THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

If you are in any doubt as to any aspect of this circular or as to the action to be taken, you should consult your licensed securities dealer, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in Lenovo Group Limited, you should at once hand this circular and the accompanying form of proxy to the purchaser or to the bank, licensed securities dealer or other agent through whom the sale or transfer was effected for transmission to the purchaser or transferee.

This circular is for information purposes only and does not constitute an invitation or offer to acquire, purchase or subscribe for the securities mentioned herein.

lenovo 联想

Lenovo Group Limited 聯想集團有限公司

(Incorporated in Hong Kong with limited liability)

(Stock code: 992)

VERY SUBSTANTIAL ACQUISITION RELATING TO THE PERSONAL COMPUTER BUSINESS OF INTERNATIONAL BUSINESS MACHINES CORPORATION AND CONTINUING CONNECTED TRANSACTIONS

Financial adviser to the Company

Goldman Sachs

Goldman Sachs (Asia) L.L.C.

Independent financial adviser to the Independent Board Committee and the Independent Shareholders

CAZENOVE

Cazenove Asia Limited

A letter from the Independent Board Committee containing its recommendations in respect of the Continuing Connected Transactions to the Independent Shareholders is set out on pages 60 to 61 of this circular. A letter from Cazenove Asia Limited, the independent financial adviser, containing its advice to the Independent Board Committee and the Independent Shareholders is set out on pages 62 to 101 of this circular.

A notice convening the Extraordinary General Meeting to be held on Thursday, 27 January 2005 at 9:30 a.m. at Ballroom B, Level 5, Island Shangri-La Hong Kong, Pacific Place, Supreme Court Road, Central, Hong Kong is set out on pages 324 to 326 of this circular. Whether or not you are able to attend the Extraordinary General Meeting, please complete the enclosed form of proxy in accordance with the instructions printed thereon and return it to the share registrar of the Company, Abacus Share Registrars Limited at Ground Floor, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong as soon as possible and in any event no less than 48 hours before the time appointed for the holding of the Extraordinary General Meeting or any adjourned meeting thereof. Completion and return of the form of proxy will not preclude you from attending and voting in person at the Extraordinary General Meeting or any adjourned meeting thereof and, in such event, the relevant form of proxy shall be deemed to be revoked.

31 December 2004

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In this circular, the following expressions have the meanings set out below unless the context otherwise requires:

"Acquired Assets"	the assets to be acquired by the Company pursuant to the Asset Purchase Agreement, details of which are set out in the sub-section entitled "Assets to be acquired and liabilities to be assumed by the Company" under the section entitled "Asset Purchase Agreement" in the letter from the Board contained in this circular
"Acquired Intellectual Property"	all rights, titles and interests of IBM or its relevant subsidiaries in relation to intellectual property which is required to be transferred or assigned to the Company pursuant to the Intellectual Property Agreements
"affiliate"	with respect to any person, any other person who directly or indirectly or who through one or more intermediaries, controls or is controlled by or is under common control with the person specified
"Americas"	the USA, Canada, South America and Latin America
"Ancillary Agreements"	the agreements and arrangements the particulars of which are set out in the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Announcement"	the announcement dated 8 December 2004 made by the Company relating to, inter alia, the entering into of the Asset Purchase Agreement
"Articles"	the articles of association of the Company, in the form which prevails at the date of this circular
"Asia Pacific"	Japan, the PRC, South Korea, Australia, New Zealand, Association of South East Asian Nations, Hong Kong and Taiwan
"Asset Acquisition"	the acquisition of the Acquired Assets by the Company from IBM pursuant to the Asset Purchase Agreement
"Asset Purchase Agreement"	the asset purchase agreement entered into between the Company and IBM in relation to the Asset Acquisition on 7 December 2004, details of which are set out in the section entitled "Asset Purchase Agreement" in the Letter from the Board contained in this circular
"Assumed Liabilities"	the liabilities to be assumed by the Company under the Asset Purchase Agreement, details of which are set out in the sub-section entitled "Assets to be acquired and liabilities to be assumed by the Company" under the section entitled "Asset Purchase Agreement" in the letter from the Board contained in this circular
"Base Consideration Shares"	1,307,153,271 Shares and Non-voting Shares being part of the Consideration Shares

"Board"	the board of Directors
"Bridge Loan"	the bridge loan discussed in the sub-section entitled "Bridge Loan" under the section entitled "Asset Purchase Agreement" in the letter from the Board contained in this circular
"Business" or "PCD"	the business conducted by IBM and its subsidiaries in their personal computing division of designing, developing, manufacturing, marketing and selling Products but does not include the businesses of: (a) providing maintenance and warranties services or any other Global Services (including in each case with respect to the Products); (b) leasing, renting, financing or selling leased Products; (c) providing financing services and disposal services; (d) designing, developing, manufacturing, marketing or selling Excluded Products; or (e) marketing or selling Products to the extent conducted by employees of IBM or any of its subsidiaries who will not be employed by the Company following the Initial Closing
"Business Day"	any day other than (a) a Saturday or Sunday, (b) any day on which banks located in New York City, USA or Hong Kong are authorized or required by law to be closed for the conduct of regular banking business and (c) when such term is used in relation to a country other than USA, any other day on which commercial banks in such country are authorized or required by law to be closed for the conduct of regular banking business
"Caps"	the proposed annual limits for the values of the non-exempt continuing connected transactions under the Listing Rules
"Cash Consideration"	US$650 million payable by the Company in cash to IBM as part of the consideration under the Asset Purchase Agreement, subject to certain adjustments set out in the sub-section entitled "Consideration" in the letter from the Board contained in this circular
"Cazenove Asia"	Cazenove Asia Limited, the independent financial adviser to the Independent Board Committee and the Independent Shareholders in relation to the Continuing Connected Transactions
"Chinese Business Unit"	the Business related to the Products, operated under International Information Products (Shenzhen) Co., Ltd., a Sino-foreign equity joint venture currently owned as to 80% by IBM. The remaining 20% is held by China Great Wall Computer Shenzhen Co., Ltd.. China Great Wall Computer Shenzhen Co., Ltd., its parent company, Great Wall Technology Company Limited (a company listed on the Stock Exchange) and China Great Wall Computer Group Company, being the controlling shareholder thereof, are parties independent of the Company and its connected persons
"Closings"	the Initial Closing and the Subsequent Closings, and "Closing" means any one of them

"Company"	Lenovo Group Limited, a company incorporated on 5 October 1993 with limited liability under the laws of Hong Kong, the Shares of which are listed on the main board of the Stock Exchange
"Company Agreement"	the company agreement entered into between the Company and IBM on 7 December 2004, details of which are set out in the section entitled "Company Agreement" in the letter from the Board contained in this circular
"Conditions Precedent"	the conditions precedent to the Closings under the Asset Purchase Agreement, details of which are set out in the sub-section entitled "Conditions Precedent for the Closings" under the section entitled "Asset Purchase Agreement" in the letter from the Board contained in this circular
"connected person"	has the meaning set out in the Listing Rules
"Consideration Shares"	up to 821,234,569 new Shares and up to 921,636,459 new Non-voting Shares to be allotted and issued by the Company to IBM to satisfy part of the consideration for the Acquired Assets in accordance with the Asset Purchase Agreement
"Continuing Connected Transactions"	the transactions underlying the Transition Services Agreement, the Strategic Financing and Asset Disposition Services Agreement, the IGS Services Agreement, the Marketing Support Agreement, the Internal Use Purchase Agreement, the Master Distribution Agreement and the Real Estate Arrangements
"controlling shareholder"	has the meaning set out in the Listing Rules
"Customer Financing Services"	the provision of leasing and financing to the customers of the Business for personal computing products and associated equipment
"Digital China"	Digital China Holdings Limited, a company incorporated in Bermuda with limited liability, whose shares are listed and traded on the main board of the Stock Exchange (stock code: 861)
"Directors"	the directors of the Company
"Distribution Channel Financing Services"	the provision of financing to remarketers of personal computing products and associated equipment
"EBITDA"	earnings before interest, taxation, depreciation and amortization expenses
"EMEA"	Europe, Middle East and Africa

"Employee Matters Agreement"	the employee matters agreement entered into between the Company and IBM on 7 December 2004, details of which are set out in the sub-section entitled "Employee Matters Agreement" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Enlarged Group"	the Lenovo Group following the Asset Acquisition and the assumption of the Assumed Liabilities
"Excess Shares"	up to 435,717,757 of the Consideration Shares, subject to the Company's ability to pay cash instead, pursuant to the Asset Purchase Agreement
"Excess Surplus Disposition Services"	the provision of excess surplus disposition services with respect to used personal computing products
"Excluded Assets"	assets of the Business other than the Acquired Assets, details of which are set out in the sub-section entitled "Assets to be acquired and liabilities to be assumed by the Company" under the section entitled "Asset Purchase Agreement" in the letter from the Board contained in this circular
"Excluded Liabilities"	all liabilities related to the Business other than the Assumed Liabilities, details of which are set out in the sub-section entitled "Assets to be acquired and liabilities to be assumed by the Company" under the section entitled "Asset Purchase Agreement" in the letter from the Board contained in this circular
"Excluded Products"	the products described in the Asset Purchase Agreement including, among others, server solutions; workstations and similar standalone products that are designed and marketed for use in high-end professional applications; special purpose devices that are designed, marketed and used for one or more dedicated purposes, whether or not such devices incorporate all or part of a Product or Personal Computer; mobile devices in a more compact form-factor than laptop or notebook Personal Computers, which lack a display screen measuring at least 6 inches diagonally; components sold and marketed as such and options and accessories
"Extraordinary General Meeting"	the extraordinary general meeting of the Company to be held for the purposes of considering and, if thought fit, approving, among other things, the Asset Acquisition and the Continuing Connected Transactions

"Global Services"	maintenance and warranty services and all other services, including, information technology outsourcing, system integration services, professional information technology services, integrated technology services, strategic outsourcing, business process outsourcing, business consulting services, business transformation outsourcing, e-business hosting services, application management services, web sales or tele-sales services and the provision of services through variable utilities pricing
"Goldman Sachs"	Goldman Sachs (Asia) L.L.C.
"Goodwill Deposit"	the goodwill deposit in the amount of US$25 million paid by the Company to IBM upon the signing of the Asset Purchase Agreement, details of which are set out in the sub-section entitled "Goodwill Deposit" under the section entitled "Asset Purchase Agreement" in the letter from the Board contained in this circular
"HK$"	Hong Kong Dollar, the lawful currency of Hong Kong
"holding company"	has the meaning set out in the Listing Rules
"Hong Kong"	the Hong Kong Special Administrative Region of the PRC
"Hong Kong GAAP"	accounting principles that are generally accepted in Hong Kong
"HSR Act"	Section 7A of the United States Clayton Act (Title II of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended) and the rules and regulations promulgated thereunder
"IBM"	International Business Machines Corporation
"IGF"	IBM's global financing services and disposal services business conducted through one or more subsidiaries and affiliates of IBM
"IGS"	IBM's global services business conducted through one or more subsidiaries and affiliates of IBM
"IGS Services Agreement"	the IGS services agreement entered into by the Company and IBM on 7 December 2004, details of which are set out in the sub-section entitled "IGS Services Agreement" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Independent Board Committee"	the independent committee of the Board, comprising Mr Wong Wai Ming, Professor Woo Chia-Wei and Mr Ting Lee Sen, being the independent non-executive Directors
"Independent Shareholders"	Shareholders who do not have any material interest in the Asset Acquisition or any of the Continuing Connected Transactions
"Initial Closing"	Closing of the Asset Acquisition (relating to the Acquired Assets other than the Remaining Assets) in accordance with the terms thereof

"Initial Closing Countries"	the PRC, Japan, the USA, Singapore and the United Kingdom
"Intellectual Property Agreements"	the Trademark Assignment Agreement, the Trademark License Agreement, the Patent Assignment Agreement, the Patent Cross License Agreement and the Intellectual Property Assignment and License Agreement, details of which are set out in the sub-section entitled "Intellectual Property Agreements" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Intellectual Property Assignment and License Agreement"	the intellectual property assignment and license agreement entered into by the Company and IBM on 7 December 2004, details of which are set out in the sub-section entitled "Intellectual Property Agreements" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Internal Use Purchase Agreement"	the internal use purchase agreement entered into by the Company and IBM on 7 December 2004, details of which are set out in the sub-section entitled "Internal Use Purchase Agreement" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Issue Price"	the price of HK$2.675 per new Share and per new Non-voting Share
"IT Products"	Personal Computers, servers and other related hardware products
"Korean Joint Venture"	an existing joint venture between IBM and LG IBM PC Company Limited which is going to be dissolved with effect from 1 January 2005
"Latest Practicable Date"	24 December 2004, being the latest practicable date for ascertaining certain information contained in this circular
"Lenovo Group" or "Group"	the Company and its subsidiaries
"LIBOR"	the London Interbank Offered Rate
"Listing Committee"	has the meaning set out in the Listing Rules
"Listing Rules"	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
"Major Shareholder"	Legend Holdings Limited, the controlling shareholder of the Company holding approximately 57% of all the Shares in issue as at the Latest Practicable Date

"Marketing Support Agreement"	the marketing support agreement entered into by the Company and IBM on 7 December 2004, details of which are set out in the sub-section entitled "Marketing Support Agreement" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Master Distribution Agreement"	the master distribution agreement entered into by the Company and IBM on 7 December 2004, details of which are set out in the sub-section entitled "Master Distribution Agreement" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"MSA Service Description Attachments"	attachments 1–9 to the Marketing Support Agreement, particulars of which are set out in the sub-section entitled "Marketing Support Agreement" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"MSA Services"	collectively, the services set forth in or contemplated by the MSA Service Description Attachment
"Non-voting Shares"	ordinary unlisted shares of par value HK$0.025 each in the share capital of the Company, which have the same rights as the Shares save that the Non-voting Shares shall not carry any voting rights until they are converted into Shares
"ODM and EMS companies"	original design manufacturer and electronic manufacturing services
"OEM"	original equipment manufacturer
"Patent Assignment Agreement"	the patent assignment agreement entered into by IBM and a subsidiary of IBM on 7 December 2004, details of which are set out in the sub-section entitled "Intellectual Property Agreements" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Patent Cross License Agreement"	the patent cross license agreement entered into between the Company, IBM and a subsidiary of IBM on 7 December 2004, details of which are set out in the sub-section entitled "Intellectual Property Agreements" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"PCAOB"	the Public Company Accounting Oversight Board (United States)
"PCAOB Standards"	the standards of PCAOB
"person"	any natural person, corporation, general partnership, limited partnership, limited or unlimited liability company, proprietorship, joint venture, other business organisation, trust, union, association or governmental authority

"Personal Computers"	any self-contained, programmable, general purpose computing device in a desktop (including a thin client and a desktop system designed for media distribution for residential use), mobile or tablet platform, generally used by a single local user at a time, consisting of microprocessor hardware architecture, on-board memory, multiple input/output capabilities and a single user desktop/mobile/tablet operating system, other than the Excluded Products
"PRC"	the People's Republic of China (for the purposes of this circular, excluding Hong Kong, the Macau Special Administrative Region of the PRC and Taiwan)
"Products"	desktop personal computers and ThinkPad laptop personal computers and peripherals, a list of which is referenced in IBM's disclosure letter
"Property Valuation Report"	the property valuation report prepared by Vigers Appraisal and Consulting Limited set out in Appendix VI to this circular
"Real Estate Arrangements"	the real estate arrangements to be entered into by the Company and IBM with effect from the Initial Closing, particulars of which are set out in the sub-section entitled "Real Estate Arrangements" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Remaining Assets"	subject to the terms and conditions of the Asset Purchase Agreement, the Acquired Assets located in certain countries which are not to be transferred to the Company at the Initial Closing under the multiple closing arrangements set out in the sub-section entitled "Multiple Closing Arrangements" under the section entitled "Asset Purchase Agreement" in the letter from the Board contained in this circular
"SFAD Services"	collectively, the Customer Financing Services, the Distribution Channel Financing Services and the Excess Surplus Disposition Services
"SFAD Services Attachments"	the SFAD Services set forth in the attachments to the Strategic Financing and Asset Disposition Services Agreement, particulars of which are set out in the sub-section entitled "Strategic Financing and Asset Disposition Services Agreement" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"SFO"	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
"Shareholders"	holders of the Shares
"Shares"	ordinary shares of par value HK$0.025 each in the share capital of the Company, which for the avoidance of doubt, do not include the Non-voting Shares

"Stock Exchange"	The Stock Exchange of Hong Kong Limited
"Strategic Financing and Asset Disposition Services Agreement"	the strategic financing and asset disposition services agreement entered into by the Company and IBM on 7 December 2004, details of which are set out in the sub-section entitled "Strategic Financing and Asset Disposition Services Agreement" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Subsequent Closings"	the subsequent closings of the Asset Acquisition which take place after the Initial Closing contemplated under the multiple closing arrangements under the Asset Purchase Agreement, details of which are set out in the sub-section entitled "Multiple Closing Arrangements" under the section entitled "Asset Purchase Agreement" in the letter from the Board contained in this circular
"subsidiary"	has the meaning set out in the Listing Rules
"Trademark Assignment Agreement"	the trademark assignment agreement entered into by IBM and a subsidiary of IBM on 7 December 2004, details of which are set out in the sub-section entitled "Intellectual Property Agreements" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Trademark License Agreement"	the trademark license agreement entered into between the Company, IBM and a subsidiary of IBM on 7 December 2004, details of which are set out in the sub-section entitled "Intellectual Property Agreements" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"Transition Services"	collectively, the transition services set forth in or contemplated by the TSA Service Description Attachments
"Transition Services Agreement"	the transition services agreement entered into between the Company and IBM on 7 December 2004, details of which are set out in the sub-section entitled "Transition Services Agreement" under the section entitled "Ancillary Agreements" in the letter from the Board contained in this circular
"TSA Service Description Attachment"	each of the attachments to the Transition Services Agreement which sets forth the Transition Services
"USA"	the United States of America
"US GAAP"	accounting principles that are generally accepted in the USA
"US$"	United States Dollar, the lawful currency of the USA
"Voting Agreement"	the voting agreement entered into between the Major Shareholder and IBM on 7 December 2004

This circular contains translation between HK$ and US$ at HK$7.8 = US$1. The translation shall not be taken as a representation that the HK$ amount could actually be converted into US$ at that rate, or at all.

lenovo联想

Lenovo Group Limited 聯想集團有限公司

(Incorporated in Hong Kong with limited liability)

(Stock Code: 992)

Executive Directors:
Mr Liu Chuanzhi
Mr Yang Yuanqing
Ms Ma Xuezheng

Non-executive Director:
Mr Zeng Maochao

Independent Non-executive Directors:
Mr Wong Wai Ming
Professor Woo Chia-Wei
Mr Ting Lee Sen

Registered office:
23rd Floor, Lincoln House,
Taikoo Place, 979 King's Road,
Quarry Bay,
Hong Kong

31 December 2004

VERY SUBSTANTIAL ACQUISITION RELATING TO THE PERSONAL COMPUTER BUSINESS OF INTERNATIONAL BUSINESS MACHINES CORPORATION AND CONTINUING CONNECTED TRANSACTIONS

To the Shareholders

Dear Sir or Madam,

INTRODUCTION

Reference is made to the Announcement and the subsequent announcements of the Company dated 10 and 28 December 2004 respectively relating to, among other things, the entering into of the Asset Purchase Agreement and the Continuing Connected Transactions.

Pursuant to the Asset Acquisition, the Company will acquire from IBM certain assets and assume certain liabilities in connection with the Business. The consideration to be paid by the Company is US$1.25 billion (approximately HK$9.75 billion), subject to certain adjustments (details of which are contained in the sub-section entitled "Consideration" under the section entitled "Asset Purchase Agreement" below). The Company will be required to pay a cash consideration of US$650 million (approximately HK$5.07 billion) (subject to adjustments) and issue up to 821,234,569 new Shares and up to 921,636,459 new Non-voting Shares in each case, credited as fully paid to IBM at the Issue Price.

As a result of the issuance in full of such new Shares and Non-voting Shares, IBM will hold up to approximately 9.9% (comprising Shares only) of the enlarged issued share capital (comprising Shares only) and up to approximately 18.9% (comprising Shares and Non-voting Shares) of the total enlarged issued share capital (comprising Shares and Non-voting Shares), in each case, of the Company immediately following the Initial Closing. This will not result in any change of control of the Company. Notwithstanding this, the Stock Exchange has deemed IBM as a connected person under the Listing Rules upon the Initial Closing.

The obligations of the Company and IBM under the Asset Purchase Agreement are subject to the fulfilment of the Conditions Precedent.

The Company and IBM have entered into the Company Agreement relating to IBM's shareholding in the Company which will become effective from the Initial Closing.

Pursuant to the Asset Purchase Agreement, the Company and IBM entered into various Ancillary Agreements pursuant to which IBM will, among other things, provide a broad range of transition services to the Lenovo Group to assist the Lenovo Group in conducting the Business following the Initial Closing. The Ancillary Agreements will become effective from the Initial Closing. Since the Stock Exchange has deemed IBM as a connected person upon the Initial Closing under the Listing Rules, the transactions underlying the Ancillary Agreements will constitute continuing connected transactions of the Company under the Listing Rules. The Independent Board Committee, constituted by Mr Wong Wai Ming, Professor Woo Chia-Wei and Mr Ting Lee Sen, being the independent non-executive Directors, has been established to advise the Independent Shareholders in respect of the Continuing Connected Transactions. Cazenove Asia has been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders and a copy of its letter is set out on pages 62 to 101 of this circular.

The Business recorded revenue of US$9,566 million in the latest financial year ended 31 December 2003 under US GAAP. The amount was approximately 322% of the Lenovo Group's revenue of HK$23,176 million (approximately US$2,971 million) for the financial year ended 31 March 2004. Accordingly, the Asset Acquisition constitutes a very substantial acquisition of the Company under Rule 14.08 of the Listing Rules and requires the approval of the Independent Shareholders at the Extraordinary General Meeting.

The main purposes of this circular are:

(a) to provide you with further information relating to the Asset Purchase Agreement, the Company Agreement, the Ancillary Agreements as well as the Continuing Connected Transactions;

(b) to set out the letter of advice from Cazenove Asia to the Independent Board Committee and the Independent Shareholders and the recommendation and opinion of the Independent Board Committee as advised by Cazenove Asia in relation to the Continuing Connected Transactions; and

(c) to give you notice of the Extraordinary General Meeting to consider and, if thought fit, to approve, among other things, the Asset Acquisition and the Continuing Connected Transactions.

To the best knowledge, information and belief of the Directors, and having made all reasonable enquiries, IBM and its holding company are third parties independent of the Company and any connected persons of the Company.

The Directors are of the view and confirm that the Major Shareholder does not have any interest in the transactions mentioned in this circular which is different from the interest of the other Shareholders.

ASSET PURCHASE AGREEMENT

Date

7 December 2004

Parties

IBM as the seller and the Company as the purchaser

Assets to be acquired and liabilities to be assumed by the Company

The Acquired Assets include, among others, the following, as more specifically set forth in the Asset Purchase Agreement:

(a) certain tangible property that is shared by the Business and another retained business of IBM only to the extent provided in the Asset Purchase Agreement, the personal equipment primarily used or held for use by covered employees of the Business in the conduct of the Business as well as all computer hardware, machinery, tools, equipment, fixtures, vehicles, spare parts and other tangible personal property, which are now, or at the time of the applicable Closing will be, used or held for use exclusively in the Business;

(b) all inventory of Products and work in process for the Products used or held for use in the Business;

(c) all accounts receivable constituting the right to receive payments in respect of goods delivered or services provided by the Business, but excluding all receivables sold to IGF;

(d) the Acquired Intellectual Property;

(e) certain real property leases, certain customer contracts, and other agreements, leases, purchase orders or other commitments exclusively related to the Business;

(f) goodwill relating to or arising from the Business;

(g) books and records used or held for use exclusively in the conduct of the Business and copies of records that are not exclusively related to, but are required to operate, the Business;

(h) all permits used exclusively in the conduct of the Business; and

(i) all rights of IBM or its affiliates to the extent such rights relate to warranties, enhanced warranties and maintenance obligations relating to Products sold and shipped by the Business from and after the Initial Closing.

In relation to the Chinese Business Unit, IBM proposes to effect a restructuring of the shareholding and a restructuring of the business of such unit. It is currently contemplated that, upon completion of such restructurings, IBM will then transfer its interest in the Chinese Business Unit to the Company. The consideration for this transfer has already been reflected in the consideration payable by the Company under the Asset Purchase Agreement.

The Acquired Assets shall exclude, among others, the following, as more specifically set forth in the Asset Purchase Agreement:

(i) cash and cash equivalents held by the Business as at the applicable Closing, other than assets of an employee benefits plan being transferred to the Company and sale and insurance proceeds for assets of the Business to the extent provided in the Asset Purchase Agreement;

(ii) inter-company receivables due from IBM or its affiliates;

(iii) except for the rights granted pursuant to the Trademark License Agreement, rights to the "IBM" name or logo or any derivation thereof or any rights to use "Think";

(iv) assets used or held for use in the Business relating to or arising from financing services, maintenance and warranty services, any other Global Services, disposal services or the retail stores solutions businesses;

(v) all rights to tax refunds, offsets, deductions and other tax attributes or credits to the extent attributable to a taxable period or portion before the Initial Closing or to a transfer tax for which IBM is responsible and rights to refunds of custom duties and fees to the extent relating to or arising from customs entries made before the Initial Closing in each case subject to the Asset Purchase Agreement;

(vi) all products other than the Products and all assets related to the business of designing, developing, manufacturing, marketing or selling any products other than the Products;

(vii) all assets related to research and development performed by IBM, including its research division, other than tangible property used exclusively in the research and development projects that are exclusively related to the Business; and

(viii) assets related to the Korean Joint Venture, including IBM's equity interest in the Korean Joint Venture and all the assets of the Korean Joint Venture.

The Company will assume, among others, the following Assumed Liabilities as of the applicable Closing, as more specifically set forth in the Asset Purchase Agreement:

(a) all liabilities, including environmental liabilities, arising from the conduct or operation of the Business and the ownership of the Acquired Assets from and after the applicable Closing;

(b) the liabilities under the contracts assigned to the Company;

(c) the assumed accounts payable constituting the obligation to make payments in respect of goods and services received by the Business and all accounts payable that are solely among IBM and its subsidiaries (i.e., subsidiaries being formed by IBM pursuant to a restructuring which will own the Acquired Assets and the Assumed Liabilities that will be transferred to the Company upon the Initial Closing); and

(d) all liabilities based on any defect in the design, manufacture, quality, conformity to specification or fitness for purpose of any Product sold and shipped by the Business from and after the Initial Closing.

The following liabilities, among others, shall be excluded from the Assumed Liabilities, as more specifically set forth in the Asset Purchase Agreement:

(i) the liabilities to the extent relating to or arising from the Excluded Assets;

(ii) all warranty, enhanced warranty and maintenance obligations relating to or arising from the Products sold or shipped by the Business prior to the Initial Closing;

(iii) all liabilities to the extent relating to or arising from any defect in the design, manufacture, quality, conformity to specification or fitness for purpose of any Product sold and shipped by the Business prior to the Initial Closing;

(iv) all liabilities under the contracts that are being assigned to the Company to the extent relating to or arising from the conduct or operation of the Business or the ownership of the Acquired Assets prior to the applicable Closing, including all such liabilities to the extent actually relating to or arising from any breach, default or failure to perform, or any overcharge or underpayment;

(v) all liabilities relating to environmental conditions existing prior to the Initial Closing, to the extent set forth in the Asset Purchase Agreement;

(vi) all liabilities, to the extent relating to or arising from the conduct or operation of the Business or the ownership of the Acquired Assets prior to the applicable Closing that the Company is not required to assume; and

(vii) all inter-company liabilities owed to IBM or its affiliates.

