
NET TANGIBLE ASSETS			<u>5,592</u>
INTANGIBLE ASSETS			
Deferred development costs	(f)		<u>1,719</u>
NET ASSETS			<u><u>7,311</u></u>

Notes:

(a) **Fixed assets**

	Cost <i>HK\$'000</i>	Accumulated depreciation <i>HK\$'000</i>	Net book value <i>HK\$'000</i>
Leasehold properties in the PRC	349	(41)	308
Leasehold improvements	536	(242)	294
Furniture and fixtures	2,025	(1,289)	736
Plant and machinery	596	(477)	119
Motor vehicles	320	(156)	164
	<u>3,826</u>	<u>(2,205)</u>	<u>1,621</u>

(b) **Investment securities**

	<i>HK\$'000</i>
Equity securities	
Unlisted in Hong Kong, at cost	<u>1,605</u>

Name	Place of incorporation/ operations	Principal activities	Particulars of issued shares held	Interest held
Starwise International Computers Limited	Hong Kong	Systems integration and provision of turnkey solutions	305,000 ordinary shares of HK\$1 each	30%
Manpower Resource Computing Limited	Hong Kong	Payroll and human resources management	400,000 ordinary shares of HK\$1 each	30.8%

Notwithstanding that the Company holds an interest in each of these investments in excess of 20%, the Company has no representation on their respective boards of directors and consequently the directors are of the opinion that the Company has no significant influence and the investments should not be accounted for as associated companies.

(c) Amount due from a director

Name of director	Maximum amount outstanding during the Relevant Periods <i>HK\$'000</i>	Amount outstanding at 31st March, 1999 <i>HK\$'000</i>	Amount outstanding at 31st March, 2000 <i>HK\$'000</i>
Lok Wai Man	16,539	4,502	5,469

The amount due from a director represents funds advanced to the director during the Relevant Periods. It is unsecured, interest-free and has been fully settled on 6th July, 2000.

(d) Amount due from a related company

The balance represents an amount due from FlexCorp Limited, arising mainly from the related party transactions as mentioned in section 3 (h)(i), which is unsecured, interest-free and has been fully settled on 15th July 2000.

(e) Bank and cash balances

Included in the balance is an amount of HK\$92,066 which is denominated in Renminbi. Renminbi is not a freely convertible currency.

(f) Deferred development costs

This represents the amount of staff costs of approximately HK\$2,579,000 incurred and capitalised in relation to a development project less accumulated amortisation of approximately HK\$860,000.

(g) Commitments under operating leases

- (i) As at 31st March, 2000, the Group had a commitment in the next twelve months under an operating lease in respect of certain premises as follows:

	<i>HK\$'000</i>
Within one year	170

- (ii) The monthly licence fee payable under the license agreement as disclosed in section 3(h)(ii) for the remaining and unexpired term is HK\$81,896.

(h) Contingent liabilities

No companies within the Group had any loan capital, bank overdrafts, loans or other similar indebtedness, liabilities under acceptances (other than normal trade bills), acceptance credits, debentures, mortgages, charges, finance leases or hire purchase commitments, guarantees or other material contingent liabilities outstanding at the close of business on 31st March, 2000.

(i) **Net assets of the Company**

The Company was incorporated in the Cayman Islands on 8th May, 2000 with an authorised share capital of HK\$380,000, divided into 3,800,000 shares of HK\$0.10 each. At 31st March, 2000, the Company had not been incorporated and, accordingly, it had no assets or liabilities as at that date. The net assets of the Company as at 31st March, 2000 prepared on the basis set out in section 1 above, amounted to approximately HK\$7,311,000, representing its investment in the subsidiaries.

(j) **Distributable reserves**

As at 31st March, 2000, the Company had not been incorporated and hence there were no reserves available for distribution to the Company's shareholders at that date.

5 SIGNIFICANT SUBSEQUENT EVENTS

The following significant transactions took place subsequent to 31st March, 2000.

- (a) Subsequent to 31st March, 2000, the companies in the Group underwent a Reorganisation in preparation for the listing of the Company's shares on GEM of the Stock Exchange. Details of the Reorganisation and alterations in the share capital of the Company are set out in the subsection headed "Further information about the Company" in Appendix IV of the Prospectus.
- (b) The Group's leasehold properties situated in the PRC have been revalued by an independent valuer, DTZ Debenham Tie Leung Limited, as at 31st May, 2000. The aggregate surplus on revaluation, which is not reflected in the net assets of the Group as at 31st March, 2000, amounting to approximately HK\$44,000, will be incorporated into the Group's accounts for the year ending 31st March, 2001.

Save as aforesaid, no other material events took place subsequent to 31st March, 2000.

6 SUBSEQUENT ACCOUNTS

No audited accounts have been prepared for the Company or any of the companies now comprising the Group in respect of any period subsequent to 31st March, 2000 and save as disclosed in this report, no dividend or other distribution has been declared, made or paid by the Company or any of its subsidiaries in respect of any period subsequent to 31st March, 2000.

Yours faithfully
PricewaterhouseCoopers
Certified Public Accountants
Hong Kong