As of 30 June 2004, the unaudited pro forma net book value of the Acquired Assets and Assumed Liabilities under US GAAP, as stated in the Asset Purchase Agreement, was approximately negative US$680 million, which comprises Acquired Assets of US$935 million and Assumed Liabilities of US$1,615 million. The unaudited pro forma net book value of the Acquired Assets and Assumed Liabilities under US GAAP is arrived at using the net book value of the Business as at 30 June 2004 as per the audited US GAAP combined financial statements of US$975 million (which comprises total assets of US$1,534 million and total liabilities of US$2,509 million), and adjusted by certain assets and liabilities not to be acquired or assumed by the Group pursuant to the Asset Purchase Agreement as if the Asset Purchase Agreement was completed as at 30 June 2004.

The statement that reconciles the audited net book value of the total assets and total liabilities of the Business as at 30 June 2004 to the unaudited pro forma net book value of the Acquired Assets and Assumed Liabilities under US GAAP as of 30 June 2004 is disclosed in Appendix IV of this circular. The negative net book value of the Acquired Assets and Assumed Liabilities reflects the working capital deficit under which the Business has been operating in the three financial years ended 31 December 2003 and the six months ended 30 June 2004 as a result of the effective use of channel financing and leasing arrangements through IGF. The Business has been able to realize cash from a large portion of its revenue expeditiously, compared with the average turnover of accounts payable.

The net revenue and results of the Business for the six months ended 30 June 2004 and each of the two years ended 31 December 2003 and 2002 under US GAAP, extracted from the audited financial statements of the Business as set out in Appendix I to this circular, are as follows:

	Six months ended 30 June 2004	Financial year ended 31 December 2003	Financial year ended 31 December 2002
	US$ million	*US$ million*	*US$ million*
Net revenue	5,217	9,566	9,237
Loss before taxation and minority interests	44	117	68
Provision for income taxes	74	115	86
Minority interests	21	26	17
Net loss	139	258	171

In addition to the financial information of the Business as disclosed above, for illustrative purpose, the unaudited pro forma net revenue and results of the Business for the six months ended 30 June 2004 and the year ended 31 December 2003 under US GAAP, which are extracted from the unaudited financial information of the Enlarged Group as set out in Appendix IV to this circular, are set out below. As this financial information is for illustrative purpose only and because of its nature, it may not give a true picture of the net revenue and results of the Business for any future financial periods.

	After pro forma adjustments and under US GAAP		After pro forma adjustments and under HK GAAP	
	Six months ended 30 June 2004	Financial year ended 31 December 2003	Six months ended 30 June 2004	Financial year ended 31 December 2003
	US$ million (unaudited)	*US$ million (unaudited)*	*US$ million (unaudited)*	*US$ million (unaudited)*
Net revenue	5,217	9,566	5,217	9,566
Loss before taxation and minority interests	34	95	31	92
Provision for income taxes	74	115	74	115
Minority interests	21	26	21	26
Net loss	129	236	126	233

Recent financial performance of the Business has been adversely affected by exceptionally high warranty expenses for the financial year ended 31 December 2003 and the six months ended 30 June 2004, due to certain Personal Computer products with problematic components produced and sold previously. The warranty costs charged to the cost of sales of the Business for each of the three years ended 31 December 2001, 2002 and 2003 and each of the six months ended 30 June 2003 and 2004 amounted to approximately US$452 million, US$430 million, US$586 million, US$226 million and US$365 million, respectively. The Business estimated the warranty costs based on historical warranty claim experience for eligible products under warranty. The relevant percentages of the warranty cost to the net revenue of the Business for each of the three years ended 31 December 2001, 2002 and 2003 and each of the six months ended 30 June 2003 and 2004 were approximately 4.5%, 4.7%, 6.1%, 5.3% and 7.0%, respectively. The Business has stopped the production of systems with the previously identified problematic components. Pursuant to the Asset Purchase Agreement, IBM will bear all the warranty expenses in the future in relation to such component problems that have been identified with respect to certain Personal Computer products, and the Company will not assume any of the warranty, enhanced warranty and maintenance obligations relating to or arising from the Products sold and shipped by the Business prior to the Initial Closing. In addition, IBM has agreed to reimburse the Company, subject to a maximum of US$100 million in aggregate, for the costs incurred by the Company or its subsidiaries in performing standard warranty obligations in respect of desktop and notebook computers shipped by the Company or its subsidiaries in the first two years after the Initial Closing, to the extent the level of defects requiring warranty services exceeds specified target levels and the product design and components of such Products were qualified by IBM or its affiliates before the Initial Closing and have not been modified by the Company.

There was no extraordinary gain or loss recorded by the Business for the two financial years ended 31 December 2003.

Consideration

The Asset Purchase Agreement was negotiated and entered into on an arm's length basis and on normal commercial terms. The consideration to be paid by the Company under the Asset Purchase Agreement is US$1.25 billion (approximately HK$9.75 billion), subject to certain adjustments (discussed in the following two paragraphs), and will be satisfied at the Initial Closing by the payment by the Company of the Cash Consideration of US$650 million, and the balance of the consideration of US$600 million to be satisfied by the allotment and issuance of up to 821,234,569 new Shares and up to 921,636,459 new Non-voting Shares as Consideration Shares, credited as fully paid and free and clear of encumbrances, by the Company to IBM at the Issue Price. The Consideration Shares can be divided into 1,307,153,271 Base Consideration Shares and up to 435,717,757 Excess Shares for the purposes of the lock-up provisions contained in the Company Agreement. The numbers of Shares and Non-voting Shares comprising the Base Consideration Shares and the Excess Shares will be determined upon Initial Closing. Further details of the lock-up provisions are set out in the paragraph entitled "the Company Agreement" below. The Excess Shares represent the additional Consideration Shares that IBM has agreed to take up as part of the consideration for the Asset Acquisition. However, the Company may pay IBM HK$2.675 in cash for each Excess Share instead of issuing all the Excess Shares at the Initial Closing.

Pursuant to the terms of the Asset Purchase Agreement, the amount of the adjustment to the consideration will be determined by subtracting target net working capital from actual net working capital. It is not possible to deduce the "target net working capital" at this time. It will be determined based on the historical patterns of the relationship between (a) accounts receivable, inventory and accounts payable, and (b) revenue, in each case, of the Business. A further public announcement will be made by the Company in relation to the "target net working capital" amount and the amount of the adjustment to the consideration once these amounts are determined. Such determination will take place around 150 days after the date of the Initial Closing.

If the adjustment amount is less than zero by an amount in excess of US$25 million, IBM will pay the Company (by wire transfer in immediately available funds) an amount equal to the adjustment amount minus US$15 million. If the adjustment amount is greater than zero by an amount in excess of US$25 million, the Company will pay IBM (by wire transfer in immediately available funds) an amount equal to the adjustment amount minus US$15 million.

The consideration has been determined based on various factors, including the historical revenue contribution of the Business to the Enlarged Group, the scope and the quality of the Acquired Assets, the growth prospects of the Business, earnings potential and synergy opportunity with the Company, the scope and nature of the Assumed Liabilities, terms of various commercial agreements being entered into and other relevant valuation benchmarks. The Directors consider that the terms of the Asset Purchase Agreement and the Ancillary Agreements are fair and reasonable so far as the Company and the Shareholders as a whole are concerned. An application will be made by the Company to the Stock Exchange for the listing of, and permission to deal in the Shares to be issued to IBM on Initial Closing as well as the Shares to be issued upon conversion of the Non-voting Shares.

The Issue Price is equal to HK$2.675, being the closing price of the Shares on the last trading day prior to the date of the Announcement and represents:

(a) a discount of approximately 0.19% to HK$2.68, the average closing price of the Shares on the Stock Exchange for the last 5 full trading days prior to the suspension of trading in the Shares prior to the date of the Announcement;

(b) a premium of approximately 1.04% over HK$2.6475, the average closing price of the Shares on the Stock Exchange for the last 10 full trading days prior to the suspension of trading in the Shares prior to the date of the Announcement;

(c) a discount of approximately 2.64% to HK$2.7475, the average closing price of the Shares on the Stock Exchange for the last 30 full trading days prior to the suspension of trading in the Shares prior to the date of the Announcement;

(d) a premium of approximately 361% over the latest unaudited consolidated net tangible assets of the Lenovo Group of approximately HK$0.58 per Share as at 30 September 2004; and

(e) a premium of approximately 8.1% over HK$2.475, the closing price of the Shares on the Stock Exchange as at the Latest Practicable Date.

The Consideration Shares will represent: (a) approximately 23.3% of the total issued share capital (comparing Shares only) of the Company immediately prior to the Initial Closing; and (b) approximately 18.9% of the total issued share capital (comparing Shares and Non-voting Shares) of the Company upon the Initial Closing.

Bridge Loan

The Asset Acquisition will be financed by internal resources (approximately US$150 million) and by third party borrowings. The Company has received a bridge financing commitment letter from Goldman Sachs Credit Partners L.P. for up to US$500 million. This Bridge Loan, if taken out, will be secured and carry interest at around United States base rate plus 2% per annum and will need to be repaid within two years.

However, the Company is in discussions with other financial institutions regarding permanent financing facilities which the Company is attempting to have available by the time of the Initial Closing and would utilize in lieu of drawing down the Bridge Loan. The Company targets to enter into a five-year term loan agreement with such financial institutions and expects the interest rate to be around 1% to 1.2% over the LIBOR or swap rate per annum.

Conditions Precedent for the Closings

The Closings are subject to the satisfaction of certain Conditions Precedent.

The respective obligations of each of the Company and IBM to effect the Initial Closing are subject to the satisfaction or waiver of of the following Conditions Precedent:

(a) the Asset Acquisition and the Continuing Connected Transactions having been approved by the Independent Shareholders at the Extraordinary General Meeting;

(b) the Listing Committee having granted the listing of, and the permission to deal in, the Shares to be issued to IBM upon Initial Closing and the Shares to be issued upon conversion of the Non-voting Shares;

(c) clearance with respect to the transactions contemplated under the Asset Purchase Agreement having been obtained from the Committee on Foreign Investment in the United States, the waiting periods under the HSR Act and Japanese anti-monopoly law having expired or been terminated and all material consents and approvals of the relevant government authorities having been obtained; and

(d) no statute, rule, regulation, order, decree or injunction that would prohibit or render unlawful consummation of the transfer of the Business in the Initial Closing Countries shall be in effect and there shall be no proceedings brought (and still pending) by any government authority that is reasonably likely to prohibit or render unlawful the consummation of the Initial Closing.

The obligations of the Company to effect the Initial Closing are further subject to the satisfaction or waiver of the following Conditions Precedent:

(i) each of the representations and warranties made by IBM that is qualified by reference to materiality or material adverse effect on the Business is true and correct and all other representations and warranties are true and correct in all material respects;

(ii) IBM has performed and complied in all material respects with each agreement, covenant and obligation required by the Asset Purchase Agreement and the Employee Matters Agreement to be performed at or before the Initial Closing;

(iii) no change, event, circumstance or effect which has had, or is reasonably likely to have, a material adverse effect on the Business has occurred;

(iv) all covered permits material to the Business and required in connection with the operation of the Business in the Initial Closing Countries have been obtained; and

(v) an officer's certificate from IBM has been delivered to the Company confirming that the Conditions Precedent set forth in paragraphs (i) and (ii) above have been satisfied.

The obligations of IBM to effect the Initial Closing are further subject to the satisfaction or waiver of the following Conditions Precedent:

(1) each of the representations and warranties made by the Company that is qualified by reference to materiality or material adverse effect on the Group is true and correct and all other representations and warranties are true and correct in all material respects;

(2) the Company has performed and complied in all material respects with each agreement, covenant and obligation required by the Asset Purchase Agreement and the Employee Matters Agreement to be performed at or before the Initial Closing;

(3) no change, event, circumstance or effect which has had, or is reasonably likely to have, a material adverse effect on the Group has occurred; and

(4) an officer's certificate from the Company has been delivered to IBM confirming that the Conditions Precedent set forth in paragraphs (1) and (2) above have been satisfied.

Multiple Closing Arrangements

The Initial Closing will take place on the first day that is both (i) at least 5 Business Days following the satisfaction or waiver of all the Conditions Precedent and (ii) the first Business Day on or following the last calendar day of the month in which such Conditions Precedent are satisfied or waived (or at such other time as the Company and IBM may mutually agree). In the event that the Initial Closing does not occur on or before the first anniversary of the signing of the Asset Purchase Agreement, either party may terminate the Asset Purchase Agreement.

With respect to the Remaining Assets which have not been transferred to the Company at the Initial Closing because the required authorizations, consents or approvals have not been obtained from the relevant government authorities, subject to applicable law, IBM shall run the part of the Business and administer the Remaining Assets at the direction of and for the sole benefit of the Company until such time as the required authorizations, consents or approvals have been obtained from the relevant government authorities. From the Initial Closing to the applicable Closing, IBM and the Company agree to make appropriate adjustments or arrangements to transfer from IBM any net profits or net losses attributable to such Remaining Assets to be taken up by the Company, which adjustment shall be undertaken using retrospective profit and loss data. Nothing in such adjustment process shall entitle IBM to directly or indirectly influence determination of its sales pricing for product distribution in the countries where such Remaining Assets are located.

The Company and IBM will effect the transfer of the Remaining Assets from time to time at one or more Subsequent Closings as agreed between them provided that:

(a) no statute, rule, regulation, order, decree or injunction that would prohibit or render unlawful the consummation of the transfer of the Remaining Assets shall be in effect and there is no proceeding brought by any governmental authority that is reasonably likely to prohibit or render unlawful the consummation of the applicable Closing;

(b) all material consents and approvals of the relevant government authorities necessary for such subsequent Closing have been obtained; and

(c) all permits material to the Business and that are required in connection with the operation of the Business by the business unit to which such applicable Closing relates have been obtained.

The Asset Purchase Agreement further provides that if the arrangements described above are prohibited by law or impracticable, the parties will agree to a good faith allocation of the consideration to the assets transferred at the Initial Closing and the remaining consideration will be payable when the Remaining Assets in relation to a particular business unit are transferred. The Company's tax advisers have confirmed that the details of how the relevant assets will be transferred at Subsequent Closings have not yet been finalized by the Company and IBM's tax teams and the amount, currency and settlement method used would likely be influenced by future discussions on that issue, and such discussions will be completed prior to the applicable Closing. A public announcement will be made by the Company in the event that the relevant amount, currency and settlement method has a material impact on the consideration to be paid by the Company to IBM or the financial position of the Enlarged Group.

Non-compete Undertakings

From the Initial Closing until the fifth anniversary of the Initial Closing, IBM agrees and undertakes with the Company, subject to certain limitations and exceptions, that it will not, and will cause its existing and future subsidiaries not to, directly or indirectly anywhere in the world engage in: (A) the manufacture of Personal Computers; (B) the sale of Personal Computers; or (C) the license, sub-license or other grant to any third party of the right to use the IBM logo on Personal Computers as a primary or shared product name; provided that on and after the third anniversary of the Initial Closing, the term "Personal Computers" shall not include "thin clients".

Goodwill Deposit

On 8 December 2004, the Company paid IBM the Goodwill Deposit. The Goodwill Deposit accrues interest at the rate of 2.56% per annum from the date it was received by IBM. At the Initial Closing, the Goodwill Deposit, together with accrued interest thereon, will be credited towards the payment of the Cash Consideration.

IBM shall retain the Goodwill Deposit in the event that certain agreed PRC authorities take any affirmative action prohibiting the consummation of the transactions contemplated by the Asset Purchase Agreement or implement any laws that will render the transactions contemplated by the Asset Purchase Agreement unlawful. If the Initial Closing does not occur for any other reason, IBM shall refund the Goodwill Deposit, together with accrued interest, to the Company.

COMPANY AGREEMENT

Date

7 December 2004

Parties

The Company and IBM

Undertakings

IBM undertakes not to, without the prior written consent of the Board, transfer any of the Excess Shares for a period of six months following the Initial Closing or transfer any of the Base Consideration Shares for a period of up to three years following the Initial Closing, except to the extent permitted by the Company Agreement. IBM may transfer up to such percentage of the Base Consideration Shares equal to the greater of:

(a) the percentage determined by dividing the number of Shares disposed of by the Major Shareholder during the period between the Extraordinary General Meeting and up to the date of the relevant transfer by the total number of Shares held by the Major Shareholder on the date of the Extraordinary General Meeting; and

(b) the following applicable percentage or fraction of the Base Consideration Shares as at the relevant time:

Period	Percentage/ fraction
Until the first anniversary of the Initial Closing	0%
From the day after the first anniversary of the Initial Closing	One-third ($^{1}/_{3}$)
From the day after the second anniversary of the Initial Closing	Two-thirds ($^{2}/_{3}$)
After the third anniversary of the Initial Closing	100%

These transfer restrictions do not apply to a transfer by IBM of the Consideration Shares to any of its affiliates or a transfer of such number of the Consideration Shares necessary to enable IBM to qualify for the cost method of accounting under US GAAP with respect to its holding of the Consideration Shares. The Excess Shares represent the additional Consideration Shares that IBM has agreed to take up as part of the consideration for the Asset Acquisition. However, the Company may pay cash to IBM instead of issuing all of the Excess Shares at the Initial Closing.

IBM undertakes to the Company not to purchase any additional Shares that would result in the holdings of the Shares by the public for the purposes of the Listing Rules falling below 25% of the total outstanding Shares (or such other percentage as is required of the Company under the Listing Rules to maintain the minimum public float).

Until IBM has sold all of the Excess Shares, the Company may not issue any new Shares except for the purpose of repaying the Bridge Loan arranged by Goldman Sachs Credit Partners L.P.. The Company agrees to use its reasonable best efforts to arrange for the sale of the Excess Shares to one or more third parties at a price per Excess Share (the "**Offer Price**") not less than the higher of (i) the then prevailing market price per Share, and (ii) the Issue Price. Subject to any applicable laws and regulations, the Company may offer to repurchase (provided that any outstanding amount under the Bridge Loan arranged by Goldman Sachs Credit Partners L.P. has been repaid in full), or offer IBM the opportunity to sell to third parties, any of the Excess Shares at the Offer Price. If IBM does not accept such an offer, the restriction on the Company to issue new Shares is lifted to the extent that IBM has declined the offer and the Company may issue such number of shares not more than the number of Excess Shares which the Company has offered to repurchase from IBM or the Company has offered IBM the opportunity to sell, at a price not higher than the Offer Price. In that event, IBM will be deemed to have sold the equivalent number of Excess Shares equal to the number of new Shares issued by the Company. When all Excess Shares are sold or deemed to be sold, the restriction on the Company to issue new Shares cease to apply.

In order to enable IBM to maintain its percentage level of shareholding in the Company, subject to applicable laws and regulations, IBM has the right of first refusal in any subsequent new issue of shares by the Company. IBM will have the right to subscribe for such number of additional shares upon the same terms and conditions as the Company issues shares to a third party, so that following such issue, IBM's percentage shareholding in the Company will remain the same as its percentage shareholding in the Company immediately before such issue. IBM may not subscribe for any new Shares if following such subscription, the holdings of the Shares by the public would fall below the minimum public float requirements under the Listing Rules. If IBM elects to subscribe for additional shares, IBM will be subscribing for Shares and Non-voting Shares in the same proportion to its holdings of the Shares and Non-voting Shares immediately prior to such issue. Alternatively, in a new issue of shares by the Company, IBM may participate in such new issue by tagging-along and requiring the Company to sell a pro-rated number of the Consideration Shares to the same transferee at the same price and on the same terms as the Company issues any new shares.

Until the later of the date that the Trademark License Agreement is terminated pursuant to its terms and the date that IBM ceases to hold 5% or more of the outstanding issued share capital of the Company, IBM may designate an observer to be present at all meetings of the Board and any committee of the Board. The observer will not be a Director and accordingly will have no right to vote and may not exercise any other rights of a Director at such meetings. The purpose of appointing a board observer is to ensure co-ordination of the strategic relationship between IBM and the Company. IBM will not appoint any Director.

The Company Agreement provides that the board observer shall maintain all information obtained from the Board confidential and shall observe all internal guidelines of the Company applicable to the Directors and insider dealing rules including the SFO and the Model Code for Securities Transactions by Directors of Listed Issuers under the Listing Rules. The Board may withhold information from the board observer if there is a potential conflict of interests. In the event of a breach of confidentiality by the board observer, the Company may bring legal action against IBM including seeking a court order of specific performance to prevent the board observer from any unauthorized disclosure of confidential material. With the confidentiality protection afforded by the provisions of the Company Agreement, the Board believes that the participation of a board observer from IBM should be beneficial to the Company as the board observer would bring valuable expertise and management experience in the global information technology industry to the Company.

Rights and Restrictions attached to the Non-voting Shares

Ranking

The Non-voting Shares shall rank *pari passu* in all respects with the Shares, except for voting rights.

Voting Rights

The Non-voting Shares will not have any voting rights at all general meetings of the Company.

Transferability

The Non-voting Shares are subject to the lock-up provisions set out in the Company Agreement and upon the expiry of such lock-ups, the Non-voting Shares are transferable. Save as otherwise disclosed, there are no restrictions on the transfer of the Non-voting Shares.

Subject to the relevant lock-up restrictions, if IBM intends to transfer its Non-voting Shares other than to its affiliates, it shall be a condition for such transfer that the transferee will request the Company to convert the Non-voting Shares into Shares immediately following the transfer.

Conversion

The Non-voting Shares are convertible, by the holder thereof giving written notice to the Company, into Shares on a one for one basis, subject to any adjustments as a result of any consolidation or sub-division of the Shares. There is not a defined period during which the Non-voting Shares must be converted.

No conversion of the Non-voting Shares shall be permitted if following such conversion the holder of the Non-voting Shares would become a substantial shareholder (as defined in the Listing Rules) of the Company immediately following such conversion.

IBM may not convert any Non-voting Shares if such conversion would reduce the holdings of Shares of persons who count as members of the public for the purposes of the Listing Rules falling below 25% of the total outstanding Shares (or such other percentage as is required of the Company under the Listing Rules to maintain the minimum public float). The Company will ensure that upon the conversion of any Non-voting Shares into Shares, the minimum public float requirements under Rule 13.32 of the Listing Rules are observed.

A further public announcement will be made by the Company in case IBM or the holder of the Non-voting Shares exercises its right to convert any Non-voting Shares.

Listing

The Non-voting Shares will not be listed.

Others

With respect to any bonus, capitalization, rights or similar issues of additional securities of the Company which all the shareholders, including holders of Shares and Non-voting Shares, are entitled to participate in or benefit from (by virtue of their being shareholders in the Company) in proportion to their shareholding, whether for any consideration or for no consideration payable by such Shareholders, any additional securities to be issued to the holder of Non-voting Shares under such issues shall be Non-voting Shares.

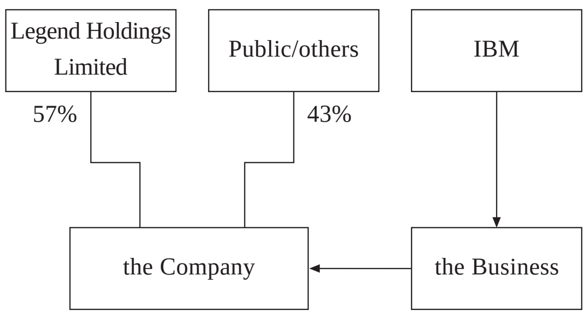
Term

Save as otherwise provided in the Company Agreement, the Company Agreement terminates upon all the Consideration Shares being free from the lock-up restrictions under the Company Agreement or such time as IBM and its affiliates hold less than 3% of the outstanding issued share capital of the Company, whichever is the later.

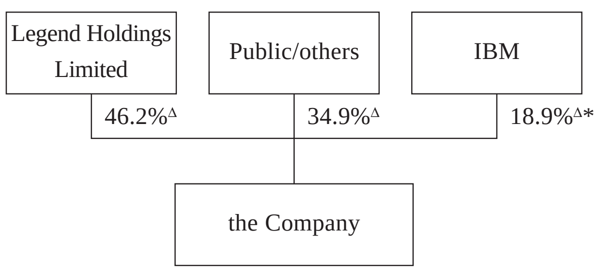
CORPORATE STRUCTURE BEFORE AND AFTER INITIAL CLOSING

The corporate structures of the Company as at the Latest Practicable Date and immediately after the Initial Closing are as follows:

As at the Latest Practicable Date



Immediately after Initial Closing



△ *represents percentage of total issued capital (comprising Shares and Non-voting Shares) only, and assuming the Consideration Shares are issued in full*

* *out of this 18.9%, 8.9% represents Shares with voting rights and 10.0% represents Non-voting Shares*

The shareholding position of the Company immediately after the Initial Closing (assuming the Consideration Shares are issued in full) will be as follows:

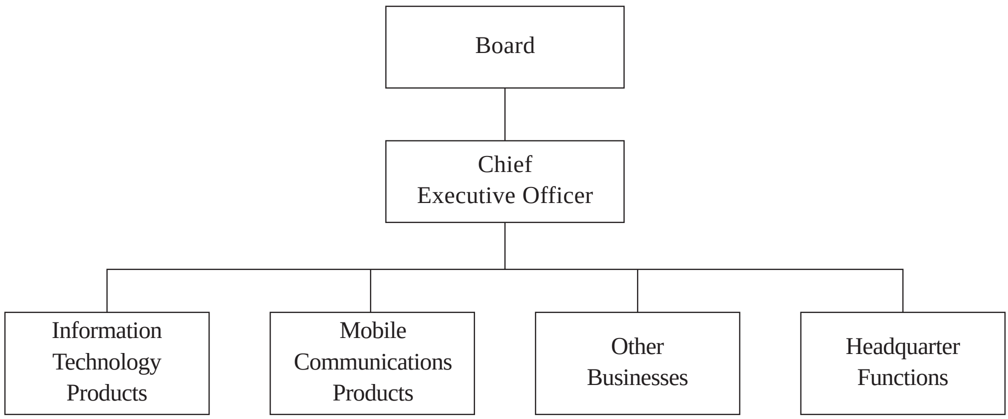
Shareholder	% of Shares held	% of Non-voting Shares held	% of total issued capital held
Legend Holdings Limited	51.3%	0%	46.2%
Directors and their associates	0.7%	0%	0.6%
Public	38.1%	0%	34.3%
IBM	9.9%	100%	18.9%
Total	100%	100%	100%

Despite the fact that IBM will hold only 9.9% of the Shares upon the Initial Closing, the Stock Exchange has deemed IBM as a connected person upon the Initial Closing under the Listing Rules.

FUNCTIONAL STRUCTURE BEFORE AND AFTER INITIAL CLOSING

Simplified current functional structure of the Lenovo Group

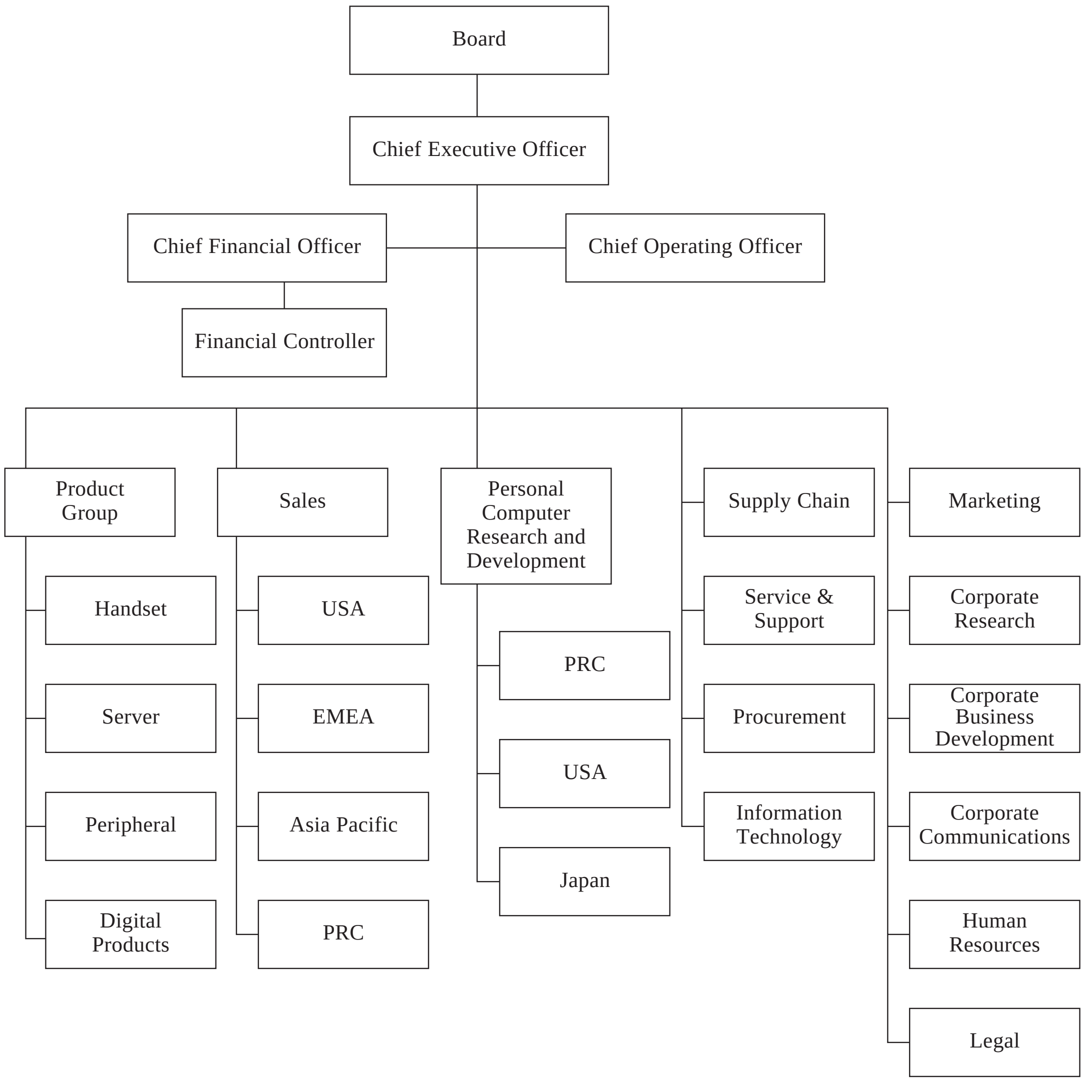
The functional structure of the Lenovo Group as at the date of this circular is as follows:



It is intended that during a transitional period after the Initial Closing, the Company's current operations and the Business' operations will largely remain separate to minimize potential disruption. To capture the potential synergies, the Company's existing personal computer business and the Business will be gradually integrated, while the other business lines of the Company will remain separate and be aggregated into a product business group.

In the long term, the integration of the said two Personal Computers businesses will mainly focus on the most synergistic back-end operation functions including integrated supply chain, manufacturing, procurement, service/support as well as research and development, while the front-end regional sales functions will largely remain unchanged except for the PRC sales that will be gradually integrated. Key corporate functions including worldwide finance, worldwide marketing, corporate business development, information technology, human resources and legal, will also be integrated eventually.

Functional structure of the Enlarged Group after Initial Closing



INFORMATION ON THE BUSINESS

Overview

The Business develops, manufactures and markets Personal Computer products including a wide variety of notebook and desktop computers and related peripherals. The Business' target customers are business customers.

The Business is headquartered in the city of Raleigh, in the state of North Carolina of the USA. It has a global presence, is active in over 160 countries and employs more than 9,500 employees worldwide.

In 2003, based on the US GAAP financial information of the Business, the Business generated revenues of US$9,566 million, representing an increase of 3.6% over 2002, with a gross profit of US$961 million. As at 31 December 2003, the Business had total assets of US$1,458 million and total liabilities of US$2,449 million.

Products

The Business' mobile notebook computer series, termed "ThinkPad", includes a range of products designed to meet users' needs such as portability, speed, networking and battery life. The ThinkPad laptops feature rugged designs and proprietary software, such as for immediate data recovery, intended to meet the needs of business users.

The Business' "ThinkCentre" desktop computers feature designs for durability and serviceability supporting new technologies at various price points. The Business also offers computer accessories such as monitors, keyboards, mice and other components.

History and development of the Business

IBM introduced its first Personal Computer in 1981, followed by the introduction of its first portable computer (weighing 30 pounds) in 1984. The first "laptop", weighing in at 12 pounds, was introduced in 1986. In 1992, IBM branded a new line of notebook computers under the "ThinkPad" logo. In 2002, IBM outsourced a significant portion of the Business' desktop Personal Computer manufacturing to Sanmina-SCI Corporation. To date, IBM's "ThinkPad" notebook series has been the best-selling notebook brand, having sold over 20 million units since its inception.

Sales and marketing

The Business operates through three primary sales/distribution channels including direct/large enterprise customers, distributors and resellers, and Internet/direct order channels. The Business' sales force comprises more than 2,500 sales personnel in over 55 countries.

The Business' business focus is on the commercial marketplace and it targets large enterprises, government and education and medium and small customer segments. The Business utilizes both a direct and indirect sales/distribution channel structure.

Manufacturing

The Business manufactures its notebooks through its Chinese Business Unit. In 1994, the Business entered into a joint venture with a local partner, which led to the construction of a state-of-the-art Personal Computer manufacturing facility in Shenzhen, the PRC, in 2000.

In January 2002, the Business sold certain of its North American and European Net Vista desktop personal computer manufacturing operations to a global electronics manufacturing service provider, Sanmina-SCI Corporation. As part of the sale, Sanmina-SCI Corporation acquired the buildings and equipment of the Business related to desktop manufacturing in North Carolina, the USA and took over the management of the Business' existing outsourcing management contract and acquired manufacturing equipment in Scotland. Along with the sale, the Business entered into a three-year outsourcing agreement with Sanmina-SCI Corporation to manufacture Personal Computers for the Business.

In January 2003, the Business sold additional fixed assets and inventories as well as certain of its mobile personal computer manufacturing operations processes to Sanmina-SCI Corporation.

Purchasing

The Business operates a centralized purchasing function responsible for the selection and management of suppliers, as well as procurement engineering and materials management activities to support the manufacture and fulfillment of Personal Computer products. The purchasing organization has major centers in Raleigh, North Carolina, the USA, Shenzhen and Shanghai, the PRC and Japan, and additional resources co-located with major sources of supply.

The role of the purchasing function is to acquire goods and services efficiently and effectively while providing flexibility in response to market changes. The focus is on the development of long term relationships with key supplier partners to ensure early access to new technologies, continuity of materials supply and competitive prices. As a result, the Business has well established relationships with industry suppliers of Personal Computer components, as well as major ODM and EMS companies.

Inventory management

The Business operates on the general principle of minimizing inventory whenever possible. In the case of outsourced manufacturing, the Business only takes ownership of a product once it leaves a supplier's back dock.

Some customers and fulfillment channels require finished goods to be built in advance of an order being received. Typically these customers or channels require there to be a very fast turnaround of an order, often requiring that the product be shipped the same day. The inventory generated in this way is managed very closely and adjusted on a daily basis in line with updated forecasts. Inventory is managed by the operations teams in the relevant geographical location.

Competition

The Personal Computer industry is highly competitive. The Business currently faces competition primarily from Dell and Hewlett-Packard, as well as Fujitsu, Toshiba, Sony and NEC, among others. This competition has resulted in strong pricing pressure across all products, and desktops in particular.

ANCILLARY AGREEMENTS

Pursuant to the Asset Purchase Agreement, on 7 December 2004, the Company entered into the following Ancillary Agreements and arrangements with IBM, pursuant to which IBM will provide a broad range of services to the Lenovo Group and certain transitional matters will be dealt with.

Since upon the Initial Closing, pursuant to the Listing Rules, IBM will be deemed to be a connected person of the Company by the Stock Exchange, the transactions underlying these agreements and arrangements (except the Employee Matters Agreement) will constitute Continuing Connected Transactions of the Company under Rule 14A.14 of the Listing Rules.

The transactions underlying the Employee Matters Agreement do not constitute continuing connected transactions of the Company under Rule 14A.14 of the Listing Rules. In respect of the transactions underlying Intellectual Property Agreements whilst they constitute Continuing Connected Transactions of the Company, since no monetary consideration is payable thereunder, they fall within the de minimis exemption under Rule 14A.33(3) of the Listing Rules.

The Ancillary Agreements will take effect upon the Initial Closing and will essentially be conditional upon the Initial Closing taking place.

In general, all the services to be provided by IBM under the Ancillary Agreements are of a unique and tailored nature and have been formulated based on the specific circumstances of the Asset Acquisition. While technically speaking, some of these services can be outsourced by the Company to third party providers (other than IBM), the Company believes there are significant advantages in having IBM provide such services because of IBM's expertise and familiarity with the Business as well as the Products.

Transition Services Agreement

Date

7 December 2004

Parties

The Company and IBM

Services to be provided

IBM and its affiliates will provide the Enlarged Group with the Transition Services which will include:

(a) certain finance and account function support services;

(b) certain marketing and sales support services;

(c) general procurement services, such as engineering and office products, building and facilities and information technology;

(d) development services (i.e. translation services for product-related information and publications, product certification services, research and development support services and general engineering services);

(e) services to assist in facilitating certain procurement and sales activities for electronic components and commodities, which are supported from Singapore;

(f) human resource services;

(g) real estate facilities services; and

(h) information technology services.

Each of the Transition Services is documented in a separate TSA Service Description Attachment.

Term and termination

The provision of Transition Services will commence on the Initial Closing and range in duration from 12 to 36 months. The Transition Services Agreement will terminate upon the earlier to occur of: (i) the date on which all of the Transition Services are terminated; and (ii) the last date indicated for the termination of a Transition Service in the TSA Service Description Attachments. The Company may cancel any Transition Service or reduce the amount of any separately priced portion of a Transition Service at any time upon 60 days' prior written notice.

Charges for Transition Services

The amount of charges which the Enlarged Group expects to pay to IBM under the Transition Services Agreement for the first 12 months after the Initial Closing is approximately US$250 million. This amount has been determined by reference to the historical costs paid by the Business as part of its budgeted expense and negotiated on an arm's length basis.

The amounts of such charges are in line with and no less favorable to the Enlarged Group than those charged by IBM internally for the relevant services prior to the Initial Closing.

Annual caps

The Directors expect that the aggregate amount of fees payable under the Transition Services Agreement for each of the three years following the Initial Closing will not exceed US$285 million, US$223 million and US$197 million, respectively.

The said aggregate amounts have been determined based on the historical costs incurred by the Business, and taking into account potential tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% premium to account for any uncertainties.

Strategic Financing and Asset Disposition Services Agreement

Date

7 December 2004

Parties

The Company and IBM

Services to be provided

IBM will provide the Company with the SFAD Services.

Term

The term of the Strategic Financing and Asset Disposition Services Agreement is for a period of five years from respective applicable closing date for the relevant country.

Fees and commissions

Customer Financing Services

For the first calendar year of the term of the Strategic Financing and Asset Disposition Services Agreement, the Company will receive from IBM a commission based on the total invoice prices of the customer financing and lease transactions that are facilitated by the Company. The magnitude of such commission has been determined as a result of arm's length negotiation between the Company and IBM.

The commission payable to the Company by IBM will be adjusted either upwards or downwards depending on total invoice prices of the transactions which take place during the relevant calendar year, with reference to a certain pre-agreed target volume.

IBM has agreed that the commission arrangements and other terms and conditions in this agreement are to be on terms no less favourable to the Enlarged Group than that IBM offered internally to its business units and externally to any other manufacturers of personal computing products prior to the date of the Asset Purchase Agreement.

Annual caps

The Directors expect that the aggregate amount of fees payable by IBM to the Company in relation to the Customer Financing Services under the Strategic Financing and Asset Deposition Services Agreement for each of the five years following the Initial Closing will not exceed US$8 million, US$9 million, US$9 million, US$9 million and US$9 million, respectively.

The said aggregate amounts have been determined based on the agreed upon commission schedule, future business volume, and taking into account potential tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% premium to account for any uncertainties.

Distribution Channel Financing Services

Whenever IBM finances a reseller purchase of inventory from the Company, the Company will be required to pay IBM a fee, being a percentage of the total invoice prices, which is determined as a result of arm's length negotiation between the Company and IBM with reference to, inter alia, interest rates, credit risk of the reseller and administration costs. Either party may initiate a benchmarking exercise to determine the competitiveness of the fees paid to IBM by the Company.

Annual caps

The Directors expect that the aggregate amount of fees payable by the Company to IBM under Distribution Channel Financing Services under the Strategic Financing and Asset Disposition Services Agreement for each of the five years following the Initial Closing will not exceed US$84 million, US$86 million, US$87 million, US$89 million and US$90 million, respectively.

The said aggregate amounts have been determined based on estimated future business volume, and taking into account potential tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% premium to account for any uncertainties.

The consideration to be paid by the Company in relation to Distribution Channel Financing Services will be in line with and not less favourable to the Enlarged Group than that charged internally by IBM prior to the Initial Closing.

Excess Surplus Disposition Services

The consideration payable by IBM to the Company in connection with IBM's purchase of any used personal computing products returned to resellers will be set forth in a price list submitted by IBM to the Company in response to a request for quotation from the Company. Such a price list has been agreed upon by the Company and IBM as a result of arm's length negotiations.

Annual caps

The Directors expect that the aggregate amount of fees payable by IBM to the Company in relation to the Excess Surplus Disposition Services under the Strategic Financing and Asset Disposition Services Agreement for each of the five years following the Initial Closing will not exceed US$58 million, US$60 million, US$61 million, US$62 million and US$63 million, respectively.

The said aggregate amounts have been determined based on estimated future business volume, and taking into account potential tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% premium to account for any uncertainties.

IGS Services Agreement

Date

7 December 2004

Parties

The Company and IBM

Maintenance and Warranty Services

To the extent base warranty services are made available by the Company for its products, the Company has agreed to engage IBM as its preferred service provider to perform such services. In addition, the Company has agreed to engage IBM as its preferred service provider to perform the Company's post-warranty and warranty upgrade services for commercial customers outside the PRC.

Promptly following the Initial Closing, IBM and the Company will negotiate in good faith and enter into a written agreement pursuant to which the Company will provide maintenance and warranty services in the PRC on IBM products sold prior to the Initial Closing. The Company will ensure that the requirements under Rule 14A.35 of the Listing Rules are complied with at the relevant time.

Consideration

The service fees for the first year will be the "best" fees, by each geographical location, that IBM offers for substantially similar services in the same geographical location (including products and delivery terms) in respect of any service provider customer contracts, in each such geographical location, that are the top three closest in volume. Such service fees have been agreed upon between the Company and IBM as a result of arm's length negotiations and are subject to adjustment pursuant to certain benchmarking procedures specified in this agreement.

In addition, the Company and IBM have agreed to certain mutual revenue sharing arrangements generated from the sales of the Company post-warranty and warranty upgrade services as well as IBM's technology deployment services.

Term

The term of this agreement is five years from the Initial Closing, and will automatically extend for additional one-year periods each unless a party gives written notice of termination at least six months prior to the expiration of the then-scheduled expiration of the term.

Annual caps

If the Company engages IBM to perform maintenance and warranty services and in respect of the said revenue sharing arrangements, the Directors expect that the aggregate amount of fees payable by the Company to IBM under the IGS Services Agreement for each of the five years following the Initial Closing will not exceed US$273 million, US$318 million, US$188 million, US$191 million and US$195 million, respectively.

The said aggregate amounts have been determined based on the estimated future business volume, market competitive terms for warranty services, the agreed upon revenue sharing arrangement, and taking into account potential tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% premium to account for any uncertainties.

If the Company refers customers to purchase IBM's technology deployment services, the Directors expect that the aggregate amount of fees payable by IBM to the Company under the IGS Services Agreement for each of the five years following the Initial Closing will not exceed US$15 million, US$15 million, US$15 million, US$16 million and US$16 million, respectively.

The said aggregate amounts have been determined based on the estimated future business volume, the agreed upon revenue sharing arrangement, and taking into account potential tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% premium to account for any uncertainties.

Marketing Support Agreement

Date

7 December 2004

Parties

The Company and IBM

Services to be provided

IBM will provide client team support to the Company to assist the Company in its post-Initial Closing sales coverage of the Company's customers by providing various MSA Services, each of which is documented in a MSA Service Description Attachment. The MSA Services include, inter alia, marketing support services, information technology services, fixed assets accounting and property control administration services (for EMEA and Asia Pacific), customer fulfillment services, sales center services, ledger support services (for EMEA and Asia Pacific), incentives and commissions services, treasury services (for EMEA and Asia Pacific) and transitional tax services (for EMEA and Asia Pacific).

Term and termination

The term of the Marketing Support Agreement is for a period of five years from the Initial Closing.

The provision of MSA Services will commence on the Initial Closing for each business unit covered by the Initial Closing and will terminate one year from the Initial Closing, except that customer fulfillment, fixed assets accounting and property control administration, and ledger support and services will terminate two years from the Initial Closing, information technology services will terminate three years from the Initial Closing and the marketing support services will terminate five years from the Initial Closing. Starting in 2007, the Company may elect to reduce the number of countries in which the Company requires MSA Services from IBM.

Fees payable

The formula on which the calculation of such fee is based is determined as a result of arm's length negotiations between the Company and IBM, undertaken with reference to historical overheads incurred by IBM in providing the relevant services. The amount of fees payable by the Company to IBM will vary depending on the specified reported revenue of the Business for MSA Services, and will not exceed 2.53% of such reported revenue. Other than with respect to the calendar year of 2006, the targeted revenues for each calendar year are expected to be agreed to by the parties in June of the preceding calendar year.

Annual caps

The Directors expect that the aggregate amount of fees payable under the Marketing Support Agreement for each of the five years following the Initial Closing will not exceed US$291 million, US$278 million, US$194 million, US$77 million and US$26 million, respectively.

The said aggregate amounts have been determined based on the agreed upon fee structure, the estimated future business volume, the estimated future service reduction, and taking into account potential tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% premium to account for any uncertainties.

Internal Use Purchase Agreement

Date

7 December 2004

Parties

The Company and IBM

Sale and purchase of Personal Computers

IBM has agreed to purchase from the Company not less than 95% of the Personal Computers IBM requires worldwide for its internal use (which includes Personal Computers for use in connection with strategic outsourcing where IBM keeps title to the Personal Computers) each calendar year during the term of the Internal Use Purchase Agreement, subject to certain reduction and other limitations. IBM also has the right to buy Personal Computers from the Company for resale in certain cases.

Consideration and liquidated damages

The consideration that the Company will receive for Personal Computers sold to IBM for internal use (including IBM's strategic outsourcing business noted above) will be the cost of the products plus an agreed upon profit margin determined as a result of arm's length negotiations between the Company and IBM. In the event that IBM fails to fulfil its obligations to purchase internal use Personal Computers under the Internal Use Purchase Agreement, it will be required to pay the Company liquidated damages. There are no obligations to pay liquidated damages in connection with Personal Computers purchased for resale.

The price that the Company will receive for Personal Computers purchased for use in certain IBM systems integration and outsourcing services, as an embedded Product in another system, to fulfil obligations under existing government contracts or in other situations that the parties mutually agree will be the Company's price to its other resellers purchasing similar quantities. The price that the Company will receive for Personal Computers purchased for resale to IBM's employees (or for IBM's employees in the case of direct sales) as part of an IBM benefit plan will be the price the Company charges its own employees pursuant to the Company's employee benefit plan. The price that the Company will receive for Personal Computers purchased by IBM for warranty and maintenance replacement services will be the base manufacturing costs of such Personal Computers plus shipping costs.

Term

The term of the Internal Use Purchase Agreement is for five years from the Initial Closing.

Annual caps

The Directors expect that the aggregate amount of fees payable under the Internal Use Purchase Agreement for each of the five years following the Initial Closing will not exceed US$500 million, US$512 million, US$520 million, US$530 million and US$541 million, respectively.

The said aggregate amounts have been determined based on the agreed upon pricing mechanism, and estimated future business volume, and taking into account potential tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% premium to account for any uncertainties.

Master Distribution Agreement

Date

7 December 2004

Parties

The Company and IBM

Distribution of Products to end users

The Company will provide IBM with Personal Computers and certain services pursuant to this agreement to the extent where the relevant customers: (i) have previously entered into non-assignable purchase agreements with IBM; (ii) insist on purchasing Products and services directly from IBM despite the fact that IBM has used commercially reasonable efforts to convince them to purchase products directly from the Company; or (iii) are in countries that are not covered by the Initial Closing. The amount of Personal Computers and services to be provided will depend on whether such events occur. IBM may also market the Company's Products through one or more subsidiaries.

Term

The term of this agreement is for two years from the Initial Closing or, for an individual agreement that has a specific commitment to sell a specified amount of products and services over a period of time, for the duration of that agreement, and may be extended if both parties agree in writing.

Consideration

Where the non-assignable agreement sets forth a specified amount of Products over a fixed period of time, the Company will provide IBM with such products or services at the price and on the terms set forth in such agreement. Where the non-assignable agreement requires IBM to accept a customer order, the Company shall provide products pursuant to an agreed pricing methodology. If the parties have mutually agreed to allow sales under a non-assignable agreement, IBM will work with the customer to set the price and other terms of such sales but such sales will be subject to the Company's agreement to provide products and services at such price. In instances of countries that are not covered by the Initial Closing, IBM and the Company will work together to continue to provide products at the prices provided to customers by IBM in such countries. The said arrangements have been formulated as a result of arm's length negotiations between the Company and IBM.

The Company considers that the transaction value of the Continuing Connected Transactions arising out of the Master Distribution Agreement shall not be subject to any annual cap for the following reasons: (a) it is impossible for annual caps to be determined because the identities and number of customers which will insist on purchasing products and services directly from IBM, as well as the level of actual sales which would arise out of the relevant purchase agreements are uncertain and entirely outside the control of the Company and IBM; (b) the level of actual sales which would arise out of the relevant purchase agreements are also uncertain because the relevant customers do not have any contractual obligations to purchase a fixed amount of products and/or services from IBM under such agreement; (c) the Company is unable to predict such identities or number of customers as there is no relevant historical pattern to base this on; and (d) the arrangement underlying the Master Distribution Agreement is in place to protect the Company from losing customers who want to deal with IBM only (and IBM will not make any profit directly out of the arrangement) and is therefore in the interests of the Company as well as all the Shareholders (including the minority Shareholders).

Hence, the Company will apply to the Stock Exchange for a waiver from compliance with the requirements set out in Rule 14A.35(2) of the Listing Rules for imposing an annual cap on the transaction value arising out of the Master Distribution Agreement.

Intellectual Property Agreements

Trademark Assignment Agreement

Date

7 December 2004

Parties

IBM as the assignor and a subsidiary of IBM as the assignee

Assignment of marks

IBM has agreed to assign to a subsidiary of IBM all of its right, title and interest in and to certain marks and domain names that exclusively relate to the Business, as specified in the Trademark Assignment Agreement together with the goodwill of the business symbolized thereby. The Company will then acquire such subsidiary at no additional cost, on or immediately prior to the Initial Closing.

Consideration

No payment is payable by the Company under the Trademark Assignment Agreement.

Effective date of assignment

The assignment under the Trademark Assignment Agreement will become effective upon the Initial Closing.

Trademark License Agreement

Date

7 December 2004

Parties

IBM as the licensor, a subsidiary of IBM as the licensee and the Company as guarantor of the obligations and responsibilities of the licensee

Grant of license

IBM will grant to a subsidiary of IBM, on a fully paid-up basis, a non-transferable license to use certain of IBM's registered and unregistered trademarks, including but not limited to "IBM" and the IBM logo, for the identification of certain products in marketing, and subject to certain restrictions, advertising (in the case of the "IBM" mark) in connection with the Business in the United States, its territories and possessions, and every other country where prior to the Initial Closing, IBM had used or had the right to use these marks. The Company will acquire such subsidiary of IBM at no additional cost, on or immediately prior to the Initial Closing.

The grant of a license under the Trademark License Agreement is subject to certain pre-existing trademark license contracts or arrangements of IBM.

Right to use

For 18 months after the Initial Closing, the Business will be permitted to use the IBM trademark and logo on all Products existing as of the Initial Closing, and on other successor products that have substantially the same functions and attributes. During this period, the Business will also be permitted to use the IBM trademark and logo in marketing and advertising materials, but only as they appear on the Products or successors to the Products. The Business will not be required to add any qualifying wording in connection with its use of the mark during this period.

For 40 months after the Initial Closing, the Business will be permitted to use the IBM trademark and logo together with a trademark of the licensee or guarantor as the licensee or guarantor selects, on all Products existing as of the Initial Closing, and on successor products that have substantially the same functions and attributes.

Until the expiry of five years after the Initial Closing, the Business will be permitted to use the IBM trademark and logo together with a trademark of the licensee or guarantor as the licensee or guarantor selects, on all Products existing as of the Initial Closing, and on other products that have substantially the same functions and attributes, provided that on those products, after the first 40 months following the Initial Closing, the Company may only use the IBM logo and trademark on a product together with an endorsement text, which must be approved by IBM.

The Business will be permitted to use the common mark during the term of the license, and may seek registration on its own for newly created marks embodying the common term.

Term

The Trademark License Agreement is for a term of five years from the Initial Closing.

Patent Assignment Agreement

Date

7 December 2004

Parties

IBM as the assignor and a subsidiary of IBM as the assignee

Effective date of assignment

The assignment under the Patent Assignment Agreement is effective on or before the Initial Closing.

Assignment of patents

Subject to all rights granted to others prior to the Initial Closing and the Asset Purchase Agreement, IBM assigns and transfers to a subsidiary of IBM all of its right, title and interest in and to all patent ownership interest IBM may have anywhere throughout the world in and to those patents that are exclusively related to the Business, as identified in the Patent Assignment Agreement. The Company will acquire such subsidiary of IBM at no additional cost, on or immediately prior to the Initial Closing.

Consideration

No payment is payable by the Company under the Patent Assignment Agreement.

Patent Cross License Agreement

Date

7 December 2004

Parties

IBM and a subsidiary of IBM and the Company

Effective date of license

The license under the Patent Cross License Agreement will become effective as of the Initial Closing and will continue until the expiration of the last to expire of the licensed patents.

License of patents

IBM grants to a subsidiary of IBM and the Company, and the Company and a subsidiary of IBM each grants to IBM a license, in relation to its respective licensed patents, as follows:

(i) to make (including the right to use any apparatus and practice any method in making), use, import, offer for sale, lease, license, sell and/or otherwise transfer the respective party's licensed products;

(ii) to have the respective party's licensed products made by another entity; and

(iii) to use any apparatus and practice any method in connection with the performance of business processes for itself or third parties.

Consideration

No payment is payable by the Company or the subsidiary of IBM under the Patent Cross License Agreement.

Intellectual Property Assignment and License Agreement

Date

7 December 2004

Parties

IBM and the Company

Assignment of programs and documentation exclusive to the Business

IBM has agreed to assign to the Company all of its right, title and interest in, to and under all intellectual property rights in and to certain software programs and tangible embodiments of information and know-how, in each case that are exclusively related to the Business.

The Company has agreed to grant back to IBM a non-exclusive, worldwide, perpetual, royalty-free license in and to the software programs and tangible embodiments of information and know-how assigned to it by IBM.

License of programs and documentation used in connection with the Business

IBM has agreed to grant to the Company a non-exclusive, worldwide, perpetual, royalty-free license in and to certain software programs and tangible embodiments of information and know-how, in each case that are used in connection with the Business and in each case only for the purpose of operating the Business.

Consideration

No payment is payable by the Company under the Intellectual Property Assignment and License Agreement.

Effective date of assignment

The assignment is effective on or before the Initial Closing. The term of each granted license under this agreement is for the life of the respective intellectual property right.

The Directors believe that the terms of this agreement are consistent with market practice in respect of intellectual property license agreements.

Employee Matters Agreement

Parties

The Company and IBM

Transfer of employees

Employees of the Business will be transferred to the Company, either as may be required by the laws of the applicable jurisdictions or by offers of employment made by the Company to such employees, on the dates of the relevant Closings. In general, the Company will honor those terms and conditions of employment that are required by law, or, if not required by law, provide salary, wages, and terms and conditions at levels at least as favorable as the terms provided by IBM, and provide pension and other employee benefit plans that are substantially comparable in the aggregate to plans that were provided to such employees by IBM.

Employer liability and employee retention

Upon the relevant Closings, the Company will be responsible for all liabilities, including but not limited to those regarding severance claims, relating to the relevant employees' employment with the Company. For the purpose of severance payments, the Company will recognise the relevant employees' previous service with IBM. IBM will retain liability for severance payments arising automatically from any termination or refusal to accept an offer of employment made by the Company in accordance with the terms of the Employee Matters Agreement.

Under the Employee Matters Agreement, the Company and IBM have agreed upon the establishment of a two-year short-term employee retention plan whereby the Company will make retention payments to certain employees transferred from IBM to the Company at the Initial Closing, at different times during a period of two years following the Initial Closing so long as the relevant employees remain under the Company's employment at the relevant times. IBM will from time to time reimburse the Company for such payments, subject to an overall cap of US$47 million (for the two-year period following the Initial Closing). This arrangement has been formulated as a result of arm's length negotiations between the Company and IBM.

Under this short-term plan, the Company is not obliged to make any payments to the relevant employees other than those in respect of which IBM will make reimbursement to the Company. The formula for determining the amount of retention payment which each relevant employee will receive (which takes into account factors such as position, seniority, etc.) has been pre-determined and set out in a schedule to the Employee Matters Agreement.

The Company also plans to adopt a long-term employee retention plan for the benefit of the transferred employees, no later than the first anniversary of the Initial Closing. The Company is responsible for funding such long-term plan.

Non-solicitation

Generally, the Company is obliged for two years after the Initial Closing, not to solicit or hire any current or former employee of IBM who had been an employee of IBM in the one-year period prior to such time, subject to an exception for solicitation in response to a general public advertisement. The same non-solicitation and non-hire restriction applies to IBM on a reciprocal basis. Notwithstanding the foregoing, the Company and IBM will be permitted to solicit or hire such employees and former employees so long as the party that desires to engage in such solicitation has obtained the written consent of the other party.

Real Estate Arrangements

Pursuant to the Asset Purchase Agreement, the Company and IBM agreed that the real estate assets of the Business would be conveyed to the Company with effect from the applicable Closing, pursuant to the following arrangements, which have been negotiated and agreed upon by the Company and IBM on an arm's length basis.

Acquisition of leasehold interests held by IBM

At the applicable Closing for the subject country, IBM will assign to the Company its entire leasehold interest in various floors of an office building located in Brisbane, Australia and a manufacturing facility in Pondicherry, India. The Company will assume IBM's payment and performance obligations under the various leases for these sites for the balance of the term of these leases; the Pondicherry, India lease runs through August 2006, and the Brisbane, Australia leases run through 31 July 2006 and 31 October 2007. In connection with the Company's purchase of the Chinese Business Unit, the Company will also acquire certain leasehold interests in certain factory, warehouse, office and research facilities located in Shenzhen, Futian, Shanghai and Beijing, the PRC.

Sublease of portions of properties currently leased and to be retained by IBM

At the applicable Closing for the subject country, IBM will sublet portions of various properties in Toronto and Montreal (Canada), Fujisawa and Yamato (Japan), Sydney and Cumberland Forrest (Australia) and Singapore to the Company. The portion of each site to be sublet will be that portion utilized by the Business, and the rental that will be payable will be the Company's pro rata share of IBM's cost for such space pursuant to its lease, based on a percentage of the total square footage occupied by the Company. The sublease term for each of these sites will commence at the applicable Closing for the subject country and be coterminous with IBM's prime lease term (the length of each of which varies, and expiring some time between 31 March 2006 and 31 March 2014), with the exception of the Toronto site which will commence after the space has been reconstructed or otherwise reconfigured as necessary to house the Business, and will run up to a four-and-a-half-year term.

Occupancy of certain additional properties for a transitional period

The Company will occupy space at over 200 IBM locations worldwide for a one year term pursuant to a licence agreement for each jurisdiction. With respect to licensed locations located within one of the countries where the Initial Closing is applicable, the licence term will commence as of the date of the Initial Closing. The licence term for other locations will commence as of the applicable Closing for the country in which such licence area is located. The licence with respect to each of these locations will be terminable by the Company upon 30 days' notice.

Option to elect either short term licence or longer term lease with respect to certain sites

Greenock, Scotland

With respect to Greenock, the Company has up to 60 days from the signing of the Asset Purchase Agreement to decide whether it will (a) occupy the in-scope portion of the site (approximately 102,000 s.f.) pursuant to a licence for a one-year term running from the date of the Initial Closing, at a rental equal to IBM's (depreciation) cost, or (b) lease the site from IBM for a three-year term at the prevailing market rate.

Tokyo, Japan

With respect to the IBM building located in Tokyo, the Company has up to 60 days from the signing of the Asset Purchase Agreement to decide whether it will (a) occupy the in-scope portion of the site pursuant to a licence for a one-year term from the date of the Initial Closing, or (b) lease the in-scope portion of the building from IBM site for a five-year term at the prevailing market rate.

Option to elect either short term licence or assumption of lease for balance of lease term

With respect to the complex leased by IBM in Raleigh/Durham, North Carolina, the Company has up to 60 days from the signing of the Asset Purchase Agreement to decide whether it will (a) occupy the in-scope portion of the site pursuant to a licence for a one-year term from the date of the Initial Closing, or (b) acquire IBM's leasehold interest in three Raleigh Research Triangle Park Buildings and two Silicon Drive Buildings (and assume the obligations of IBM under the subject leases) after occupying various portions of the site and leased locations pursuant to a licence until such time as the space has been reconfigured and built-out as necessary to consolidate the Company's employees and the Business. Once entered into one of the options as stated above, the Company and IBM will enter into a written agreement and comply with the requirements set out in Rule 14A.35 of the Listing Rules.

Annual caps

The Directors expect that the aggregate amount of fees payable under the Real Estate Arrangements for each of the five years following the Initial Closing will not exceed US$78 million, US$54 million, US$30 million, US$30 million and US$31 million, respectively.

The said aggregate amounts have been determined based on estimated costs, and taking into account potential tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% premium for uncertainties.

Reasons for terms in excess of three years

There are five agreements with terms in excess of three years, namely: the Strategic Financing and Asset Disposition Services, the IGS Services Agreement, the Marketing Support Agreement, the Internal Use Purchase Agreement and the Trademark License Agreement. All these agreements have a term of five years. Some of the Real Estate Arrangements may also have a term in excess of three years. The reasons are as follows:

(a) to ensure continuity, smooth integration of the Business, and success of the Enlarged Group;

(b) to demonstrate both the Company and IBM's commitment to work together for the success of the Enlarged Group;

(c) to allow both the Company and IBM to mutually benefit from their co-operation to work together; for example, the Company benefiting from not paying any consideration for the use of the IBM brand and securing IBM as its largest enterprise customer; further the benefit to the Company of IBM's existing global service capabilities, and IBM receiving guaranteed customers from the Company for its after-sales and financing services;

(d) to allow the Company's management to focus their attention and resources on transition and grow the Business; and

(e) in relation to the subletting of portions of properties currently leased and to be retained by IBM under the Real Estate Arrangements, the term will be coterminous with IBM's prime lease term and in some cases this may exceed three years and may in one case run for a term up to 2014.

Pursuant to Rule14A.35(1) of the Listing Rules, from pages 62 to 101 of this circular, Cazenove Asia's letter of advice to the Independent Board Committee and the Independent Shareholders has explained why a longer period for the above agreements is required and that it is normal business practice for agreements of the relevant types to be of the relevant durations.

CONTINUING CONNECTED TRANSACTIONS

Each of the Continuing Connected Transactions is subject to reporting, announcement and approval of the Independent Shareholders at the Extraordinary General Meeting.

The Directors consider that each of the Continuing Connected Transactions has been negotiated and will be conducted on an arm's length basis and on normal commercial terms between the Company and IBM.

The Directors are also of the view that as far as the Independent Shareholders are concerned, the Continuing Connected Transactions and the terms, including the relevant annual caps (note: the transactions underlying the Master Distribution Agreement are not subject to any annual cap), are fair and reasonable and in the interest of the Lenovo Group and the Independent Shareholders as a whole.

The Company seeks the approval of the Independent Shareholders for the Continuing Connected Transactions and the respective annual caps in relation to the Continuing Connected Transactions mentioned above on the condition that the Company will comply with the rules in relation to annual review of continuing connected transactions set out in Rules 14A.37 to 14A.40 of the Listing Rules. The Company further undertakes that upon any variation or renewal of the agreements or arrangements in respect of the Continuing Connected Transactions, the Company will comply with all applicable requirements set out in Chapter 14A of the Listing Rules. In particular, the Company will implement internal policies to closely monitor whether the annual caps are exceeded during the relevant 12-month periods (such policies include, without limitation: (a) setting out the responsibilities of different relevant departments within the Company in respect of monitoring the transaction values of the Continuing Connected Transactions; (b) appointing a person in each relevant department who has a good understanding of the relevant Continuing Connected Transactions to keep track of the said transaction values; (c) requiring the said person to review and consider the said transaction values on a monthly basis and report any possibility of exceeding the annual caps to senior management of the Company; and (d) taking steps to ensure that such reporting is done in a timely and efficient manner) and will, in each of the relevant annual reports, set out the transaction value in respect of each Continuing Connected Transaction for: (i) any complete 12-month period to which the annual cap relates; (ii) any period of less than 12 months to which the annual cap relates, including for the avoidance of doubt a period commencing on the beginning of a financial year of the Company and ending on the expiry of an annual cap period, as well as a period commencing on the beginning of an annual cap period and ending on the expiry of a financial year of the Company; and (iii) the financial year of the Company to which the annual report relates.

The Company will make a public announcement and comply with Chapter 14A of the Listing Rules in the event that any annual cap in relation to the Continuing Connected Transactions is exceeded.

FINANCIAL EFFECTS OF THE ASSET ACQUISITION

Shareholders are drawn to the attention that the following information pertaining to the unaudited pro forma financial information is extracted from Appendix IV to this circular headed "Unaudited pro forma financial information on the Enlarged Group", which is prepared in accordance with Rule 4.29 of the Listing Rules. The pro forma consolidated financial information is based on the audited and unaudited financial statements of the Group for the year ended 31 March 2004 and for the six months ended 30 September 2004 respectively (as extracted from Appendix III to this circular), and the Audited US Combined Financial Statements of the PCD (as defined in and extracted from Appendix I to this circular), after adjustments made to the Business as detailed in Appendix IV to this circular.

The unaudited pro forma financial information is prepared to provide information about how the Asset Acquisition might have affected the relevant financial information of the Enlarged Group as at 30 September 2004 and for the year ended 31 March 2004 and the six months ended 30 September 2004. As it is for illustrative purpose only and because of its nature, it may not give a true picture of the results and financial position of the Enlarged Group for any future financial periods or date.

Possible financial effects of the Asset Acquisition on the Lenovo Group

Net assets

The Company recorded consolidated net assets of approximately HK$4,890 million (or approximately HK$0.65 on a per Share basis) as at 30 September 2004. As shown in the section headed "Unaudited pro forma financial information on the Enlarged Group" in Appendix IV to this circular, had the Closings been taken place on 30 September 2004, the pro forma net assets of the Enlarged Group would be approximately HK$9,570 million (or approximately HK$1.04 on a pro forma per share basis, comprising Shares and Non-voting Shares), representing an increase of approximately 95.7%.

Earnings

The Company recorded consolidated EBITDA of approximately HK$1,125 million for the year ended 31 March 2004. Had the Closings been taken place on 1 April 2003, the pro forma EBITDA of the Enlarged Group for the year ended 31 March 2004 would be approximately HK$712 million as shown in Appendix IV to this circular.

The audited profit attributable to Shareholders amounted to approximately HK$1,053 million for the year ended 31 March 2004. As shown in Appendix IV to this circular, based on the current accounting standard in respect of business combinations and the treatment of goodwill, the Enlarged Group would record a pro forma net loss for the year ended 31 March 2004, which included a goodwill amortization of approximately HK$630 million. Shareholders should note that under the new accounting standard in respect of business combinations which will become effective for accounting period commencing from 1 January 2005, any goodwill recognized will no longer be subject to any amortization (i.e. the HK$630 million annual amortization of the goodwill would not be charged under the new accounting standard) instead they are tested for impairment annually, or more frequently if events or changes in circumstances indicate a possible impairment. Shareholders should also note that the values of other intangible assets arising from the Asset Acquisition are still subject to further determination of their nature and value. If the finalized aggregate value of the intangibles arising from the Asset Acquisition is higher than that stated in the pro forma financial information set out in Appendix IV to this circular, the amortization expenses of such intangible assets would increase accordingly.

Shareholders should also note that the recent financial performance of the Business has been adversely affected by exceptionally high warranty expenses for the financial year ended 31 December 2003 and the six months ended 30 June 2004, due to certain Personal Computer products with problem components produced and sold previously. IBM has agreed to reimburse the Company for the costs incurred by the Group in performing standard warranty obligations in respect of desktop and notebook computers shipped by the Enlarged Group after the Initial Closing up to a maximum of US$100 million in aggregate, to the extent the level of defects requiring warranty services exceeds specified levels. IBM's reimbursement obligation will cover personal computer designs and components that are being offered by IBM at the time of the Initial Closing or that have been fully designed and qualified as of that time, and accordingly will not apply in respect of a product if the Company changes the design, component or specification of the product. IBM's obligation also will not apply to products shipped more than two years after the Initial Closing.

The Directors believe that the above pro forma earnings analysis does not reflect the future profitability of the Enlarged Group as (i) the warranty costs of the Business for the year ended 31 December 2003 and the six months ended 30 June 2004 were exceptionally high as compared to other years due to exceptional level of repair services provided in respect of certain products with problem components produced as explained above, (ii) changes are anticipated in the accounting policy in respect of business combinations to conform with the new accounting standard and (iii) the pro forma figures do not take into account of any synergies, such as procurement advantage after the merger, the low cost production advantage of the Lenovo Group and the effective distribution network of the Lenovo Group in the PRC, which may be achieved by combining the Business and the Personal Computer business of the Lenovo Group.

Working capital

As stated in the paragraph headed "Working Capital" in Appendix V to this circular, the Directors are of the opinion that, taking into account of the present internal resources and banking facilities available to the Enlarged Group (including the Bridge Loan), the Enlarged Group has sufficient working capital for its present requirements for the next 12 months following the date of this circular.

Gearing position

Operations of the Lenovo Group are currently mainly financed by its internally generated funds. As at 30 September 2004, the Lenovo Group had outstanding loans of approximately HK$125 million, representing a gearing ratio (being the total borrowings to total shareholders' equity) of approximately 2.6%.

The Lenovo Group plans to finance the total net consideration of the Asset Acquisition of approximately US$1,250 million by (i) cash of approximately US$150 million, (ii) borrowings of approximately US$500 million; and (iii) issue of Consideration Shares of approximately US$600 million to IBM.

As shown in the section headed "Unaudited pro forma financial information on the Enlarged Group" in Appendix IV to this circular, had the Asset Acquisition been completed on 30 September 2004, the pro forma total borrowings of the Enlarged Group would be approximately HK$4,025 million, while the total equity of the Enlarged Group would increase to approximately HK$9,570 million. Based on the above pro forma financial information, the pro forma gearing ratio (calculated on the basis of total borrowings and total equity) of the Enlarged Group would be approximately 42.1%. In view of the benefits of the Asset Acquisition, the Directors consider the pro forma gearing level of the Enlarged Group to be acceptable.

REASONS AND BENEFITS OF THE ASSET ACQUISITION AND THE CONTINUING CONNECTED TRANSACTIONS

Reasons and benefits for the Asset Acquisition

A unique opportunity

The Company has focused the business on the Personal Computer sector and has achieved undisputed leadership in the PRC Personal Computer market with a 27% market share. The Company has decided that it is critical to expand globally to further enhance its competitiveness and pursue future growth. The Business is one of the leading Personal Computer businesses in the world in terms of its scale, global reach, innovation capabilities and brand strength. The combination with the Business represents a unique opportunity for the Company to fulfill its globalization strategy by further strengthening its focus and achieving its global leadership in Personal Computers and related products, and forging a long-term strategic relationship with the world's largest information technology company, which is one of the global leaders in business and technology services, information technology solution consulting services, information technology research, and information technology financing services. The combination of the Company and the Business will result in the creation of a global personal computer powerhouse representing approximately 8% of the worldwide personal computer market, with global sales, marketing, distribution and customer support infrastructure. The Company expects that this transaction would significantly strengthen its capability to compete with Dell and Hewlett-Packard in corporate and consumer markets in the PRC and globally.

Global reach and brand awareness

The Asset Acquisition will allow the Company to quickly transform from a business conducted exclusively in the PRC into a worldwide operation. Following the Asset Acquisition, the Company will leverage the Business' existing infrastructure to quickly establish direct presence in approximately 30 countries with comprehensive sales networks covering 160 countries to reach global enterprise customers. This global presence and coverage will also help the Company sell the Company's consumer products in global markets outside the PRC. As a result, the Company's sales generated outside the PRC is expected to represent approximately 72% of the revenue base of the Enlarged Group, compared to less than 2% for the year ended 31 March 2004 on a standalone basis. Pursuant to the terms of a trademark licensing arrangement between the Company and IBM, the Company intends to leverage the global recognition of IBM's brand, one of the most widely recognised in the world, to bring rapid global awareness of its own brand, eventually establishing "Lenovo" as the single worldwide brand in the long term. The Company will be allowed to market products of the Business with the IBM logo, including with the Lenovo logo co-branded and IBM endorsement on the Products over transition periods, and will also acquire the right to use the element "Think", historically used by IBM in connection with family of products and features. The Company will also be assigned several "Think" marks exclusive to the Business, including

"ThinkPad", "ThinkCentre", "ThinkVision" and "ThinkVantage", and will have the right to create new marks incorporating the "Think" element, which the Company intends to adopt as the umbrella brand for its Personal Computer products globally.

Enhanced product portfolio

Historically, the Company has enjoyed strong market leadership in the PRC for both desktop and notebook products in both commercial and consumer markets, with particular strengths in desktop and consumer products. Over the years, the Company has developed strong product and application innovation capabilities, which have been a key contributing factor to its leadership position in the PRC. The Business has evolved in the past 10 years to focus on the notebook products for the global enterprise market. Consequently, complementary product lines and core competencies in differentiated markets are expected to ensure rapid integration of the Company's desktop and consumer product lines capabilities, with IBM's technology, notebook and commercial product lines and capabilities. This combination will create a comprehensive and innovative product portfolio and significantly enhance the Company's competitiveness against its competitors in the PRC and globally for all customer segments. Little overlap in respective target market segments also allows minimal potential cannibalization of sales following the Asset Acquisition.

Cost containment

The Asset Acquisition also presents a unique synergistic opportunity for cost savings, which will be maximized by leveraging the Business' integrated supply chain management capability. The main source of cost savings is procurement synergies arising from improvement in economies of scale in procurement by combining procurement volumes of the Business and the Company. The benefit of increased scale will be further amplified by sharing best practice and prices, consolidating vender lists and increasing common parts as a result of product line consolidation between the Company and the Business.

Additional cost saving opportunities will arise from leveraging the Company's low cost infrastructure in the PRC to reduce the overall cost of the global operation of the Business. The opportunities include consolidating relevant back-office operations of the Business to the PRC, and leveraging the Company's low cost manufacturing capabilities in the PRC.

Technology leadership

The Company would acquire a part of the world's largest information technology research organisation including a highly skilled and experienced development team, advanced facilities and a portfolio of technology intellectual property and know-how. In particular, the Business' notebook research and development capability and know-how will complement the Company's current research and development strength in desktops to allow the Company to achieve technology leadership in both notebook and desktop products. The Business' strong overall product system design, component specifications and quality control capability will also further strengthen the Company's product development effectiveness across product lines. In addition to product development, the Business' unique "ThinkVantage Technologies" will allow the Company to increase product reliability and flexibility and reduce business customers' total cost of ownership. In acquiring the Business, the Company would also acquire a portion of the Business' extensive patent portfolio, thereby enhancing the Company's intellectual property portfolio. The Company would also acquire leading research and development facilities in the USA and the PRC, and one of the world's largest dedicated notebook computer research and development facilities in Japan.

Leading internationally experienced management

Because the Business sells products in almost 160 countries, the management of the Business is very experienced in development and execution of international strategy and managing large scale global operations. The Company recognizes the importance of continuity of leadership in the Business, and intends to retain an industry leading management team with significant international experience in commercial markets. As an integral part of the Asset Acquisition, the Company and IBM will make necessary arrangements and offers including compensation and benefits to ensure the retention of the management of the Business as part of the management team of the Enlarged Group. The combined experience of the retained management team of the Business and the Company's existing PRC management team will create a management team that have strong capabilities and extensive experience in both managing a large scale global business and winning in fast growing emerging markets. With the strong commitment from the Company and IBM in the success of the Enlarged Group and long term strategic partnership, the Company therefore believes that transfer of this experienced team of managers with international experience is both key to the success of the Asset Acquisition and achievable.

Reasons and benefits of certain Continuing Connected Transactions

The reasons and benefits of certain major Ancillary Agreements (whose underlying transactions, together with the transactions underlying other Ancillary Agreements, comprise the Continuing Connected Transactions) are set out below:

IGS Services Agreement

The Company believes that the IGS Services Agreement will provide several major benefits to the Company and its customers:

(1) Maintaining a relationship with IGS will minimize customer loss by maintaining the industry best award-winning warranty services to which IBM's customers are accustomed.

(2) IGS is widely regarded as one of the leading providers in after-sales services, and it is one of the few service providers that have the global coverage which is required by the Company's top enterprise customers. A strategic partnership will be a competitive advantage for the Company and help to establish and maintain the premium image of the Company's product offerings and increase credibility with enterprise customers.

(3) A strategic relationship with IGS will increase Personal Computer sales through IGS strategic outsourcing and system integration businesses, where IBM customers outsource their information technology services to IGS or buy Personal Computer products through system integration transactions and IGS recommends that such customers purchase their related information technology hardware from the Company.

(4) The IGS Services Agreement will also allow the Company to share the profit generated from services sold by IGS and its affiliates.

Please refer to the section entitled "Ancillary Agreements" for a summary of the IGS Services Agreement.

Marketing Support Agreement

Under the Marketing Support Agreement, the Company will be able to leverage IBM's well established enterprise sales force and IBM established global sales infrastructure, i.e. client representative teams, for a period of five years. The key benefits are identified below:

(1) Ensure smooth transition and minimize customer loss — IBM's client sales representatives are responsible for overall client relationships, and will play a critical role in ensuring clear communication, a smooth transition and minimizing revenue loss immediately after the Initial Closing.

(2) Protect business momentum — The Business' and IBM's client sales representatives have an established and proven sales model, pursuant to which IBM's sales representatives are responsible for client relationships and overall satisfaction, and the Business' sale representatives jointly visit and develop enterprise customers. Historically, more than one-third of the Business' sales opportunities have been identified by IBM's client representatives. Maintaining the sales model is important to protect business momentum going forward.

(3) Build customer relationships — The arrangement allows the Company to gradually build its own customer relationships with large enterprise customers through joint customer visits with IBM's client representatives and proactive facilitation of transferring customer relationships from IBM client representatives to the Company's sales team.

(4) Allow the Company to continue to leverage IBM's established global network and established infrastructure, including such functions as sales fulfillment, information technology and treasury.

(5) Minimize incremental cost to the Company — The agreed commission rate is based on historical sales related costs to the Business. This will minimize incremental cost to the Company in the future.

(6) Tiered commission structure to provide incentive and reflect future changes to the Company's sales model — The tiered commission structure is designed to incentivize IBM's sales team to meet and exceed sales targets. The total cost will change to reflect future business fluctuations, changes in sales coverage by IBM's sales team and the gradual migration to the Company's own sales team.

Please refer to the section entitled "Ancillary Agreements" for a summary of the Marketing Support Agreement.

Internal Use Purchase Agreement

Under this agreement the Company will be the preferred and nearly exclusive (95%) supplier for all Personal Computers purchased by IBM for its internal use or strategic outsourcing deals for a period of five years. In calendar year 2003, the amount of IBM's internal purchases made it the largest customer of the Business. Under the Internal Use Purchase Agreement, pricing of future sales to IBM will be based on commercial terms subject to most favoured nation pricing, which allows the Company to earn a comparable margin as sales to other top enterprise customers.

Please refer to the section entitled "Ancillary Agreements" for a summary of the Internal Use Purchase Agreement.

Strategic Financing and Asset Disposition Services Agreement

The services IGF provides are crucial to the Company's day-to-day operations and beneficial to the Company's customer and business partners and will result in several benefits to the Company and its customers:

(1) Customer Financing Services give the Company's customers in more than 40 countries the option to lease the Company's products, thus enhancing the Company's revenue potential.

(2) Distribution Channel Financing Services allow the Company to effectively manage channel credit and significantly reduce its working capital and total invested capital required.

(3) Excess Surplus Disposition Services allow the Company to manage the disposition of its used products in a global and orderly manner to avoid channel confusion and maximize residual value by leveraging IGF's extensive asset recovery/resell capability.

In view of the fact that IGF has existing relationships with IBM's customers and resellers, the Strategic Financing and Asset Disposition Services Agreement will help ensure a smooth transition and minimize business and customer disruption, employee training and business process redesign.

As one of the industry leaders with a global network and significant scale, IGF is most likely to offer the Company the best service given its unique presence in and understanding of the information technology hardware industry.

IGF has agreed to assume the credit, operational and residual value risks associated with its provision of services to the Company, which significantly reduces the Company's exposure to contingent liabilities.

Please refer to the section entitled "Ancillary Agreements" for a summary of the Strategic Financing and Asset Disposition Services Agreement.

Transition Services Agreement

The Transition Services Agreement and the services provided thereunder will provide a variety of benefits to the Company and its customers:

(1) Because the Business is fully integrated with IBM's other businesses it is not economically feasible for the Company to acquire from IBM all of the assets, functionality and services that the Business currently enjoys within IBM. Accordingly, IBM's provision of services to the Company on a transitional basis will allow the Company to be fully operational following the Initial Closing and therefore minimize business and customer disruption.

(2) The transitional period provides the Company with an opportunity to develop in-house capabilities or other plans to replace the services provided by IBM at the end of such period.

Please refer to the section entitled "Ancillary Agreements" for a summary of the Transition Services Agreement.

MANAGEMENT OF THE ENLARGED GROUP

It is expected that no variation will be made to the remuneration payable or benefits in kind receivable by the Directors as a result of the Asset Acquisition. As at the date of this circular, the Board comprises the following members:

Executive Directors

Mr Liu Chuanzhi

Mr Liu Chuanzhi, aged 60, is the Chairman of the Lenovo Group. Mr Liu has been an executive Director since 8 November 1993 and responsible for strategic planning and management of the Lenovo Group since its establishment. He graduated in 1966 from the Department of Radar Communications, Xian Military Communications Engineering College of China. He has over 34 years of experience in the computer field. Mr Liu's business address is 23rd Floor, Lincoln House, Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong.

Mr Yang Yuanqing

Mr Yang Yuanqing, aged 40, is the Vice Chairman, President and Chief Executive Officer of the Lenovo Group. Mr Yang has been an executive Director since 16 December 1997. He is responsible for the overall business and operation of the Lenovo Group. He graduated from the Department of Computer Science, University of Science and Technology of China in 1989 with a Master degree. He has over 15 years of experience in the computer field. Mr Yang's business address is 23rd Floor, Lincoln House, Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong.

Ms Ma Xuezheng

Ms Ma Xuezheng, aged 51, is the Senior Vice President and Chief Financial Officer of the Lenovo Group. Ms Ma has been an executive Director since 15 May 1997. She is responsible for finance, treasury, strategic investment, legal affairs and joint venture management of the Lenovo Group. She graduated from Capital Normal University in 1976 with a Bachelor of Arts degree. She has over 27 years of experience in financial and executive management. Ms Ma's business address is 23rd Floor, Lincoln House, Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong.

Non-executive Director

Mr Zeng Maochao

Mr Zeng Maochao, aged 71, was appointed as an executive Director on 17 July 1995 and subsequently redesignated as non-executive Director since 30 May 2001. Mr Zeng graduated from the Department of Electrical Engineering, Shanghai Jiao Tong University in 1957. He was the Director and Professor of the Institute of Computing Technology of the Chinese Academy of Sciences. He has over 47 years of experience in the computer field. Mr Zeng's business address is 23rd Floor, Lincoln House, Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong.

Independent non-executive Directors

Mr Wong Wai Ming

Mr Wong Wai Ming, aged 47, was appointed as an independent non-executive Director of the Company on 30 March 1999. Mr Wong is a chartered accountant and has extensive knowledge and experience in investment banking. He is an Executive Director and the Chief Executive Officer of Global China Group Holdings Limited. Mr Wong's business address is 6th Floor, Tower A, Sing Tao Building, 1 Wang Kwong Road, Kowloon Bay, Hong Kong.

Professor Woo Chia-Wei

Professor Woo Chia-Wei, aged 67, was appointed as an independent non-executive Director of the Company on 23 August 1999. Professor Woo is Senior Advisor to The Shui On Group. He is also President Emeritus and University Professor Emeritus of Hong Kong University of Science and Technology. He serves on the Hong Kong Special Administrative Region's Commission on Strategic Development and Council of Advisors on Innovation and Technology and also the Chinese People's Political Consultative Conferences. Professor Woo's business address is 34th Floor, Shui On Centre, 6–8 Harbour Road, Wanchai, Hong Kong.

Mr Ting Lee Sen

Mr Ting Lee Sen, aged 62, was appointed as an independent non-executive Director of the Company on 27 February 2003. Mr Ting obtained a Bachelor of Science degree in Electrical Engineering from the Oregon State University in 1965. He attended graduate studies in the same field at Stanford University and is a graduate of the Standford Executive Program. He is the Managing Director of W.R. Hambrecht + Co. and Board Director of Microelectronics Technology Inc. He was a former corporate vice president of Hewlett-Packard Company where he worked for more than 30 years. He has extensive knowledge and experience in IT industry. Mr Ting's business address is 539 Bryant Street, Suite 100, San Francisco, CA94107, USA.

Senior Management

The Company and IBM will discuss the possibility of the transferring of certain senior management staff of IBM to the Company upon or shortly prior to the Initial Closing. Details of any resultant changes to the senior management team of the Company will be provided in a further announcement.

PROPOSED APPOINTMENT OF NEW CHIEF EXECUTIVE OFFICER

It is proposed that, with effect from the Initial Closing, Mr Yang Yuanqing, currently the chief executive officer of the Company, will become the chairman of the Board while Mr Stephen M. Ward, currently a senior vice-president of IBM, will be appointed as the new chief executive officer of the Company. Mr Stephen M. Ward has been with IBM for 26 years and is currently in charge of IBM's "personal systems group" operations.

A further public announcement will be made by the Company pursuant to Rule 13.51(2).

BUSINESS PROSPECTS OF THE ENLARGED GROUP

The Lenovo Group currently maintains the number one position for sales of Personal Computers in the PRC and sells to the consumer, commercial and all other major segments of the markets. It is expected that the combination of the Company and the Business will result in the creation of the third largest Personal Computer manufacturer and seller in the world, and the largest in Asia Pacific, in each case measured by revenues. The Asset Acquisition will immediately provide the Enlarged Group with a strong presence in all major markets globally for the sale of personal computers to enterprise customers and is also expected to increase opportunities for the penetration of the consumer sector in markets other than the PRC. By serving complementary markets and mutual strengthening the competitiveness that each of the Lenovo Group and IBM currently have in their respective target market, the Enlarged Group expects to have significantly improved competitiveness against the major competitors such as Dell and Hewlett-Packard.

Build the Lenovo brand

With the strong brand presence of IBM in the most important major commercial markets globally, and of the Lenovo Group in the PRC, the Enlarged Group is expected to have the foundation to build greater brand awareness among potential customers than its competitors. This enhanced brand awareness, together with the full range of products by the Enlarged Group, will enable the Company to serve a wide span of end markets and the various segments within each sector after closing.

In order to establish Lenovo's brand as a single, worldwide brand with an innovative and premium image, and with a view to minimizing any loss of business for the Enlarged Group, IBM and the Company have agreed that there will be a transition period during which the Enlarged Group may use the IBM logo on specific products. Pursuant to the terms and conditions of an agreement between the Company and IBM, certain rights to the "Think" family brand historically used by IBM in a family of products and features (such as, for example, "ThinkPad", "ThinkCentre", "ThinkVision" and "ThinkVantage") will be licensed by the Enlarged Group. Under the license, the Enlarged Group will be permitted to adopt new brands incorporating the "Think" common family mark, which the Company intends to adopt as the umbrella brand for its Personal Computer products globally. The Company will be assigned several marks exclusive to the Business, including "ThinkPad", "ThinkCentre", "ThinkVision" and "ThinkVantage", and will have the right to create new marks incorporating the "Think" element. The Company believes there will be significant leverage in using "Think" as the umbrella brand because of the significant brand awareness and recall that IBM has developed in respect of these particular product lines.

Focus on innovation

The Business and the Company share a consistent aspiration on technology and product innovation. The Enlarged Group will be expected to continue focusing on product differentiation, and aspiring to sustain its technology advantage and provide end customer with broader and more innovative products. The combination of the respective research and development strengths of the Company and the Business is one of the most critical factors to achieve the aspiration. The Enlarged Group will seek to consolidate and optimize research and development resources in three research and development centres as follows:

(1) the USA research and development centre in Raleigh will be responsible overall process coordination, research and development program management, technology roadmap setting, specifications and quality standard control, and global technical support;

(2) the Japan research and development centre in Yamato will continue to be the center of notebook development, responsible for developing core technology and common platforms for notebook; and

(3) the China research and development centre will be the Enlarged Group's centre of desktop development. It will also be responsible for regional tailored notebook design, application development, peripheral product development and product engineering and testing.

Over the next two years, the Enlarged Group will evaluate and consolidate its product portfolio with an objective of having a single worldwide product portfolio based on existing strongest product offerings and further driving technology and product innovation in a consistent and more efficient manner. In addition, by increasing the number of common platforms, the Enlarged Group will be able to consolidate component sourcing and supplier to maximize sourcing synergies.

Strengthen sales

The Enlarged Group's sales initiatives will adapt to different sectors of the market, with a view to developing a presence in every major global market through either maintaining its own office or its channel partners. Enlarged Group's full product range can exploit the three primary sales approaches historically used by the Business: (a) direct sales with continuous collaboration with IBM corporate account representatives, to enterprise customers; (b) sales channel partners, as part of a discrete technology platform decision to achieve broad global reach; and (c) to clients wanting third-party face to face assistance. The three primary sales approaches will be complemented with online and telephone sales and assistance. To support this strategy, IBM will continue providing support to the Enlarged Group with its global sales infrastructure and its corporate sales team of approximately 8,260 account representatives who combine a deep understanding of each client's organisational and industry-specific needs with comprehensive knowledge of the products, technologies, and services offered by the Business and its network of business partners. In the enterprise market, the Enlarged Group will leverage the current IBM sales team and continue to execute sales by collaborate with IBM account representatives during the transition period, with a view to minimising any negative impact on the Business. The Enlarged Group will at the same time leverage IBM's sales force for any sales leads it generates and seek to execute those for itself so as to assume increasing responsibility in operating the Business without any material disruptions following the transition period.

The Enlarged Group expects to continue the year-on-year growth obtained in 2003 by each of the Lenovo Group and IBM in complementary sectors of the Personal Computer market. In particular in the commercial sector, the Enlarged Group's focus will be on strengthening its market share of sales to small and medium sized enterprises and maintenance of IBM's market leadership in sales to large enterprises. The Enlarged Group intends to leverage its experience in the consumer market in the PRC, where the Company historically has held a strong market share, by the introduction of new consumer products to the global market through the existing sales, marketing and distribution infrastructure that the Business has in place.

Drive down cost

The Enlarged Group is expected to aggressively drive down cost through two key initiatives. The first initiative is to leverage the combined scale and its leading market position in the Personal Computer industry to obtain preferential terms from suppliers and actively manage the partnership relationship with OEM suppliers and contract manufacturers.

The second initiative is to fully leverage PRC low cost infrastructure to reduce the global operating cost, including restructuring integrated supply chain operation and leveraging PRC low cost manufacturing capability. The headquarters of the Enlarged Group's integrated supply chain will be located in the PRC, from where it intends to conduct the global procurement of components required in the manufacturing of Products, operate its integrated supply chain and back-end operations, including responsibility for sourcing, manufacturing, global logistics in respect of delivery of Personal Computers to end users, worldwide solutions and coordination of supply operations. In addition, the PRC will also serve as the regional control tower for the Asia Pacific region. The Enlarged Group will also consider optimizing the regional control towers, which are responsible for coordinating the sales and final assembly of Products for the respective regions, for Americas and EMEA by exploring the opportunities to relocating them to low cost jurisdictions in the respective regions.

To enhance manufacturing cost efficiencies, manufacturing of desktop computers for PRC market and Asia Pacific region will be carried out mainly in the PRC in conjunction with notebooks required for the global market. In respect of desktop computers for the global market, the Enlarged Group will aggressively pursue maximum cost containment by manufacturing barebone system in the PRC and arranging final assembly of the desktop computers in the local region in which they are intended to be sold. To maximize cost efficiencies in manufacturing, all final assemblies are to be outsourced to a electronic manufacturing services partner who has factories in low cost jurisdictions for Americas and EMEA regions.

INFORMATION ON THE LENOVO GROUP

The principal activity of the Company is investment holding. The principal activities of the Lenovo Group are the provision of advanced information technology products and services in the PRC.

The Company has been listed on the Stock Exchange since 1994 and is a constituent stock of the Hang Seng Index. Its American Depositary Receipts are also traded in the over the counter market in the USA.

INFORMATION ON IBM

IBM is the largest supplier of "hardware", "software" and information technology services, and pioneered the development and implementation of "e-business" solutions. Over the past decade, IBM has been a leader in the information technology market's shift of focus from selling hardware, software, and services, to the creation of solutions to clients' business problems. The common stock of IBM is listed on the New York, Chicago and Pacific stock exchanges and on other exchanges in the USA and around the world. IBM and its associates do not hold any Shares in the Company.

SHAREHOLDERS' APPROVAL

The Asset Acquisition constitutes a very substantial acquisition of the Company under the Listing Rules which requires the approval of the Independent Shareholders at the Extraordinary General Meeting. Each Continuing Connected Transaction is subject to the approval of the Independent Shareholders at the Extraordinary General Meeting.

Neither the Major Shareholder nor its associates has any interest in the Asset Acquisition or the Continuing Connected Transactions which is different from that of the other Shareholders. Hence, the Major Shareholder will not be required to abstain from voting at the Extraordinary General Meeting. The Company is not aware of any Shareholder who will need to abstain from voting at the Extraordinary General Meeting.

The Independent Board Committee has been established to advise the Independent Shareholders on the Continuing Connected Transactions. Cazenove Asia has been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders on the Continuing Connected Transactions. Goldman Sachs has been appointed as the financial adviser to advise the Company in relation to the Asset Acquisition and the Continuing Connected Transactions.

Shareholders should note that the Asset Acquisition, which is subject to the Conditions Precedent, may or may not be completed. Shareholders are reminded to exercise caution when dealing in the securities of the Company.

EXTRAORDINARY GENERAL MEETING AND VOTING AGREEMENT

A notice convening the Extraordinary General Meeting to be held on Thursday, 27 January 2005 at 9:30 a.m. at Ballroom B, Level 5, Island Shangri-La Hong Kong, Pacific Place, Supreme Court Road, Central, Hong Kong or any adjournment thereof is set out on pages 324 to 326 of this circular for the purpose of considering and, if thought fit, passing, inter alia, the resolutions in respect of the Asset Acquisition and the Continuing Connected Transactions.

A form of proxy for use by the Independent Shareholders at the Extraordinary General Meeting is enclosed. Whether or not you are able to attend the meeting in person, you are requested to complete and return the form of proxy in accordance with the instructions printed thereon to the share registrar of the Company, Abacus Share Registrars Limited at Ground Floor, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong as soon as possible and in any event not later than 48 hours before the time appointed for holding such meeting or any adjourned meeting (as the case may be). Completion and return of the form of proxy will not preclude you from attending and voting in person at the Extraordinary General Meeting or any adjourned meeting thereof (as the case may be) and in such event, the relevant forms of proxy shall be deemed to be revoked.

Pursuant to Article 73 of the articles of association of the Company, a poll may be demanded by the Chairman or:

(a) by at least three Shareholders present in person or by proxy for the time being entitled to vote at the meeting; or

(b) by any Shareholder present in person or by proxy and representing no less than one-tenth of the total voting rights of all the Shareholders having the right to vote at the meeting; or

(c) by any Shareholder present in person or by proxy and holding shares in the Company conferring a right to vote at the meeting being shares on which an aggregate sum has been paid up equal to and not less than one-tenth of the total sum paid up on all the Shares conferring that right.

According to Rule 14A.52 of the Listing Rules, the votes taken at the Extraordinary General Meeting to seek approval of the Continuing Connected Transactions and their respective annual caps will be taken by poll.

Subject to any applicable laws or regulations, the Listing Rules and the requirements and decisions of any regulatory authority, the Major Shareholder has, under the Voting Agreement, covenanted and agreed with IBM to vote (or cause to be voted) in favour of the Asset Purchase Agreement, the Company Agreement, the Ancillary Agreements and any other agreements relating to the transactions mentioned herein, and any transaction contemplated under such agreements at the Extraordinary General Meeting and any adjourned meeting. The Major Shareholder also covenanted and agreed with IBM not to take any action which would frustrate its ability to perform its obligations and undertakings under the Voting Agreement.

LISTING AND DEALING

Application will be made to the Listing Committee of the Stock Exchange for the listing of and permission to deal in the Shares which shall be issued to IBM upon the Initial Closing and the Shares to be issued upon conversion of the Non-voting Shares. No part of the share capital of the Company is listed or being dealt in on, and no listing or permission to deal is being proposed to be sought on, any other stock exchange.

RECOMMENDATION OF THE INDEPENDENT BOARD COMMITTEE

Your attention is drawn to the letter of advice from the Independent Board Committee and the letter from Cazenove Asia containing its recommendations to the Independent Board Committee and the Independent Shareholders in relation to the terms of the Continuing Connected Transactions set out on pages 60 to 61 and pages 62 to 101 of this circular, respectively.

Your attention is also drawn to the additional information set out in the appendices to this circular and the notice of the Extraordinary General Meeting.

By order of the Board
Liu Chuanzhi
Chairman

lenovo联想

Lenovo Group Limited 聯想集團有限公司

(Incorporated in Hong Kong with limited liability)

(Stock Code: 992)

Executive Directors:
Mr Liu Chuanzhi
Mr Yang Yuanqing
Ms Ma Xuezheng

Non-executive Director:
Mr Zeng Maochao

Independent Non-executive Directors:
Mr Wong Wai Ming
Professor Woo Chia-Wei
Mr Ting Lee Sen

Registered office:
23rd Floor, Lincoln House,
Taikoo Place, 979 King's Road,
Quarry Bay,
Hong Kong

31 December 2004

To the Independent Shareholders

Dear Sirs/Madam,

CONTINUING CONNECTED TRANSACTIONS

We refer to the circular dated 31 December 2004 of the Company (the "circular") of which this letter forms part. Terms defined in the circular shall have the same meanings herein unless the context otherwise requires.

We have been appointed to form the Independent Board Committee to consider and advise the Independent Shareholders as to whether, in our opinion, the terms of the Continuing Connected Transactions, including the annual caps for each of the relevant years following the Initial Closing (including that the transactions underlying the Master Distribution Agreement are not subject to any annual cap), are fair and reasonable and in the interest of the Company and the Shareholders as a whole. Cazenove Asia has been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the terms of the Continuing Connected Transactions, including the annual caps for each of the relevant years following the Initial Closing (including that the transactions underlying the Master Distribution Agreement are not subject to any annual cap).

We wish to draw your attention to the "Letter from the Board" set out on pages 11 to 59 of the circular which contains, inter alia, information on the Asset Acquisition and the Continuing Connected Transactions as well as the letter from Cazenove Asia set out on pages 62 to 101 of the circular which contains its advice in respect of the terms of the Continuing Connected Transactions, including the annual caps for each of the relevant years following the Initial Closing (including that the transactions underlying the Master Distribution Agreement are not subject to any annual cap).

Having taken into account the advice of Cazenove Asia, we consider that the terms of the Continuing Connected Transactions, including the annual caps for each of the relevant years following the Initial Closing (including that the transactions underlying the Master Distribution Agreement are not subject to any annual cap) are fair and reasonable and are in the interest of the Company and the Shareholders as a whole. Accordingly, we recommend the Independent Shareholders to vote in favor of the ordinary resolution to be proposed at the Extraordinary General Meeting to the extent of the terms of the Continuing Connected Transactions and the annual caps thereunder (including that the transactions underlying the Master Distribution Agreement are not subject to any annual cap). Shareholders should note that the resolution to be proposed to approve the Continuing Connected Transactions also cover the Asset Acquisition. Accordingly, Independent Shareholders voting at the resolution will need to consider the merits of the Asset Acquisition and the Continuing Connected Transactions as a whole.

Your faithfully
For and on behalf of
Independent Board Committee

Wong Wai Ming **Woo Chia-Wai** **Ting Lee Sen**

Independent non-executive Directors

The following is the full text of the letter from Cazenove Asia setting out its advice to the Independent Board Committee and the Independent Shareholders in relation to the Continuing Connected Transactions prepared for the purpose of inclusion in the circular:

CAZENOVE
Cazenove Asia Limited

31 December 2004

The Independent Board Committee and
the Independent Shareholders of
Lenovo Group Limited
23rd Floor, Lincoln House
Taikoo Place
979 King's Road
Quarry Bay
Hong Kong

Dear Sirs/Madam,

CONTINUING CONNECTED TRANSACTIONS IN RELATION TO VERY SUBSTANTIAL ACQUISITION OF THE PERSONAL COMPUTER BUSINESS OF INTERNATIONAL BUSINESS MACHINES CORPORATION

INTRODUCTION

We refer to our appointment by the Company as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders in respect of the Continuing Connected Transactions, details of which are set out in the circular of the Company to its Shareholders dated 31 December 2004, of which this letter forms part (the "Circular"). Terms defined in the Circular have the same respective meanings when used in this letter, unless the context otherwise requires.

Asset Purchase Agreement

On 8 December 2004, the Board announced that the Company entered into the Asset Purchase Agreement with IBM under which the Company agreed to acquire certain assets and assume certain liabilities in connection with the Business. Details of the Asset Purchase Agreement are set out in the section headed "Asset Purchase Agreement" in the Letter from the Board as set out in the Circular. The Asset Acquisition constitutes a very substantial acquisition of the Company under Rule 14.08 of the Listing Rules and requires the approval of the Independent Shareholders at the Extraordinary General Meeting. Immediately following the Initial Closing, IBM will hold up to approximately 9.9% (comprising Shares only) of the enlarged issued share capital (comprising Shares only) and up to approximately 18.9% (comprising Shares and Non-voting Shares) of the total enlarged issued share capital (comprising Shares and Non-voting Shares), in each case, of the Company. The Stock Exchange has deemed IBM as a connected person of the Company under the Listing Rules upon the Initial Closing.

Although the Asset Acquisition constitutes a very substantial acquisition as referred to above and Independent Shareholders' approval is required, it has been confirmed to us by the Directors that it does not constitute a connected transaction under the Listing Rules. Accordingly, it is not within our terms of reference to advise the Independent Board Committee and the Independent Shareholders in relation to the terms (including but not limited to the Cash Consideration and the Consideration Shares), commercial merits or other aspects of the Asset Purchase Agreement. In addition, it is not within our terms of reference to consider or advise on the terms, commercial merits or other aspects of the Company Agreement, the Employee Matters Agreement and the Intellectual Property Agreements. In these respects, the Independent Shareholders are recommended to consult their own professional advisers and refer to the information contained in the Circular.

Ancillary Agreements

Pursuant to the Asset Purchase Agreement, the Company and IBM entered into the Ancillary Agreements under which IBM agrees to, amongst other things, provide a broad range of services to the Enlarged Group post-Initial Closing. Details of the terms of these Ancillary Agreements are set out in the section headed "Ancillary Agreements" in the Letter from the Board as set out in the Circular. The Ancillary Agreements are conditional, and will take effect, on Initial Closing.

As a result of IBM being deemed a connected person of the Company under the Listing Rules as from the Initial Closing, the transactions under these Ancillary Agreements (except for the Employee Matters Agreement) will constitute continuing connected transactions of the Company under the Listing Rules, which are subject to the approval by the Independent Shareholders at the Extraordinary General Meeting. In respect of the Employee Matters Agreement, we are given to understand that the transactions contemplated thereunder do not constitute continuing connected transactions of the Company under Rule 14A.14 of the Listing Rules. In respect of the Intellectual Property Agreements, the Company has confirmed that whilst they constitute continuing connected transactions of the Company, the transactions thereunder fall within the de minimis exemptions under Rule 14A.33(3) of the Listing Rules.

We, Cazenove Asia, have been appointed as the independent financial adviser to advise the Independent Board Committee and the Independent Shareholders as to whether the terms of these Continuing Connected Transactions are (a) carried out in the ordinary and usual course of the Enlarged Group's business; (b) based on normal commercial terms and are fair and reasonable; and (c) in the interests of the Company and the Shareholders as a whole, and to advise the Independent Shareholders on how to vote on the resolution to be proposed at the Extraordinary General Meeting to approve, inter alia, the Continuing Connected Transactions. It should be noted that the resolution has been structured by the Company to approve the Asset Acquisition and the Continuing Connected Transactions together in one single resolution. Accordingly, Independent Shareholders should note that the Asset Acquisition and the Continuing Connected Transactions will be approved or disapproved together while it will not be possible to approve one but not the other. Our advice will also be accordingly limited to voting on part only of such resolution to the extent of the Continuing Connected Transactions.

In formulating our opinion and recommendation, we have relied on the information and facts supplied, representations made and opinions expressed to us by the Company, the Directors and the Company's advisers and representatives, for which they are solely responsible. We have assumed that all such information, statements and representations supplied or made to us are true, accurate and complete at the time they were made, and continue to be so as at the date of this letter and up to the date of the Extraordinary General Meeting, and there has been no material change thereof. We have also assumed that all information, statements and representations contained or referred to in the

Circular are true, complete and accurate and have been included or made after due enquiry and careful consideration. We have been advised by the Company and the Directors that no material facts have been omitted from the information provided to us or included in the Circular. We have also been advised by the Company and the Directors that there are no other facts or representations, the omission of which would make any statement contained in the Circular, including this letter, incorrect, inaccurate or misleading in relation to the Continuing Connected Transactions. We have also assumed that the Continuing Connected Transactions will be conducted in accordance with the terms of the respective agreements under which they fall under.

As the independent financial adviser to the Independent Board Committee and the Independent Shareholders, we have not been involved in the negotiations in respect of the terms of the Asset Purchase Agreement and the Ancillary Agreements, including the underlying Continuing Connected Transactions. We consider that we have been provided with, and we have reviewed, sufficient information to enable us to reach an informed view regarding the Continuing Connected Transactions. We have not carried out any independent verification of the information provided to us by the Company, the Directors and the Company's advisers and representatives, nor have we conducted any independent in-depth investigation into the business and affairs or future prospects of the Enlarged Group. Accordingly, we do not warrant the accuracy or completeness of any such information. However, we have no reason to suspect that any material facts or information have been omitted or withheld from the information supplied or opinions expressed to us nor to doubt the truth, accuracy and completeness of the information and representations provided, or the reasonableness of the opinions expressed, to us by the Company, the Directors and the Company's advisers and representatives.

This letter is for the information of the Independent Board Committee and the Independent Shareholders solely in connection with their consideration of the Continuing Connected Transactions and, except for its inclusion in the Circular and references thereto in the letter from the Independent Board Committee set out in the Circular, is not to be quoted or referred to, in whole or in part, nor shall this letter be used for any other purpose, without our prior written consent.

Cazenove Asia is a licensed corporation to carry out types 1, 4, 6 and 9 of the regulated activities under the SFO. Cazenove Asia and its affiliates, whose ordinary business involves, among others, trading of and dealing in securities, may be involved in the trading of, dealing in, and the holding of the securities of the Company for client accounts.

CONTINUING CONNECTED TRANSACTIONS

Out of the Ancillary Agreements, the Company has confirmed that the following, due to their ongoing nature, constitute continuing connected transactions which require Independent Shareholders' approval under the Listing Rules:

- Transition Services Agreement;
- Strategic Financing and Asset Disposition Services Agreement;
- IGS Services Agreement;
- Internal Use Purchase Agreement;
- Marketing Support Agreement;

- Master Distribution Agreement; and
- Real Estate Arrangements (except leasehold interests assigned to the Lenovo Group).

We understand that out of the Ancillary Agreements, (1) the transactions contemplated under the Employee Matters Agreement do not constitute continuing connected transactions of the Company under Rule 14A.14 of the Listing Rules; and (2) the transactions under the Intellectual Property Agreements fall within the de minimis exemption under Rule 14A.33(3) of the Listing Rules.

The Company is of the view that the Continuing Connected Transactions constitute non-exempt continuing connected transactions under the Listing Rules as the annual service fees and other consideration payable under these transactions, whether under each of the relevant Ancillary Agreement on a standalone basis, or in aggregate, are greater than 2.5% as calculated under each applicable percentage ratio pursuant to Rule 14.04(9) of the Listing Rules (other than the profits ratio).

The Company has confirmed to us that it has undertaken to conduct an annual review by the independent non-executive Directors and the Company's auditors of the Continuing Connected Transactions in accordance with the requirements as set out in Rule 14A.37 to Rule 14A.40 of the Listing Rules. The Company has also specifically undertaken to fully comply with the relevant disclosure and/or Independent Shareholders' approval requirements under Chapter 14A of the Listing Rules should there be a change of circumstances in respect of the Continuing Connected Transactions which would render it necessary on the part of the Company to make a disclosure or obtain the approval of the Independent Shareholders.

We have been advised by the Directors and the Company's management that the terms of the Continuing Connected Transactions form part of the Asset Purchase Agreement and their terms were negotiated on an arm's length basis and are determined by reference to historical intra-group charges paid by the Business to other business units of IBM and market rates charged by other independent third party providers or charged to independent third party customers for the same and similar services in the ordinary and usual course of business (if any). We are advised by the Directors and the Company's management that the terms of the services provided by the Enlarged Group to IBM or supplied by IBM to the Enlarged Group will, as a whole, be no less favourable to the Enlarged Group than those provided to or supplied by any independent third parties for the same or similar services.

GENERAL PRINCIPAL FACTORS CONSIDERED

The Directors believe that the combination of the Company's business with the Business is a unique opportunity for the Company to expand beyond the PRC and fulfil its globalisation strategy and to achieve a global leadership in the Personal Computer sector. The Company has before the Asset Acquisition achieved a leading position in the PRC Personal Computer industry. It will also facilitate the forging of a long-term strategic relationship with one of the world's largest information technology companies. This will also create a comprehensive and innovative product portfolio and significantly enhance the Company's competitiveness against its competitors in and outside the PRC for all customer segments.

The Directors also consider that the Asset Acquisition will allow the Company to quickly transform from a business conducted mainly in the PRC into a worldwide operation with a global business platform over which integration of the Enlarged Group's various business activities can be enhanced, including integrated supply chain (such as strategic procurement and manufacturing etc.), strategic marketing, branding and public relations, corporate research and development, services and Lenovo.com. Other synergistic opportunities offered under the combination with the Business include branding recognition (with a view to eventually establishing "Lenovo" as a worldwide brand name), enhanced product portfolio etc.. The Directors are of the view that given the Business is one of the leading Personal Computer businesses in the world in terms of its scale, global reach, innovation capabilities and brand strength, such integration would provide advantages to the Enlarged Group's business, such as streamlining of operations and cost efficiency. Such advantages are particularly valuable in the highly competitive environment of the Personal Computer industry, which results in strong pricing pressure across the board. Such integration of business on a global basis thus increases the Company's competitive edge in the Personal Computer market.

The transfer of the assets and businesses under the Business to the Company post-Closings include the core business for the manufacturing, development and marketing of Personal Computers of a defined scope. Some of the supporting functions remain in the IBM group since such functions are an integral part of IBM's remaining business and hence it would not be feasible to segregate such supporting functions for sale to the Company. We have been informed by the Board and the Company's management that they are considering plans to develop and establish their own resources and infrastructure to perform such supporting functions and services. However, as these are large-scale projects, the implementation of such projects will take time, efforts and resources. Following Initial Closing of the Asset Acquisition, it would be necessary to secure IBM's support for the Business, utilising IBM's existing infrastructure and personnel. The Continuing Connected Transactions offer such interim continuing support to the Business post-Closings.

One of the objectives of the Asset Acquisition was the forging of a long-term strategic relationship with the world's largest information technology company, which is one of the global leaders in business and technology services, information technology solution consulting services, information technology research and information technology financing services. Certain of the Continuing Connected Transactions are aimed to secure the long-term strategic relationship with IBM so as to ensure that the Enlarged Group can focus on the Personal Computers business while at the same time, a complete offering of services is made to customers.

The Company has sought to secure support for the Business over varying periods after Initial Closing in the form of the Continuing Connected Transactions to ensure that, as far as possible, the objectives mentioned above are met. We are advised by the Directors that it is also anticipated that the Continuing Connected Transactions will secure a successful long term integration of the Business and will enhance minimum disruption to the Business, its customers, business partners, operations and management.

In arriving at our opinion and advice to the Independent Board Committee and the Independent Shareholders with regard to the Continuing Connected Transactions, we have relied upon the general principal factors set out above.

On each separate agreement, we have in particular considered and taken into account the following rationale and factors for consideration, which are set out below together with further details of each of the Continuing Connected Transactions.

1. TRANSITION SERVICES AGREEMENT

1.1 Description

We are informed by the Directors that it is essential for the smooth transfer of the Business, and to achieve significant operational synergies, for IBM and the Company to enter into the Transition Services Agreement pursuant to which IBM and its affiliates will provide the Enlarged Group with the Transition Services.

The Transition Services are supporting functions essential for the Business which are provided mostly by IBM's head office in the United States.

The TSA Service Description Attachments, which form part of the Transition Services Agreement, document each of the Transition Services. We summarise the Transition Services to be provided by IBM below:

1.1.1 *Information Technology*

- *TSA — information technology services*

  Management of the Company's mainframe environment and the midrange server environment using appropriate system management control disciplines, the delivery of storage area network, global storage architecture and AFS/DFS file system space to multi-platform end users, management of the email system and the provision of necessary servers, help desk services, telephone services, application services, network services and remote access services.

1.1.2 *Development*

- *TSA — development services*

  Single byte character set preload services, translation services for product-related information and publications, regulatory compliance services, support services and general engineering services.

1.1.3 *Sales and Marketing*

- *TSA — Marketing Communications services*

  Advice and consultative services in support of the Company's marketing communications and demand generation campaigns and the provision of advice, reporting and resources access for certain services related to marketing communications operations, agency operations, advertising and media services.

- *TSA — Customer and reseller satisfaction services*

  Market research and other market intelligence services to measure the Company's customer and reseller satisfaction.

- *TSA — One Voice Marketing Campaign services*

  An integrated program consisting of advertising and demand generation tactics that builds demand for participating products and services in certain jurisdictions.

- *TSA — Raleigh Briefing Center services*

  Services for the use of IBM's briefing center in Raleigh, North Carolina for customer presentations and demonstrations.

- *TSA — PartnerWorld program services*

  Sales and marketing tools, skill building courses and technical support to assist the Company in creating new opportunities to grow its business through IBM's worldwide program for business partners.

1.1.4 *Finance*

- *TSA — worldwide accounts payable production procurement services*

  Worldwide accounts payable production procurement services to include invoice processing, the making of payments, instituting practices, policies and controls and providing help desk support.

- *TSA — worldwide accounts payable general procurement services*

  Worldwide general procurement accounts payable services to include invoice processing, the making of payments, instituting practices, policies and controls and providing help desk support.

- *TSA — payment systems services*

  Electronic payment transaction services (e.g., credit check and credit card validation and authorisation), order validation with respect to compliance with export regulations, real-time calculation of sales tax and value added tax on orders, on-line payment management services, fraud prevention services, risk management services, credit card fee optimisation and collection services, financial services and account management services.

- *TSA — fixed assets accounting and property control administration — Americas*

  Fixed asset accounting services (i.e. recording of asset values, monthly depreciation, asset transfer processing, asset retirements processing, reconciliation and monthly and ad hoc reporting) and property control services to track/control fixed assets.

- *TSA — ledger support services — Americas*

  Ledger processing and data incorporation.

- *TSA — software royalty management services*

Financial administration of software royalty payments, including consultation regarding software royalty provisions in draft contracts, calculation of software royalties and interfacing with both accounts payable for vendor payments and the general ledger for financial reporting.

- *TSA — inter-company accounting services*

Cross border billing services through a common inter-company accounting system.

- *TSA — treasury services — Americas*

Assistance with cash forecasting, the cash management process, setting up bank accounts for the Company's subsidiaries and other cash management related activities.

- *TSA — credit evaluation services*

Credit evaluations of the financial condition of certain customers of the Company.

- *TSA — tax services — Americas*

Value added tax, goods and services tax and sales tax returns services for each country and personal property tax returns and assistance in implementing a worldwide income tax compliance and planning function.

1.1.5 *Human Resources*

- *TSA — HR services*

Administrative, transactional and process support services for the Company's human resources services.

- *TSA — Learning services*

Provision of the IBM Learning Services programs to the Company's employees, seconded employees, business partners and clients through IBM's learning organisation using currently existing training methods, including both online learning and classroom based learning programs and content.

1.1.6 *Integrated Supply Chain*

- *TSA — General procurement services*

Worldwide provision of requisitioning, purchase order generation, placement and close out, sourcing, receipt tracking, maintenance of controls and audibility, measurement and metrics tracking and other related procurement services in connection with, among other categories, travel and hospitality, marketing and advertising, engineering and office products, building and facilities and IT and communications.

- *TSA — Singapore Trading Center services*

  Services in relation to the Singapore Trading Center (a major outsourced supply chain location that supports transactions primarily with Asia Pacific component or commodity suppliers and CM/EMS/ODM suppliers).

1.1.7 ***Facilities services***

- *TSA — Facilities services*

  Provision of general real estate and property management services, building security services, general maintenance services, health and safety, and environmental services, administrative type services, mailroom services, copy/fax and printing services, office supplies services and other building related services to the Company's properties in various jurisdictions.

1.2 Rationale

From our discussions with the Company, the Directors and the Company's advisers and representatives, we understand that the Transition Services comprise services which are currently used by the Business and are necessary for its proper operation following Initial Closing. At present, the Company does not have equivalent capabilities to provide such services itself. In order to operate the Business, the Company will need to ensure that these or similar services are in place to support and service the Business from Initial Closing.

We also understand from the Directors that it is the Company's intention to establish its own capabilities so that it can provide the Transition Services itself on expiration of the Transition Services Agreement. However, before the Company can build these capabilities, it is necessary for IBM to provide such services. There is expected to be a migration of know how relating to the provision of the Transition Services from IBM to the Company which will assist the Company in establishing its own capabilities to deliver similar supporting function in the future. In this regard, for the subsequent years of the Transition Services Agreement, IBM and the Company shall collaborate in developing a migration plan for each Transition Service beginning no later than 90 days after the commencement of such service and to be completed no later than 90 days prior to the termination of such service pursuant to the TSA Service Description Attachments.

The Transition Services will provide the infrastructure to, after Initial Closing and until the Company is able to complete the integration of the Business, assist and support the Company's operation of the Business and thus help minimising disruption to operation and customer service.

Whilst certain of the Transition Services could be outsourced to other third party service providers, we understand from the Directors that there are significant advantages in having IBM provide the Transition Services as a whole because of its familiarity with the Business and its expertise as well as compatibility with the products of the Business. The Directors believe that there is no other directly comparable service provider and IBM will be able to provide the Transition Services more efficiently than other similar service providers and at favourable fees and charges.

1.3 Term and expiration

All the Transition Services will be provided by IBM as from Initial Closing for a period of one year, except for certain development services (which will be for a period of 18 months), certain finance and integrated supply chain services (which will be for a period of two years) and information technology services (which will be for a period of three years).

The Transition Services Agreement will terminate upon the earlier of: (i) the date on which all of the Transition Services are terminated; (ii) the last date indicated for the termination of a Transition Service in the TSA Service Description Attachments; or (iii) either party exercising its right of termination if there is any material breach of obligations by the other party and such party fails to cure such default in all material respects within 60 days after receiving notice of such breach. The Company may also cancel any Transition Service or reduce the amount of any separately priced portion of a Transition Service at any time upon 60 days' prior written notice, for instance, upon the Company sourcing such services from another party or developing its own similar capabilities in the future.

1.4 Fees/Pricing

The total amount of charges which the Company expects to pay to IBM under the Transition Services Agreement for each of the coming three years after Initial Closing will be approximately:

		Total annual fee for each of the annual year commencing on Initial Closing		
Transition Services Agreement	**Year**	**1st**	**2nd**	**3rd**
			(US$ million)	
Total		246	193	170

The charges under the Transition Services Agreement are initially for a fixed monthly amount for each service. The amount of the charges to be paid has been determined by reference to historical costs allocated to the Business by IBM with reference to the revenues, gross profit and operating expenses as part of its budgeted expenses. Reference is made to the sections headed "Allocated Costs/Expenses" and "Agreement with IBM" on pages 122 and 123 in the audited US combined financial statements set out in Appendix I to the Circular. According to the Directors, the total annual fee of US$246 million for the first year after the Initial Closing under the Transition Services Agreement is approximately equivalent to the amount allocated to the Business by IBM for the year ended 31 December 2003 (the full financial year of the Business before the date of entering into of the Ancillary Agreements). IBM has confirmed to the Company that there will be no changes in their cost allocation basis for the Transition Services before and after the transfer of the Business.

The Company may request for increased staffing, equipment or other services from IBM above the agreed service level, in which case the additional services will be provided only if IBM and the Company agree on the additional charge with a view to accommodate the additional actual costs so incurred by IBM. If mutual agreement is not reached by the parties, IBM is not obliged to provide the additional service requested.

The annual fees payable under the Transition Services Agreement will be reduced over time because some of the Transition Services will expire pursuant to its terms. Such fees will also reduce if the Company terminates a Transition Service prior to expiration of its term or if the Company reduces the level or types of services when the Company has established its own infrastructure and capabilities to handle such services.

1.5 Factors considered

We have reviewed the following factors with regard to the Transition Services Agreement:

(A) The Directors are of the view that the services under the Transition Services Agreement are fundamental to the operation of the Business before and after the Closings. We are informed by the Directors that the Transition Services should be in place following Initial Closing for the proper and efficient operation of the Business and in order to minimise business and customer disruption.

(B) Before the Company can complete rolling out its own capabilities, it is necessary for the services under the Transition Services Agreement to be provided by a third party. The Directors consider that IBM is the most appropriate service provider in this aspect, taking into account its familiarity with the Business, and its expertise and compatibility of its software and other technology with the Business.

(C) The amount of charges to be paid has been determined by reference to the historical costs allocated to the Business by IBM with reference to revenue, gross profit and operating expenses as part of the budgeted expenses. We have reviewed the historical cost for the year ended 31 December 2003 of the Business (the full financial year of the Business before the date of entering into of the Ancillary Agreements) provided by the Company, which is in line with, and approximately equivalent to, the proposed charges for the first year after the Initial Closing under the Transition Services Agreement.

(D) The transitional period provides the Company with an opportunity to develop in-house capabilities or other plans to replace the services provided by IBM at the end of such period.

(E) The flexibility of the Company to cancel any Transition Service or reduce the amount of any separately priced portion of a Transition Service with prior requisite notice is also beneficial by offering the Enlarged Group the flexibility to reduce payments to IBM if and when it has established its own infrastructure and capabilities for the relevant services.

1.6 Proposed Annual Monetary Caps

The maximum limits on the fees payable by the Company under the Transition Services Agreement set out below have been determined by reference to the historical costs incurred by the Business, and taking into account potential 5% business tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% contingency to account for any uncertainties or additional charges:

Agreement	Year	Proposed annual monetary limit for each of the annual year commencing on Initial Closing 1st	2nd	3rd
		(US$ million)		
Transition Services Agreement		285	223	197

We have reviewed and considered historical figures provided by the Company in connection with the Business and potential 5% business tax consequences relating to the payments under the Transition Services Agreement. The Directors have advised that when determining the annual monetary limits, the charges for additional services which may be agreed between the parties in the future as described in paragraph 1.4 above have been included and our opinion therefore does cover such additional services with regard to the proposed annual monetary limits. After discussion with the Directors with regard to all of the above, we are of the view that the proposed annual monetary limits are fair and reasonable in so far as the Shareholders as a whole are concerned.

Having considered the above, we are of the view that the Transition Services Agreement is (a) carried out in the ordinary and usual course of the Enlarged Group's business; (b) based on normal commercial terms and is fair and reasonable; and (c) in the interests of the Company and the Shareholders as a whole.

2. STRATEGIC FINANCING AND ASSET DISPOSITION SERVICES AGREEMENT (THE "SFAD AGREEMENT")

2.1 Introduction

IBM (acting through IGF, which is the organisational designation for its various financing activities), will provide the following services to the Company:

- the Customer Financing Services;
- the Distribution Channel Financing Services; and
- the Excess Surplus Disposition Services.

According to the Directors, the services to be provided by IBM under the SFAD Agreement will add value to the Business. These services provide financing solutions to consumers and remarketers to purchase the Company's products, as well as a channel to the Company to dispose of returned products.

We describe below in more detail each of the Customer Financing Services, Distribution Channel Financing Services and Excess Surplus Disposition Services to be provided by IBM under the SFAD Agreement.

2.2 Customer Financing Services

2.2.1 *Description*

Customer Financing Services involve the provision of leasing and financing services to end-user customers by IBM in respect of their purchase of personal computing products and associated equipment from the Enlarged Group. Under this arrangement, the Company has the discretion on whether or not to offer Customer Financing Services to eligible customers (being those outside the PRC). However, if eligible customers request leasing or financing services or the Company offers Customer Financing Services, the Enlarged Group is obliged to refer all such customers to IBM which, in return, will pay the Enlarged Group a commission for referring customers. We note that the Enlarged Group is not obliged to offer such services if (i) the relevant Customer Financing Services are not then available for the kind of transaction proposed by the relevant customer; or (ii) the eligible customer advises the Enlarged Group that it prefers an alternative financing source.

2.2.2 *Rationale*

This service gives customers in more than 40 countries the option to purchase the Company's products by way of instalments or other financing arrangements, rather than paying the full purchase price. This arrangement is expected to enhance the revenue of the Company.

2.2.3 *Term and expiration*

The term of the SFAD Agreement is for a period of five years from the respective applicable closing date for the relevant country under the SFAD Agreement. Either party may terminate the Customer Financing Services (i) if the parties mutually agree; (ii) if there is a material breach of the agreement by a party which has not been cured within 30 days of notice of breach; (iii) upon three months' written notice, if the Company permanently ceases operation of all or a material portion of the Business or suspends such operation for a period of more than 12 months; (iv) upon three months' written notice, if IBM permanently ceases operation of all or a material portion of its business as it relates to the Customer Financing Services or suspends such operation for a period of more than 12 months; or (v) upon the occurrence of certain bankruptcy related events with respect to the other party.

2.2.4 *Fees/Pricing*

Under the Customer Financing Services of the SFAD Agreement, the Company will receive from IBM a commission based on the total invoice price of the customer financing and leasing transactions that are facilitated by the Company. The commission rates payable to the Company will be as follow:

Type of Transaction	**Commission (percentage of total invoice price)**
Financing transactions in which the total invoice price of financed items is less than US$50,000	2%
All other financing transactions	1%

Commencing with the first full calendar year post Initial Closing (i.e. 1 January, 2006 to 31 December 2006, assuming Initial Closing takes place within 2005) and in respect of each calendar year thereafter, the commission under the SFAD Agreement payable to the Company for such calendar year will be adjusted either upwards by 0.25% if the total invoice price is greater than 120% of a pre-agreed target volume, or downwards by 0.25% if the total invoice price is less than 80% of the such target volume, depending on the total invoice prices of the transactions which take place during that year.

IBM has agreed that commission arrangements and other terms and conditions of the SFAD Agreement are to be on terms no less favourable to the Company than those which IBM offered externally to any other manufacturers of personal computing products and related equipment as of the date of the Asset Purchase Agreement.

2.2.5 *Factors considered*

We have considered the following factors with regard to the Customer Financing Services:

- The Company has confirmed that the commission rates of 1% and 2% described above are comparable to other similar financing arrangements prevailing in the market.

- The commission arrangements and other terms pursuant to the SFAD Agreement must be no less favourable to the Company than similar arrangements between IBM and independent third parties as of the date of the Asset Purchase Agreement.

- The payment of commission from IBM to the Company under the Customer Financing Services also represents an additional revenue source for the Company in addition to computer sales generated by the Company.

- The Company is under no obligation in favour of IBM to procure that customers use IBM exclusively in respect of the Customer Financing Services.

- The Company has audit rights under the SFAD Agreement to ensure the accuracy of commission fees paid by IBM and that commission arrangements are no less favourable to the Company than those between IBM and independent third parties. The parties have also agreed to have quarterly meetings to review the status of the arrangements between them.

2.2.6 *Proposed Annual Monetary Caps*

The maximum limits on the fees payable by IBM to the Company in relation to the Customer Financing Services have been determined based on the agreed upon commission schedule, estimated future business volume and taking into account potential 5% business tax consequences arising as a result of payments to be made pursuant to the SFAD Agreement and the historical amount recorded, plus a 10% contingency to account for any uncertainties.

		Proposed annual monetary limit for each of the annual year commencing on Initial Closing				
Agreement	**Year**	**1st**	**2nd**	**3rd**	**4th**	**5th**
				(US$ million)		
SFAD Agreement (Customer Financing Services)		8	9	9	9	9

We have reviewed both historical figures and projected revenue information in connection with the Business provided by the Company, assuming Initial Closing taking place at the end of March 2005, the level of commission, potential 5% business tax consequences relating to the payments under the agreement and the factoring of the 10% contingency. Having reviewed the bases and assumptions of such estimation, we consider that such estimates have been reasonably made. Based on the foregoing, we are of the view that the proposed annual monetary limits are fair and reasonable in so far as the Shareholders as a whole are concerned.

2.3 Distribution Channel Financing Services

2.3.1 *Description*

Under the Distribution Channel Financing Services under the SFAD Agreement, IBM will finance remarketers purchases of inventory from the Company. IBM will be the exclusive provider of these services to remarketers (operating principally outside the PRC) to the extent the Company chooses to offer payment terms to the remarketers. The Company will, in return, be required to pay a fee to IBM. IBM will be responsible to take up credit, funding and operational risks and related liabilities associated with the provision of the Distribution Channel Financing Services.

2.3.2 *Rationale*

The Directors are of the view that the Distribution Channel Financing Services will allow the Company to effectively manage channel credit and, as a result, significantly reduce its working capital and total invested capital required. Following Initial Closing, the increased business volume of the Enlarged Group will make working capital management a key consideration. The Directors believe that the Distribution Channel Financing Services will significantly improve the working capital management of the Enlarged Group and will therefore ensure that the anticipated future growth of the Enlarged Group will not be constrained by insufficiency in working capital.

2.3.3 *Term and expiration*

The term of the SFAD Agreement is for a period of five years from the respective applicable closing date of the relevant country under the SFAD agreement. Either party may terminate the Distribution Channel Financing Services (i) if the parties mutually agree; (ii) if there is a material breach of the agreement by the other party, which has not been cured within 30 days of notice of breach; (iii) upon three months' written notice, if the Company permanently ceases operation of all or a material portion of the Business or suspends such operation for a period of more than 12 months; (iv) upon three months' written notice, if IBM permanently ceases operation of all or a material portion of its business as it relates to the Distribution Channel Financing Services or suspends such operation for a period of more than 12 months; or (v) upon the occurrence of certain bankruptcy related events with respect to the other party.

After the first anniversary of the Initial Closing and on an annual basis thereafter, the Company or IBM can initiate a benchmarking exercise in certain countries with significant sales to determine the competitiveness of the fees paid to IBM by the Company.

Each party also has the right to terminate the Distribution Channel Financing Services in respect of certain benchmarked countries if there is any disagreement as to the charges payable by giving three months' written notice to the other party.

2.3.4 *Fees/Pricing*

Whenever IBM finances a remarketer's purchase of inventory from the Company, the Company will be required to pay IBM a fee, being a percentage of the total invoice amount determined with reference to a fee schedule, which differs in various countries and is determined with reference to, inter alia, interest rates, credit risk of the relevant remarketers and the administration and financing costs in the different jurisdictions. Such rates are subject to the benchmarking mechanism and the range will fluctuate from time to time.

The consideration to be paid by the Company in relation to Distribution Channel Financing Services will be in line with and not less favorable to the Company than the fee arrangements between IBM and any other manufacturers of personal computing products and related equipment.

2.3.5 *Factors considered*

We have considered the following factors with regard to the Distribution Channel Financing Services:

- The fee arrangements for the Distribution Channel Financing Services must be on terms which are no less favourable to the Company than the fee arrangements between IBM and other personal computer manufacturers. The Directors consider that this provision, together with the fact that IBM provides similar services to third parties, provides a "checking" mechanism for keeping the rates offered by IBM comparable with market rates.

- The parties may select external consulting companies to conduct a benchmarking exercise to determine the rates for similar services in the market. This mechanism ensures that the rates to be charged to the Company are comparable to prevailing market rates.

- The Distribution Channel Financing Services essentially constitute a "preferred arrangement". If the Company makes an offer of payment terms, it will first refer the remarketers to IBM under the arrangement. The Company will use its sole discretion whether to offer payment terms. Remarketers can choose not to use the services provided by IBM (although in such case the Company may not pay fees to the financier so chosen by the relevant remarketers).

- The Distribution Channel Financing Services are expected to enhance the working capital position of the Company.

- The Company has audit rights under the SFAD Agreement to ensure that the fee arrangements are no less favourable to the Company than those agreed between IBM and other personal computer manufacturers.

- Each party also has the right to terminate the Distribution Channel Financing Services in respect of a number of benchmarked countries if there is any disagreement as to the charges payable.

2.3.6 *Proposed Annual Monetary Caps*

The maximum amount on the fees payable by the Company under the Distribution Channel Financing Services set out below have been determined based on the estimated future business volume, rates to be charged and taking into account potential 5% business tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% contingency to account for any uncertainties.

		Proposed annual monetary limit for each of the annual year commencing on Initial Closing				
Agreement	**Year**	**1st**	**2nd**	**3rd**	**4th**	**5th**
		(US$ million)				
SFAD Agreement (Distribution Channel Financing Services)		84	86	87	89	90

We have reviewed both historical figures and projected revenue information in connection with the Business provided by the Company, assuming Initial Closing taking place at the end of March 2005, the rates to be charged, potential 5% business tax consequences relating to the payments under the SFAD Agreement and the factoring of the 10% contingency. Having reviewed the bases and assumptions of such estimation, we consider that such estimates have been reasonably made. Based on the foregoing, we are of the view that the proposed annual monetary limits are fair and reasonable in so far as the Shareholders as a whole are concerned.

2.4 Excess Surplus Disposition Services

2.4.1 *Description*

Pursuant to the Excess Surplus Disposition Services, the Company grants IBM the exclusive right of first offer with respect to all the personal computing products manufactured by or on behalf of the Company that have been returned to the Company by remarketers and cannot be resold as new. However, the Company is free to sell the relevant products to third parties if the price offered by IBM is not acceptable to the Company.

2.4.2 *Rationale*

Excess Surplus Disposition Services allow the Company to manage the disposition of its used products in a global and orderly manner to avoid channel confusion and maximise residual value by leveraging on IBM's extensive asset resell capability. The Directors consider that the global presence of IBM in different parts of the computer industry enables it to dispose of surplus equipment through various channels effectively. The Company, which currently conducts its business mainly in the PRC, does not possess such capabilities at present.

2.4.3 *Term and expiration*

The term of the SFAD Agreement is for a period of five years from the respective applicable closing date for the relevant country under the SFAD Agreement. Either party may terminate the Excess Surplus Disposition Services (i) if the parties mutually agree; (ii) if there is a material breach of the agreement by the other party which has not been cured within 30 days of notice of breach; (iii) upon three months' written notice, if the Company permanently ceases operation of all or a material portion of the Business or suspends such operation for a period of more than 12 months; (iv) upon three months' written notice, if IBM permanently ceases operation of all or a material portion of its business as it relates to the Excess Surplus Disposition Services or suspends such operation for a period of more than 12 months; or (v) upon the occurrence of certain bankruptcy related events with respect to the other party.

2.4.4 *Fees/Pricing*

At any time the Company may submit to IBM a request for quotations in relation to IBM acquiring used Personal Computers. Within three business days of receipt of such quotation, IBM will respond with a price list indicating its offer price (if any) in respect of all or a portion of the products specified in the request. The Directors have advised that IBM's offer price will be based on the quantities and model types specified in the price list. The Company may choose to accept or reject IBM's offer set out in the price list. If the Company does not accept IBM's offer, it is free to sell the used Personal Computers to other parties.

2.4.5 *Factors considered*

We have considered the following factors with regard to the Excess Surplus Disposition Services:

- The Company is under no obligation to sell such products to IBM; it may sell the products to another person if the price offered by IBM is not acceptable.
- The arrangement gives the Company access to additional channels to dispose of used computers, thus providing alternatives to those it currently uses.
- The Company confirms that it will compare the price offered by other companies before it sells its products to IBM.

Based on the above and the pricing mechanism set out in the SFAD Agreement, we consider that the Excess Surplus Disposition Services can assist the Enlarged Group to dispose of used products at a price at least equal to that offered by independent third parties.

2.4.6 *Proposed Annual Monetary Caps*

The maximum limit for the amount of purchases by IBM from the Company under the Excess Surplus Disposition Services set out below have been determined based on the estimated future business volume, and taking into account potential 5% business tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% contingency to account for any uncertainties.

		Proposed annual monetary limit for each of the annual year commencing on Initial Closing				
Agreement	**Year**	**1st**	**2nd**	**3rd**	**4th**	**5th**
				(US$ million)		
SFAD Agreement (Excess Surplus Disposition Services)		58	60	61	62	63

We have reviewed both historical figures and projected revenue information in connection with the Business provided by the Company, assuming Initial Closing taking place at the end of March 2005, potential 5% business tax consequences relating to the payments under the agreement and the factoring of the 10% contingency. Having reviewed the bases and assumptions of such estimation, we consider that such estimates have been reasonably made. Based on the foregoing, we are of the view that the proposed annual monetary limits are fair and reasonable in so far as the Shareholders as a whole are concerned.

Having considered the above, we are of the view that the SFAD Agreement is (a) carried out in the ordinary and usual course of the Enlarged Group's business; (b) based on normal commercial terms and is fair and reasonable; and (c) in the interests of the Company and the Shareholders as a whole.

3. IGS SERVICES AGREEMENT

3.1 Description

The Company has agreed to engage IBM on a preferred basis in relation to maintenance and warranty services (including (i) base warranty services and (ii) post-warranty and warranty upgrade services) which means that, on an annual basis, at least 95% of all maintenance and warranty services in a prescribed territory will be offered to IBM subject to certain exclusions. IBM may provide similar services to other parties. The Company is subject to certain restrictions in its dealings with third parties outside the PRC in connection with such services. The Directors have advised that the Company will itself provide such services in the PRC.

To the extent base warranty services are made available by the Company in respect of its products, the Company will engage IBM as its preferred service provider to perform such services outside the PRC. Base warranty services are essentially "no charge" maintenance and warranty services that are commercially advertised in association with the sale of a product.

To the extent that commercial customers outside the PRC require post-warranty and warranty upgrade services after the base warranty period attached to the products of the Company, the Company has agreed to engage IBM as its preferred service provider.

The Company will also receive a sale referral fee for referring customers to purchase IBM's technology deployment services and related branding services.

Promptly following the Initial Closing, IBM and the Company will negotiate in good faith and enter into a written agreement pursuant to which the Company will provide maintenance and warranty services in the PRC on IBM products sold prior to the Initial Closing. The Company has confirmed that it will ensure that the requirement under Rule 14A.35 of the Listing Rules are complied with at the relevant time.

3.2 Rationale

The Company believes that the IGS Services Agreement will provide the following major benefits to the Company and its customers:

(A) It will help minimise customer loss by maintaining the industry best award-winning warranty services to which IBM's customers are accustomed.

(B) The Directors consider that IBM is widely regarded as one of the leading providers of after-sales services and due to its global coverage, which is uncommon in the industry, is required by the Company's top enterprise customers. The Directors also believe that a strategic partnership with IBM will help establish and maintain the premium image of the Company's product offerings and increase credibility with its enterprise customers.

(C) A strategic relationship with IBM will increase Personal Computer sales through IBM's strategic outsourcing and system integration businesses, where IBM customers outsource their information technology services to IBM or buy Personal Computer products through system integration transactions and IBM recommends that such customers purchase their related information technology hardware from the Company.

(D) The Company is allowed under this arrangement to share the profit generated from services sold by IBM and its affiliates.

3.3 Term and expiration

The term of the IGS Services Agreement is five years from the Initial Closing, and will automatically extend for additional one year periods each subject to early termination by either the Company or IBM by written notice for at least six months prior to the expiration of the then scheduled expiration of the term.

Further, either the Company or IBM may terminate the IGS Services Agreement in any one geography (i) by mutual written agreement to terminate; (ii) if there is a material breach of the agreement by any one of them which is not cured within 30 days of notice by the non-defaulting party; (iii) if any one of them permanently ceases or suspends for a period of more than 12 months the operations of a material portion of its business related to the IGS Services Agreement; or (iv) upon the occurrence of certain bankruptcy related events with respect to the other party.

3.4 Fees/Pricing

The Company will pay service fees to IBM for providing the maintenance and warranty services. The service fees for the first year will be the pricing, by each geographical location, that IBM offers for substantially similar services in the same geographical location (including products and delivery terms) in respect of any service provider customer contracts with volumes being the top three closest to the volume incurred by the Company in the relevant geographical location. Such fees will also apply to the second year of the agreement. Service fees for the remainder of the term of the agreement must be negotiated in good faith on an annual basis. If service fees cannot be agreed between the parties for any of the years three to five of the agreement, IBM may increase its fees with reference to the United States Consumer Price Index for All Urban Consumers in effect from time to time.

Under the IGS Services Agreement, the Company shall pay IBM, in addition to service fees, 10% of revenues generated from post-warranty services and warranty upgrade services, including, but not limited to, warranty extensions and post-warranty maintenance and product installation ("10% fee").

IBM shall pay to the Company a sale referral or introduction fee equal to 5% of IBM's revenues generated from sales to the Company's customers of IBM's technology deployment services and related branding services ("5% fee").

3.5 Factors considered

As mentioned above, the service fees for the first and second years will be a price benchmarked with reference to similar service provider customer contracts and, for the remainder of the term, the fees will be mutually agreed on an annual basis (and if such fees cannot be agreed, it will be determined with reference to benchmarking procedures). We consider this fee mechanism to be reasonable on the basis that (i) the fees for the first and second years refer to direct market comparables; and (ii) the fees for the remainder of the term are negotiated between the parties on a regular basis, and if they cannot be agreed, it will be determined with reference to the fixed benchmarking mechanisms discussed above.

We have reviewed the 10% fee with reference to:

(i) discussions with the Company and its advisers on the rationale and basis used;

(ii) the benefits for the Company and its customers for such services to be provided globally;

(iii) the fact that the Company does not have facilities or resources to conduct these services and must outsource these functions at present; and

(iv) the profit margins of companies that provide IT services similar to those of IBM, although we are of the view that the different locations, sizes, customer bases, etc. of such companies means that such companies may not represent direct comparables.

With regard to the 5% fee payable by IBM, we have considered:

(i) the Company currently does not and would not be able in the near future to have the capacity to provide this type of service;

(ii) the 5% fee represents an additional revenue source for the Company (we understand from the Directors that the Company does not currently have the global platform for the same type of business);

(iii) no operating costs and related risks will be incurred by the Company; and

(iv) our review of publicly available information on the fee percentages payable in similar IT related service arrangements, from which we form the view that there is no arrangement that is directly comparable to the 5% fee situation for the purpose of our review.

IBM is required to provide services at a standard materially consistent with the services provided by IBM to IBM's personal computer division prior to the date of the Asset Purchase Agreement unless otherwise mutually agreed. The parties are entitled to conduct audit against each other under the IGS Services Agreement and they must conduct monthly review meetings in respect of their performance under the agreement.

3.6 Proposed Annual Monetary Cap

The maximum limit amount on the fees payable by the Company to IBM under the IGS Services Agreement set out below have been determined based on, in our opinion, reasonable estimated future business volume, market competitive terms for warranty services, the agreed upon revenue sharing arrangement and taking into account potential 5% business tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% contingency to account for any uncertainties.

The maximum limit on the amount of the fees payable by IBM to the Company under the IGS Services Agreement set out below have been determined based on estimated future business volume, the agreed upon revenue sharing arrangement and taking into account potential 5% business tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% contingency to account for any uncertainties.

		Proposed annual monetary limit for each of the annual year commencing on Initial Closing				
IGS Services Agreement:	**Year**	**1st**	**2nd**	**3rd**	**4th**	**5th**
			(US$ million)			
Payable by the Company to IBM (regarding service fees and 10% fee)		273	318	188	191	195
Payable by IBM to the Company (regarding 5% fee)		15	15	15	16	16

We have reviewed both historical figures and projected financial information in connection with the Business provided by the Company, assuming Initial Closing taking place at the end of March 2005, potential 5% business tax consequences relating to the payments under the IGS Services Agreement and the factoring of the 10% contingency. Having reviewed the bases and assumptions of such estimation, we consider that such estimates have been reasonably made. Based on the foregoing, we are of the view that the proposed annual monetary limits are fair and reasonable in so far as the Shareholders as a whole are concerned.

Having considered the above, we are of the view that the IGS Services Agreement is (a) carried out in the ordinary and usual course of the Enlarged Group's business; (b) based on normal commercial terms and is fair and reasonable; and (c) in the interests of the Company and the Shareholders as a whole.

4. INTERNAL USE PURCHASE AGREEMENT

4.1 Description

IBM has agreed to purchase from the Company not less than 95% of the Personal Computers IBM requires world-wide for its internal use (which includes Personal Computers for use in connection with strategic outsourcing where IBM keeps title to the Personal Computers or resale business), each calendar year during the term of the Internal Use Purchase Agreement, subject to certain reductions and other limitations. IBM also has the right under the

Internal Use Purchase Agreement to buy from the Company Personal Computers for resale in certain cases, for example, in connection with various IBM services, obligations under government contracts and for use in specific IBM systems integration and outsourcing services.

4.2 Rationale

Under the Internal Use Purchase Agreement, the Company will be the preferred supplier for all Personal Computers required by IBM for its internal use, strategic outsourcing or resale deals for a period of five years. This represents a potentially significant amount of sales. In the year ended 31 December 2003 (the full financial year of the Business before the date of entering into of the Ancillary Agreements), the amount of IBM's internal purchases made it one of the largest customers of the Business. The Directors have informed us that the pricing of future sales to IBM will allow the Company to earn a comparable margin in respect of sales to other top enterprise customers.

4.3 Term and expiration

The term of the Internal Use Purchase Agreement is five years from the Initial Closing. Either the Company or IBM may terminate the Internal Use Purchase Agreement, without any cancellation charge: (i) if there is a material breach of the agreement by the other; or (ii) upon the occurrence of certain bankruptcy related events with respect to the other. Such termination will become effective on expiry of a 60 days' written notice period if the relevant cause of termination remains uncured.

4.4 Fees/Pricing

The price that the Company will receive for Personal Computers purchased for IBM's internal use (including IBM's strategic outsourcing) will be the benchmark price applicable at the time of receipt by the Company of a mutually agreed order form. The benchmark price will be determined by reference to the cost of the products plus an adjusted average profit margin (such adjusted average profit margin will be calculated with reference to the gross profit margins on a revenue weighted average basis for the Company's two largest customers in terms of the number of Personal Computers sold, which are independent third parties).

The price that the Company will receive for Personal Computers purchased for use in certain IBM systems integration and outsourcing services, as an embedded Product in another system, to fulfil obligations under existing government contracts or in other situations that the parties mutually agree will be the Company's price to its resellers for such product in similar quantities.

The price that the Company will receive for Personal Computers purchased for resale to IBM's employees (or for IBM's employees in the case of direct sales) as part of an IBM benefit plan will be the price the Company charges its own employees pursuant to the Company's employee benefit plan plus actual shipping costs. The price that the Company will receive for Personal Computers purchased by IBM for warranty and maintenance replacement service will be the base manufacturing costs of such Personal Computers plus actual shipping costs. As such arrangement is specific to this particular case, there is no market comparable available.

In the event that IBM fails to fulfil its obligations to purchase internal use Personal Computers under the Internal Use Purchase Agreement (save in respect of strategic outsourcing), it will be required to pay the Company liquidated damages in an amount equal to 2% of the price of the affected products plus the gross profit margin the Company would have derived from the sale the products (determined with reference to gross profit margin benchmarks). There are no obligations to pay liquidated damages in connection with Personal Computers for resale.

4.5 Factors considered

We note that the benchmark pricing mechanisms described above are based on profit margins of existing customers of the Company who require similar volumes of Personal Computers and the Company's pricing with its resellers in similar quantities. These existing arrangements with customers and resellers serve as applicable comparables.

We also note that the imposition of liquidated damages, being 2% plus the benchmarked profit margins of the price of the affected products, has the effect of compensating the Company in the event of a sale not proceeding.

IBM is also required to provide the Company with a report in relation to its actual requirements for, and purchases of, Personal Computers on an annual basis. We understand that this report is intended to facilitate the calculation of the 95% purchase threshold discussed in paragraph 4.1 above.

4.6 Proposed Annual Monetary Cap

The maximum limit on the amounts of purchases by IBM from the Company under the Internal Use Purchase Agreement set out below have been determined based on the agreed pricing mechanism described above, estimates of future business volume, and taking into account potential 5% business tax consequences arising as a result of payments to be made pursuant to the Internal Use Purchase Agreement, plus a 10% contingency to account for any uncertainties.

		Proposed annual monetary limit for each of the annual year commencing on Initial Closing				
Agreement	**Year**	**1st**	**2nd**	**3rd**	**4th**	**5th**
				(US$ million)		
Internal Use Purchase Agreement		500	512	520	530	541

We have reviewed both historical figures and projected revenue information in connection with the Business provided by the Company, assuming Initial Closing taking place at the end of March 2005, potential 5% business tax consequences relating to the payments under the Internal Use Purchase Agreement and the factoring of the 10% contingency. Having reviewed the bases and assumptions of such estimation, we consider that such estimates have been reasonably made. Based on the foregoing, we are of the view that the proposed annual monetary limits are fair and reasonable in so far as the Shareholders as a whole are concerned.

Having considered the above, we are of the view that the Internal Use Purchase Agreement is (a) carried out in the ordinary and usual course of the Enlarged Group's business; (b) based on normal commercial terms and is fair and reasonable; and (c) in the interests of the Company and the Shareholders as a whole.

5. MARKETING SUPPORT AGREEMENT

5.1 Description

IBM will provide client team support to the Company to assist the Company in its post Initial Closing sales coverage of the Company's customers by providing various MSA Services. The MSA Services include, inter alia, marketing support services, information technology services, fixed assets accounting and property control administration services (for EMEA and Asia Pacific), customer fulfilment services, sales center services, ledger support services (for EMEA and Asia Pacific), incentives and commissions services, treasury services (EMEA and Asia Pacific) and transitional tax services (in EMEA and Asia Pacific).

5.2 Rationale

One of the benefits of the Marketing Support Agreement highlighted by the Directors is the ability of the Company to leverage on IBM's well established enterprise sales force and IBM's established global sales infrastructure, that is, it's sales representative teams, for a period of five years from Initial Closing.

Other specific key benefits include:

(A) IBM's sales representatives will be responsible for overall client relationships, and will play a critical role in ensuring clear communication and a smooth transition which minimise revenue loss immediately after the Initial Closing;

(B) the sales representatives of the Business and IBM have an established and proven sales model, pursuant to which IBM's sales representatives are responsible for client relationships and overall satisfaction, and the Business' sales representatives jointly visit and develop enterprise customers. We understand that, historically, more than one-third of the Business' sales opportunities have been identified by IBM's sales representatives. We understand that maintaining the sales model is important to protect business momentum going forward;

(C) the arrangement allows the Company to gradually build its own customer relationships with large enterprise customers through joint customer visits with IBM's sales representatives and proactive facilitation of transferring customer relationships from IBM sales representatives to the Company's sales team;

(D) the arrangement allows the Company to continue to leverage on IBM's established global network and established infrastructure, including such functions as sales fulfilment, information technology and treasury;

(E) the agreed fee rate is based on historical sales related costs to the Business. This will facilitate control of incremental cost to the Company in the future; and

(F) the tiered fee structure is designed to incentivize IBM's sales team to meet or even exceed sales targets. The total fee payable will be changed to reflect future business fluctuations, changes in sales coverage by IBM's sales team and the gradual migration to the Company's own sales team.

5.3 Term and expiration

The term of the Marketing Support Agreement is for a maximum period of five years from the Initial Closing.

MSA Services will be provided as from the Initial Closing and will terminate one year from the Initial Closing save for customer fulfilment, fixed assets accounting and property control administration, and ledger support services which will terminate two years from the Initial Closing, information technology services which will terminate three years from the Initial Closing and marketing support services which will terminate five years from the Initial Closing. Starting in 2007, the Company may elect to reduce the number of countries in which the Company requires MSA Services from IBM.

5.4 Fees/Pricing

The Company will pay IBM a fee of no less than 1.53% and no more than 2.53% of the specified reported revenue of the Business for MSA Services. Other than with respect to calendar year 2005, the projected specified reported revenue for each calendar year are expected to be agreed by the parties in June of each preceding calendar year, subject to negotiation between the parties. For the calendar year 2005, the Company will pay 2.3% of the specified reported revenue of the Business for MSA Services.

The mechanism for determining the fees payable under the Marketing Support Agreement is structured according to a sliding scale such that if the specified reported revenue represents less than 95% of the projected specified reported revenue, the fee will be calculated at a rate as low as 1.53%. Whereas if the specified reported revenue represents more than 100% of the projected specified reported revenue, the fee will be calculated at a rate of up to a maximum of 2.53% of the specified reported revenue.

5.5 Factors considered

The Directors have advised that the fees to be paid by the Company of no less than 1.53% and no more than 2.53%, and 2.3% for the calendar year ending 2005 respectively, of the specified reported revenue of the Business for MSA Services have been agreed by arm's length negotiations with reference to historical overhead costs incurred by the relevant IBM departments. (We understand from the Company that the actual costs for IBM to provide such services for the year ended 31 December 2003 (being the full financial year of the Business before the date of entering into of the Ancillary Agreements) represented approximately 2.43% of the specified reported revenue for that year). While these figures were quantified with regard to historical costs, the fees payable by the Company going forward will be calculated with reference to sales revenue and will be adjusted upwards or downwards on a sliding scale depending on a number of factors including the sales performance of the Business. We understand from the Directors that an additional objective of this scaling mechanism is to incentivise IBM in providing the services (i.e. to be paid a maximum fee in respect of the specified reported revenue).

5.6 Proposed Annual Monetary Cap

The maximum limit on fees payable by the Company under the Marketing Support Agreement set out below has been determined based on the agreed upon fee structure, estimates of future business volume, the estimated future service reduction, and taking into account potential 5% business tax consequences arising as a result of payments to be made pursuant to the Marketing Support Agreement, plus a 10% contingency to account for any uncertainties.

Agreement	Year	1st	2nd	3rd	4th	5th
		Proposed annual monetary limit for each of the annual year commencing on Initial Closing (US$ million)				
Marketing Support Agreement		291	278	194	77	26

We have reviewed both historical figures and projected revenue information in connection with the Business provided by the Company, assuming Initial Closing taking place at the end of March 2005, potential 5% business tax consequences relating to the payments under the Marketing Support Agreement and the factoring of the 10% contingency. Having reviewed the bases and assumptions of such estimation, we consider that such estimates have been reasonably made. Based on the foregoing, we are of the view that the proposed annual monetary limits are fair and reasonable in so far as the Shareholders as a whole are concerned.

Having considered the above, we are of the view that the MSA Services will be (a) carried out in the ordinary and usual course of the Enlarged Group's business; (b) based on normal commercial terms and are fair and reasonable; and (c) in the interests of the Company and the Shareholders as a whole.

6. MASTER DISTRIBUTION AGREEMENT

6.1 Description

IBM will be permitted to acquire Personal Computers and certain services from the Company and resell those products and services to customers who: (i) have previously entered into non-assignable purchase agreements with IBM; (ii) insist on purchasing products and services directly from IBM despite the fact that IBM has used commercially reasonable efforts to convince them to purchase relevant products and services directly from the Company; or (iii) are in countries that are not covered by the Initial Closing. The amount of Personal Computers and services to be provided under this agreement will depend on whether such events occur. IBM may market the Company's Products through one or more subsidiaries.

6.2 Rationale

We understand from the Directors that the rationale for entering into the Master Distribution Agreement is to effectively facilitate the successful transition of certain existing customers of IBM who, due to their contractual obligations or consumption preference, are not able or willing to be directly transferred to the Enlarged Group. The arrangement underlying the Master Distribution Agreement is in place to protect the Company from losing customers who want to deal with IBM only.

6.3 Term and expiration

The term of the Master Distribution Agreement is two years from the Initial Closing, or in respect of individual agreements that contain specific commitments to sell specified amounts of products and services over a period of time, for the duration of those agreements (which may be extended by the parties in writing). The term of the Master Distribution Agreement may be extended if both parties agree in writing. In the event that the Master Distribution Agreement is extended by the parties in accordance with its terms, the Company has confirmed that it will further comply with the provisions of the Listing Rules as required.

6.4 Fee/Pricing

Under the Master Distribution Agreement, where a non-assignable agreement sets forth a specified amount of Products to be provided over a fixed period of time, the Company will provide IBM with such products or services at the price and on the terms set forth in such agreement. Where the non-assignable agreement requires IBM to accept a customer order, the Company shall provide products pursuant to an agreed pricing methodology. If the parties have mutually agreed to allow sales under a non-assignable agreement, IBM will work with the customer to set the price and other terms of such sales, however, such sales will be subject to the Company's agreement to provide products and services at such price. In instances of countries are not covered by the Initial Closing, IBM and the Company will work together to continue to provide products at the prices provided to customers by IBM in such countries.

Generally, the Products and services are purchased by IBM for onward sale to the end customers. The Company will sell to IBM at a price that is 99.5% of the price commitment to the specific customer. Where IBM is obliged under pre-existing contractual obligations to customers, the Company may elect to sell the Products or services at a price identical to the price it sells to its resellers for similar quantities. In other words, IBM earns a margin of 0.5% of the price on the Products or for the provision of the services under the Master Distribution Agreement. In the event that IBM sells the Products at a price higher than the price commitment to such customer, IBM shall reimburse to the Company the incremental price. The Company possesses the right to audit the pricing between IBM and the relevant customers. As discussed with the Company, the 0.5% margin earned by IBM serves to cover the costs incurred by IBM in facilitating transactions under the Master Distribution Agreement.

6.5 Factors considered

As set out above, we note that the various pricing mechanisms specified under the Master Distribution Agreement serve to preserve the price of the Business prevailing prior to the Initial Closings and at prices that are agreeable to the Company. A price difference of approximately 0.5% earned by IBM represents a relatively small portion of the value of the Products and serve to cover the costs to IBM. Incremental margins earned on such sales will be enjoyed by the Company.

6.6 Proposed Annual Monetary Caps

The Directors consider that the transaction value of the Continuing Connected Transactions arising out of the Master Distribution Agreement shall not be subject to any annual cap for the following reasons:

(A) such annual caps cannot be determined because the identities and numbers of customers which will insist on purchasing products and services directly from IBM, as well as, the level of actual sales which would arise out of the relevant purchase agreements, are uncertain and outside the control of the Company and IBM;

(B) the level of actual sales which arise out of the relevant purchase agreements are also uncertain because the relevant customers do not have any contractual obligations to purchase a fixed amount of products and/or services from IBM under such agreements;

(C) the Company is unable to predict such identities or number of customers as there is no relevant historical patterns to base on; and

(D) the arrangements are in place to protect the Company from losing customers who want to deal with IBM only (and IBM will not make any profit directly out of the arrangement) and it is therefore in the interests of the Company as well as the Shareholders as a whole.

In view of the practical difficulties in estimating the amounts that are expected to arise from the Continuing Connected Transactions under the Master Distribution Agreement, and taking into account that:

(i) the pricing mechanism pursuant to the Master Distribution Agreement being structured to reflect the pre-existing pricing agreed between IBM and its customers or a price agreeable to the Company;

(ii) the undertaking by the Company to comply with the Listing Rules disclosure and approval requirements in the event that the term of the Master Distribution Agreement is extended;

(iii) the Company possessing the right to audit the pricing between IBM and the relevant customers; and

(iv) we have been advised by the Company that the future annual amounts of the relevant transactions will still be disclosed in the future annual reports of the Company and reviewed by the independent non-executive Directors and the auditors of the Company,

we believe that the lack of an annual cap for the transactions will not hinder the future monitoring of the Continuing Connected Transactions under the Master Distribution Agreement and there is sufficient mechanism for safeguarding the interest of the Independent Shareholders.

Having considered the above, we are of the view that the Master Distribution Agreement is (a) carried out in the ordinary and usual course of the Enlarged Group's business; (b) based on normal commercial terms and is fair and reasonable; and (c) in the interests of the Company and the Shareholders as a whole.

7. REAL ESTATE ARRANGEMENTS

7.1 Description

The Company and IBM agreed that the real estate assets in relation to the Business would be conveyed to the Company with effect from the applicable Closing, which will be effected by way of one of the following:

(i) acquisition of leasehold interests held by IBM;

(ii) sublease of portions of properties currently leased and to be retained by IBM;

(iii) occupancy of certain additional properties for a transitional period;

(iv) option to elect either licence or lease arrangements with respect to certain sites; and

(v) option to elect either licence arrangement or assumption of lease for balance of the lease term.

We understand from the Company that the acquisition of certain leasehold interests held by IBM is a one-off transaction as part of in the Asset Acquisition and will not constitute a Continuing Connected Transaction. Thus, we will not opine on such acquisition of leasehold interests.

Sublease of portions of properties currently leased and to be retained by IBM

IBM has leased various properties in different locations, portions of which will be sublet to the Company which are utilised by the Business. In such situations, the Company will be a tenant of IBM. Under the terms of the sublease, the Company will pay rent which includes:

(i) a fixed rent (which will be pro-rated with reference to the corresponding area occupied by the Company); and

(ii) an additional rent (which will be calculated based on proportional shares of the Company in the subleased area in the premises in the forms of tax payment, operating payments, electrical charges, chilled water charges and other charges).

If there is a disproportionate use by non-subleased space or by subleased spaces of electricity or other utilities, there will be an equitable adjustment. There will be no double-billing for the services provided by IBM pursuant to the Transition Services Agreement. The sublease is subject and subordinated to the terms and conditions of IBM's prime lease.

With respect to the sublease for Yamato (Japan), apart from the above, the Company will provide laboratory access and support services to IBM and IBM will pay to the Company costs and expenses reasonably incurred in connection with the provision of such services, provided that reimbursements that exceed certain amounts need to be preapproved by IBM. IBM may cancel or reduce the amount of any services with at least 60 days' prior written notice, and if there is a material breach, the non-breaching party may terminate the provision of such services with prior notice.

Term

The term of the sublease generally will commence at the applicable Closing and be coterminous with IBM's prime lease term (the length of each of which varies, and expiring some time between 31 March 2006 and 31 March 2014), with the exception of the sub-lease in Toronto which will commence after the space has been reconstructed or otherwise reconfigured as necessary to house the Business, and will run up to a four-and-a-half-year term. IBM may request in writing 60 days prior to the end of the term to extend the term, subject to the mutual agreement by IBM and the Company.

Occupancy of certain additional properties for a transitional period

Based on our discussions with the Directors, the Company will occupy space at over 200 IBM locations worldwide. IBM or its subsidiaries will grant a licence to the Company or its affiliate to use and occupy portions of certain facilities which were occupied by the Business on the date of the Asset Purchase Agreement, and were interspersed or otherwise located within a larger area owned or leased by IBM. We note from the terms of the licence that IBM or its subsidiary has transferred to the Company and/or its affiliate certain equipment located in the properties and certain personnel previously employed by IBM or its subsidiary at the properties. Without additional charge (beyond the licence fee), the Company or its affiliate will also have the right to use certain furniture, fixtures and equipment, including communications and information system equipment, cabling and appurtenant items, which were used by the Business during the 12 month period immediately preceding the Initial Closing.

We note that the licence fee will be based on the current average cost incurred by IBM at all licensed locations and will be converted to a flat fee per person per year. The licence fee will be subject to adjustment if the relevant headcount is reduced.

Term

The licence will commence as of the date of the applicable Closing and will expire 12 months thereafter, with the exception of the licence of certain space in Toronto which will expire according to the term mentioned above. The licence will automatically terminate when IBM's lease terminates. IBM may also terminate the license due to fire or other casualty reasons, if applicable. The licence will be terminable by the Company with respect to each of the locations with 30 days' notice. In the event of default, the non-defaulting party may have a right to terminate the license.

Option to elect licence or lease with respect to certain sites

In respect of certain sites, the Company has an option to elect whether to enter into a licence arrangement or a lease arrangement. In relation to the lease arrangement, the annual rent will include "base rent" (calculated based on a rate of rental per square foot occupied by the leased premises) and "additional rent" (including a pro-rata share of real estate taxes and component charges for the services, utilities, supplies and facilities provided by IBM or its subsidiary). Estimated component charges and reasons for any changes and relevant documentation will be provided to the Company or its affiliate upon request. IBM or its subsidiaries will also maintain an accurate accounting system in relation to the "additional rent" charged to the Company or its affiliate and will allow access to the accounting record.

Term

With respect to those sites, the Company has up to 60 days from the signing of the Asset Purchase Agreement to decide whether it will (a) occupy the in-scope portion of the site pursuant to a licence for a one year term from the date of the Initial Closing, or (b) lease the site from IBM for a three year term or five year term at the prevailing market rate. If the site is damaged for fire or other casualty reasons, the lease may be terminable upon notice. In the event of default, the non-defaulting party may have a right to terminate the lease by giving prior notice.

Option to elect either licence or assumption of lease for balance of lease term

In respect of the complex leased by IBM in Raleigh/Durham, North Carolina, the Company has an option to elect whether to enter into a licence arrangement at a licence fee to be based on IBM's cost therefor per headcount (similar to the terms discussed above) or assume the lease of IBM for the balance of the lease term. Once entered into one of the options as stated above, the Company and IBM will enter into a written agreement and comply with the requirements set out in Rule 14A.35 of the Listing Rules.

Term

In respect of the complex leased by IBM in Raleigh/Durham, North Carolina, the Company has up to 60 days from the signing of the Asset Purchase Agreement to decide whether it will (a) occupy the in-scope portion of the site pursuant to a licence for 12 calendar months from the date of the Initial Closing, or (b) acquire IBM's leasehold interest in three Raleigh Research Triangle Park Buildings and two Silicon Drive Buildings (and assume the obligations of IBM) after occupying various portions of the site and leased locations pursuant to a licence, until such time as the space has been reconfigured and built-out as necessary to consolidate the Company's employees and the Business.

7.2 Rationale

The Company believes that the Real Estate Arrangements will provide the Company with appropriate premises to ensure the smooth transition of the Business following the applicable Closing and to avoid any additional administrative disruption in connection with the need to identify suitable premises within a short period of time.

7.3 Rental and licence fees

Sublease of portions of properties currently leased and to be retained by IBM

The Company will pay to IBM a pro-rated amount of rental payable by IBM in respect of its own head leases of various properties according to the area occupied by the Company as a percentage of the total square footage occupied by IBM.

Licensing arrangement for a transitional period

Pursuant to the Real Estate Arrangements, the Company will have the licensing arrangement, in respect of its use of office space at the IBM locations worldwide for a one year term and that the licence fee payable under such arrangements shall be consistent with historical costs allocated to the Business.

The licence fee has been determined on the basis of US$10,000 per headcount per year, which is consistent with IBM's historical costs. Based on the Company's calculations, if the Company was to set up its own operations and premises to replace such arrangements provided by IBM, the replacement cost, based on the Lenovo Group's existing cost breakdown for reference, will exceed US$10,000 per person. This is particularly so given the fact that, according to the Company, over 50 offices of the Enlarged Group will have a headcount of not more than two staff, therefore economy of scale will not be achieved and setting up costs for such offices would far exceed what is payable to IBM.

7.4 Factors considered

Our opinion in relation to the Real Estate Arrangements is principally based on the forms of the agreements attached as Exhibit M-1 to M-5 attached to the Asset Purchase Agreement as of 7 December 2004, the forms of which may be modified to comply with the local law and custom of the relevant local jurisdictions before actual signing thereof. In the event that subsequent changes are made to those forms, we are not deemed to be giving opinion on any of the forms as subsequently amended or modified, in which case the Company should consider applying to the Stock Exchange again to ensure that the forms as modified are in compliance with the Listing Rules.

7.5 Proposed Annual Monetary Cap

The maximum limit on rental or fees payable by the Company under the Real Estate Arrangements set out below have been determined based on costs estimated on a reasonable basis, and taking into account potential 5% business tax consequences arising as a result of payments to be made pursuant to this agreement, plus a 10% contingency to account for any uncertainties.

Agreement	Year	Proposed annual monetary limit for each of the annual year commencing on Initial Closing				
		1st	2nd	3rd	4th	5th
		(US$ million)				
Real Estate Arrangements		78	54	30	30	31

We have reviewed the historical figures in connection with the Business provided by the Company, assuming Initial Closing taking place at the end of March 2005, potential 5% business tax consequences relating to the payments under the agreement and the factoring of the 10% contingency. Based on the foregoing, we are of the view that the proposed annual monetary limits are fair and reasonable in so far as the Shareholders as a whole are concerned.

Having considered the above, we are of the view that the Real Estate Arrangements are (a) carried out in the ordinary and usual course of the Enlarged Group's business; (b) based on normal commercial terms and are fair and reasonable; and (c) in the interests of the Company and the Shareholders as a whole.

8. TERMS IN EXCESS OF THREE YEARS

8.1 Rationale

There are five types of Continuing Connected Transactions which exceed the three year term as set out in Rule 14A.35 of the Listing Rules, namely: the SFAD Agreement, the IGS Services Agreement, the Marketing Support Agreement, the Internal Use Purchase Agreement and certain Real Estate Arrangements (the "Extended Agreements"). All these agreements have a term of more than three years. Pursuant to Rule 14A.35(1), a company entering into a continuing connected transaction should have the period for the relevant agreement as a fixed term, except in special circumstances, of not exceeding three years.

General Rationale

The Directors have advised the general rationale for the terms of these Continuing Connected Transactions being in excess of three years as follows:

(A) a period longer than three years is necessary to ensure continuity in operation, smooth integration of the Business, and success of the Enlarged Group with the ability to maintain a stable supply of service to support the Business with quality which is consistent with pre-Closing standard;

(B) to demonstrate both IBM and the Company's commitment to work together for the success of the Enlarged Group which is fundamental for the spirit behind a strategic alliance;

(C) to allow both the Company and IBM to mutually benefit from their co-operation to work together; for example, the Company benefiting from not paying any consideration for the use of the IBM brand and securing IBM as its largest enterprise customer; extending the benefit to the Company of IBM's existing global service capabilities; and IBM receiving guaranteed customers from the Company for its after-sales and financing services; and

(D) to allow the Company's management to focus their attention and resources on the transition and growth of the Business, instead of the areas under these Continuing Connected Transactions, which are not the core business, but just peripheral to the Business.

The above sets out the general rationale which applies to each and every Continuing Connected Transaction exceeding 3 years. We understand from the Company that the following are additional reasonings which warrant a term of over three years for each specific agreement:

8.1.1 *SFAD Agreement*

The Company considers that it is practically difficult to identify a financier with in-depth knowledge in products of the Business which can offer financing service to customers and remarketers in most of the countries in which the Business locates and with such minimum disruption to the Business and the management of the Company. For the management to attempt to identify other financiers in each country and for each service, it will take up considerable time and resources, which would otherwise be incurred unnecessarily. The SFAD Agreement also enables the Company to leverage on the strength of global financing provided by IBM so that the Company can preserve the resources and effort to be spent in this area (which is not a core business) in order to focus on the future development of the Business. Further:

(1) it is important for the Company to enter into the Excess Surplus Disposition Services for a longer duration in order to enable the Group to manage the disposition of its used products in a global and orderly manner to avoid channel confusion and maximise residual value by leveraging on IBM's extensive asset resell capability;

(2) it is beneficial for the Company to enter into the Distribution Channel Financing Services and the Customer Financing Services for a longer duration in order to enable the Enlarged Group to effectively manage channel credit and significantly reduce its working capital and total invested capital required; and

(3) it is beneficial for the Company to utilise the Customer Financing Services for a longer duration in order to provide the Company's customers in more than 40 countries the option to lease the Company's products and thus enhancing the Company's revenue potential before the Company can develop its own global infrastructure which may take a reasonably long time.

8.1.2 *IGS Services Agreement*

IBM is regarded in the computer industry as a leading provider of after sales service with a global coverage. Further, IBM is the only warranty service provider which has complete compatibility with the products of the Business, including, among others, software, technology and knowledge of the products. As a result, IBM can offer services with compatibility which no other service provider in the world can offer. Such special circumstances result in IBM being practically the best feasible option for the Company in terms of provision of the IGS services and a longer term is essential to cater for the time allowed for the Company to build up its own infrastructure and to leave a buffer in case of unexpected changes or disruption in implementation of the Company's roll out plan.

Through the IGS Services Agreement, we understand that the Company will be able to use IBM in respect of its after sales services which the Company considers to be a significant benefit to both customers of the Company and to the Company itself. The use of IBM is also expected to lead to opportunities for additional computer sales through IBM's strategic outsourcing and system integration businesses. Such strategic outsourcing entails IBM customers outsourcing their personal computer products through system integration transactions to IBM and these IBM customers usually purchase their computer hardware on recommendation by IBM. The arrangements underpinning the IGS Service Agreement also allows the Company to share in the profit generated from services sold by IBM and its affiliates.

8.1.3 *Internal Use Purchase Agreement*

Pursuant to the Internal Use Purchase Agreement, the Company will be the preferred and nearly exclusive (95%) supplier for all Personal Computers purchased by IBM for its internal use or strategic outsourcing deals. In the year ended 31 December 2003 (which is the full financial year of the Business before the date of entering into of the Ancillary Agreements), the amount of IBM's internal purchases made it one of the Business' largest customers. We understand from the Directors that it is anticipated that IBM will become one of the Company's largest customers as a result of the transactions contemplated in this agreement and the arrangements will therefore contribute to the Company's revenue stabilisation. This potentially represents a significant income source for the Company.

The circumstances for this "internal use purchase" arrangement is special in the sense that the Company is the product provider and will be receiving purchase price with profit margins from IBM which is expected to be one of the largest customers. It is therefore highly beneficial for the Company to have a longer term in order to enhance market share, revenue as well as profit.

8.1.4 *Marketing Support Agreement*

We understand from the Directors that the services to the provided by IBM under the Marketing Support Agreement will assist in a smooth transition for the Company following Initial Closing and, in the longer term, will contribute to the development and strengthening of the Company's customer base and revenue source.

The fact that IBM secures the sale force which is currently maintaining all the existing relationship with the Business' clients poses a special circumstances that continuous relationship with the existing customers may not otherwise be able to be maintained without the Marketing Support Agreement. Similar to the reasons above, a longer term is fundamental to keep such customer relationship intact to ensure maintainence of the existing scale of operation of the Business and to allow time for the personnel of the Company to take over from such sale force, with a margin to cater for unforeseen disruption to such plan as a matter of practice.

Under the terms of the Marketing Support Agreement, the Company will have the option to reduce the scope of services to be provided by IBM and accordingly reduce the amount of fees chargeable under the Marketing Support Agreement. As such, despite the term of the Marketing Support Agreement being in excess of three years, the Company can elect to reduce the services required once it is in a position to perform such services. In this regard, the length of the Marketing Support Agreement serves to better ensure that the Business can operate with minimal disruption in terms of client servicing and therefore it is in the interest of the Company that the Marketing Support Agreement shall have a length in excess of three years.

8.1.5 *Real Estate Arrangements*

The terms of the subleases for a number of properties, which is coterminous with IBM's head lease terms and the Toronto sublease is expected to exceed three years. In respect of certain sites that the Company has an option to elect to enter into a lease or assume the existing lease of IBM for the balance of the lease term, if the Company exercises such option, the term of those leases may also exceed three years. We understand from the Directors that entry into the above subleases and lease arrangements by the Company will assist in a smooth transition for the Business following the Initial Closing.

8.2 Factors considered

We have reviewed the terms of a number of transactions involving the establishment of long term cross-border strategic relationship. Such transactions comprise several ongoing ancillary arrangements of similar nature as the Continuing Connected Transactions with terms in excess of 3 years.

As discussed with the management of the Company, the terms of the Extended Agreements, including the length of these agreements, have been negotiated in the context of all other terms under each agreement, and IBM is willing to provide the services under each Extended Agreement to the Company only with a long term commitment in excess of 3 years.

8.3 Conclusion

As mentioned in the section headed "Introduction" above, all the Continuing Connected Transactions, together with the Asset Acquisition, are proposed to be passed in one single resolution. The Continuing Connected Transactions are therefore to be approved or disapproved altogether. All the Continuing Connected Transactions accordingly should be considered as a whole. We consider that the circumstances in this transaction do not warrant consideration of each Continuing Connected Transaction separately.

Accordingly, based on (i) our review of available information of cross-border strategic alliance transactions relating to similar ongoing arrangements ancillary to strategic partnership or joint ventures (although no direct comparables are available in the market due to the specific circumstances of this transaction); (ii) our discussions with the Directors and the Company's management; and (iii) the general rationale and special circumstances as explicated by the Company above, and taking all the Continuing Connected Transactions as a whole, we are of the view that it is normal business practice for ongoing arrangements between strategic partners which are ancillary to and taking effect after formation of the strategic alliance or joint ventures, including contracts of this type of Continuing Connected Transactions, to be of duration exceeding three years.

9. PROPOSED ANNUAL MONETARY LIMITS FOR THE CONTINUING CONNECTED TRANSACTIONS

By an announcement dated 8 December 2004 (and revised on 28 December 2004), the Directors announced their expectation of the aggregate amount of fees payable for each applicable year under each of the Continuing Connected Transactions.

A summary of the annual monetary limits proposed by the Company, and which have been referred to in this letter, is set out below:

Fees payable by the Company to IBM:

Agreement	Year	Proposed annual monetary limit for each of the annual year commencing on Initial Closing 1st	2nd	3rd	4th	5th
		(US$ million)				
Transition Services Agreement		285	223	197	N/A	N/A
SFAD Agreement (Distribution Channel Financing Services)		84	86	87	89	90
IGS Services Agreement		273	318	188	191	195
Marketing Support Agreement		291	278	194	77	26
Real Estate Arrangements		78	54	30	30	31

Fees payable by IBM to the Company:

Agreement	Year	Proposed annual monetary limit for each of the annual year commencing on Initial Closing 1st	2nd	3rd	4th	5th
		(US$ million)				
SFAD Agreement (Customer Financing Services)		8	9	9	9	9
SFAD Agreement (Excess Surplus Disposition Services)		58	60	61	62	63
IGS Services Agreement		15	15	15	16	16
Internal Use Purchase Agreement		500	512	520	530	541

In respect of the Master Distribution Agreement, no annual cap amount has been determined by the Company. Shareholders should refer to pages 89–91 of this letter for further details on the reason that no such cap is applicable in respect of the Master Distribution Agreements.

As set out above, the annual caps for the future monitoring of the Continuing Connected Transactions will be calculated according to the annual anniversary of the Initial Closing, instead of the Company's financial year. However, the Company has stated that it will implement such procedures and annual disclosure in the future so as to monitor the accurate control of the transactions within the relevant caps. Shareholders should note the procedures detailed in the Letter from the Board on page 45 of the Circular in this relation. The Company has also confirmed that it undertakes to comply in full with Rules 14A.37 to 14A.40 of the Listing Rules, including, among others, auditors' annual confirmation on whether the caps have been exceeded. Assuming and based on strict implementation of the procedures and strict compliance with the Listing Rules, we consider that the cap amount can be referenced against future financial information of the Enlarged Group in its future annual reports.

10. REQUIREMENTS UNDER THE LISTING RULES AND INDEPENDENT SHAREHOLDERS' APPROVAL

Under the Listing Rules, the Continuing Connected Transactions are subject to disclosure and Independent Shareholders' approval requirements as set out in Rule 14A.35 of the Listing Rules. As stated in the Letter from the Board, no Shareholder is required to abstain from voting in respect of the resolution to consider the Continuing Connected Transactions.

At the Extraordinary General Meeting, resolution numbered 1 will be proposed for the purpose of considering and, if thought fit, approving, among others, the Continuing Connected Transactions, notice of which is set out on pages 324 to 327 of the Circular. According to Rule 14A.52 of the Listing Rules, the votes taken for resolution numbered 1 will be taken by poll.

Shareholders should note that resolution numbered 1 have been structured to approve the Asset Acquisition and the Continuing Connected Transactions together by combining them as one resolution. Accordingly, Shareholders should note that the Asset Acquisition and the Continuing Connected Transactions will be approved or disapproved together while it will not be possible to approve one but not the other. Pursuant to the Voting Agreement, and subject to relevant laws and regulations, the Major Shareholder, holding in excess of 50% of the existing issued Shares, has covenanted and agreed with IBM to vote (or cause to be voted) in favour of, among others, the Asset Purchase Agreement and the Continuing Connected Transactions at the Extraordinary General Meeting. Accordingly, we were given to understand that it is inevitable that the resolution will be approved at the Extraordinary General Meeting.

OVERALL RECOMMENDATION

Having taken into account the rationale and considerations set out above, we are of the view that the Continuing Connected Transactions, taken as a whole, are (a) carried out in the ordinary and usual course of the Enlarged Group's business; (b) based on normal commercial terms and are fair and reasonable; and (c) in the interests of the Company and the Shareholders as a whole. We are also of the view that the terms of the Continuing Connected Transactions, including the proposed annual monetary caps for the Continuing Connected Transactions for each of the relevant years following the Initial Closing (including that the transactions underlying the Master Distribution Agreement are not subject to any annual cap) are fair and reasonable and are in the interest of the Company and the Shareholders as a whole.

On this basis, we recommend the Independent Shareholders to vote in favour of the resolution to be proposed at the Extraordinary General Meeting to the extent of approving the Continuing Connected Transactions and the annual caps thereunder (including in respect of the Master Distribution Agreement which is not subject to any annual cap).

Yours faithfully,
For and on behalf of
Cazenove Asia Limited

Karman Hsu
Managing Director
and
Head of Corporate Finance

Michael Ngai
Director

INTRODUCTION

Pursuant to the Asset Purchase Agreement dated 7 December 2004 signed between the Company and IBM, the Company agreed, subject to certain conditions, to acquire from IBM certain assets and assume certain liabilities in connection with PCD in consideration of certain new Shares and Non-voting Shares to be issued by the Company as well as a cash payment. The Asset Acquisition constitutes a very substantial acquisition of the Company and an accountants' report in respect of PCD is therefore required by the Listing Rules to be included in the circular to its shareholders.

The audited combined financial statements of PCD, which have been prepared in accordance with US GAAP and audited by the Independent Registered Public Accounting Firm of IBM in accordance with the PCAOB Standards (hereinafter the "Audited US Combined Financial Statements"), form part of this circular and are presented in lieu of an accountants' report of PCD. Due to the following reasons, the Company has applied to the Stock Exchange for waivers from strict compliance with certain provisions of the Listing Rules governing the presentation and preparation of the accountants' report as further described below.

BACKGROUND OF PCD

IBM is a company incorporated in the USA with its primary listing on the New York Stock Exchange. PCD has been a part of a division of IBM, which has a global presence and is active in over 160 countries.

PCD has been under the management control of IBM, centrally operated by IBM together with other activities within IBM, and has never been operated individually under a separate entity or otherwise on a standalone basis. As PCD constitutes only part of IBM and is not required to be reported on as a distinct business under any regulation or legislation that governs IBM, no audited financial statements for PCD have previously been prepared or reported on a standalone basis. The financial information of PCD as set out in this appendix has been prepared as it was historically managed within IBM's management and measurement system and includes the global historical assets, liabilities and operations for which management is responsible, adjusted as necessary to conform with US GAAP. Certain assets and liabilities of PCD, which are included in the Audited US Combined Financial Statements may, or may not, be indicative of PCD on a standalone basis because PCD and IBM engage in extensive intercompany transactions, and PCD relies on IBM for substantially all of its operational and administrative support for which it allocated costs, assets and liabilities on a basis that management believes is appropriate in the circumstances. The amounts recorded for these transactions and allocations are not necessarily representative of the amounts that would have been reflected in the financial statements had PCD been an entity operated independently of IBM.

AUDITED US COMBINED FINANCIAL STATEMENTS PREPARED BY IBM AND AUDITED BY PRICEWATERHOUSECOOPERS LLP

In accordance with Rule 4.03 of the Listing Rules, an accountants' report is required to be prepared by professional accountants who are qualified under Professional Accountants Ordinance for appointment as auditors of a company. Rule 4.03 of the Listing Rules provided that, in the case of a circular issued by a listed issuer in connection with the acquisition of an overseas company, the Stock Exchange may be prepared to permit the accountants' report to be prepared by a firm of accountants who is not so qualified but acceptable to the Stock Exchange. Such a firm must normally have an international name and reputation and be a member of a recognised body of accountants.

No financial statements of PCD have previously been prepared on a standalone basis as PCD largely pertains to divisions of IBM. The Audited US Combined Financial Statements as set out in Appendix I of this circular have been prepared in accordance with US GAAP and are audited under PCAOB Standards by IBM's Independent Registered Public Accounting Firm as referred to on page 108 in this circular, who is registered with the Public Company Accounting Oversight Board (United States).

The Audited US Combined Financial Statements of PCD require that various businesses and divisions be aggregated from the audited financial statements of the entire IBM group. This necessarily requires that the auditors must be familiar with not only PCD, but also the operations, systems and structure of IBM as a whole. Any professional accounting firm which does not have the benefit of prior knowledge of IBM as a whole but is asked to report on PCD, cannot be expected to be able to opine on the standalone financial statements of PCD without extending the scope of their audit to cover all the accounting systems and control procedures of IBM, which support the operations of not just PCD but also many of the different divisions within IBM. In particular, PCD and other divisions of IBM share many corporate services which are managed centrally by IBM.

Given the Asset Acquisition is in respect of PCD (which does not include other parts of IBM which will remain with IBM post-transaction), the Company has been informed that IBM will not be in a position to allow auditors other than its own Independent Registered Public Accounting Firm to access its systems and accounting records which cover other parts of IBM. Although the Company's auditors, PricewaterhouseCoopers Hong Kong, is an affiliated firm of IBM's Independent Registered Public Accounting Firm, they are two separate legal entities and are managed independently from each other. As the Company's auditors are not the auditors of IBM, and IBM does not consent to the Company's auditors reviewing its books and records other than those of PCD, it is impossible for the Company's auditors to report on the financial information of PCD by themselves or jointly with IBM's Independent Registered Public Accounting Firm under the Auditing Guideline 3.340 issued by the Hong Kong Institute of Certified Public Accountants (the "Auditing Guideline 3.340").

Under these circumstances, IBM's Independent Registered Public Accounting Firm is the most appropriate firm to report on the Audited US Combined Financial Statements of PCD, and given IBM's Independent Registered Public Accounting Firm has already spent significant time on the audit of the Audited US Combined Financial Statements in anticipation of the planned disposal of PCD, it is indeed impossible for other accounting firms to perform the work as required.

As IBM's Independent Registered Public Accounting Firm is not registered under the Professional Accountants Ordinance of the laws of Hong Kong, the Company has therefore applied to the Stock Exchange for a waiver from strict compliance with Rule 4.03 of the Listing Rules.

AUDITED FINANCIAL STATEMENTS OF PCD PREPARED IN ACCORDANCE WITH US GAAP

In accordance with Rule 4.11 of the Listing Rules, the financial history of the results and the statement of assets and liabilities included in the accountants' report are required to be prepared in conformity with Hong Kong GAAP or International Financial Reporting Standards.

IBM advises that the existing accounting system, control procedures and data maintenance functions are managed on a centralized basis. Since the accounting records of IBM and thus PCD are maintained in accordance with US GAAP, it is not possible to prepare financial statements of PCD under Hong Kong GAAP without changing IBM's internal accounting standards to conform with Hong Kong GAAP, changing the chart of accounts and training the employees across various countries. The multiple countries in which IBM operates further complicates this exercise. Under these circumstances, audited financial statements of PCD are prepared under US GAAP instead of Hong Kong GAAP.

The audited financial statements of PCD are therefore prepared in accordance with US GAAP, with an explanation of the differences and a line-by-line reconciliation statement (the "Reconciliation") between the accounting policies of PCD and those of the Company which follow Hong Kong GAAP. The Company's auditors, PricewaterhouseCoopers Hong Kong, have reviewed the adjustments made in the Reconciliation and carried out additional procedures as required under the Auditing Guideline 3.340 in connection with the adjustments in arriving at the Hong Kong GAAP financial information. The Reconciliation and the high level assurance report issued by the Company's auditors are set out in Appendix II to this circular.

The Company has therefore applied to the Stock Exchange for a waiver from strict compliance with Rule 4.11 of the Listing Rules.

AUDITED US COMBINED FINANCIAL STATEMENTS PRESENTED IN LIEU OF ACCOUNTANTS' REPORT

In accordance with Rule 14.69 of the Listing Rules, the reporting accountants of the Company are required to prepare an accountants' report on PCD using accounting policies materially consistent with those of the Company and in accordance with the requirements of the Auditing Guideline 3.340.

IBM advises that the Audited US Combined Financial Statements are prepared in accordance with US GAAP, and therefore its Independent Registered Public Accounting Firm have limitation in preparing accountants' report as prescribed by Auditing Guideline 3.340. As a publicly traded company in the United States, IBM is subject to the periodic reporting requirements of the US Securities and Exchange Commission ("SEC"). Under the SEC's rules regarding divestitures, IBM is not required to submit any documents to the SEC regarding this transaction. In connection with the waiver application by the Company to the Stock Exchange in respect of strict compliance of Rule 14.69 (4)(a)(i) as mentioned above, IBM has agreed to submit to the SEC a Form 8K with the Audited US Combined Financial Statements, that is being presented in this transaction before or on the same date as the mailing of the circular to the shareholders of the Company. In order that the same set of financial information is published in the USA and in Hong Kong, the Company is of the opinion that IBM should not present the Audited US Combined Financial Statements of PCD in a Hong Kong accountants' report format for the purpose of fulfilling the disclosure requirements in Hong Kong.

For the purpose of disclosing the same level of information in the circular as that contained in any accountants' report, the Audited US Combined Financial Statements include additional disclosure information in accordance with the relevant requirements set out in the Listing Rules and the Hong Kong Companies Ordinance. Assets and liabilities of PCD together with its results are restated from US GAAP to Hong Kong GAAP and in accordance with the accounting policies materially consistent with those of the Company which are covered by a high level assurance report issued by the Company's auditors. The Company's auditors have carried out additional procedures as required under the Auditing Guideline 3.340 in connection with the adjustments in arriving at the Hong Kong GAAP financial information. The high level assurance report issued by the Company's auditors, PricewaterhouseCoopers Hong Kong, in this respect is set out in Appendix II to this circular.

The Company has therefore applied to the Stock Exchange for a waiver from strict compliance with Rule 14.69(4)(a)(i) of the Listing Rules, which requires the preparation of an accountants' report on the business acquired in accordance with Chapter 4 of the Listing Rules.

AUDITED US COMBINED FINANCIAL STATEMENTS AUDITED UNDER PCAOB STANDARDS

IBM advises that the financial reporting processes of IBM are designed to facilitate the independent audit purpose in accordance with PCAOB Standards and therefore, its Independent Registered Public Accounting Firm has conducted the audit on the US GAAP financial statements in accordance with PCAOB Standards.

The Company is of the opinion that PCAOB Standards and Hong Kong Statements of Auditing Standards are substantially consistent with each other. In addition, the Company's auditors have carried out additional procedures with reference to the Auditing Guideline 3.340 in connection with the adjustments to arrive at the Hong Kong GAAP financial information, details of which are set out in Appendix II to this circular. Therefore, the Company has applied to the Stock Exchange for a waiver from strict compliance with Rule 4.08(3) of the Listing Rules, which requires the accountants' report to be prepared in accordance with Auditing Guideline 3.340.

AUDIT OPINION ON THE AUDITED US COMBINED FINANCIAL STATEMENTS IS "FAIRLY PRESENTED"

The audit opinion on the Audited US Combined Financial Statements is "fairly presented" in conformity with the requirement under US GAAP. This audit opinion does not strictly comply with the requirement under Rule 4.08(2) of the Listing Rules and the Hong Kong Companies Ordinance, which requires the reporting accountants to express a "true and fair" audit opinion.

Notwithstanding the above, the Company is of the opinion that both opinions provide the same degree of assurance on any audited financial statements, and therefore has applied to the Stock Exchange for a waiver from strict compliance with Rule 4.08(2) of the Listing Rules for reporting accountants to express a true and fair audit opinion.

The following is the text of the Audited US Combined Financial Statements, prepared by IBM and audited by IBM's Independent Registered Public Accounting Firm, for inclusion in this circular:

Personal Computing Division

A Division of International Business Machines Corporation

Combined Financial Statements

June 30, 2004

December 31, 2003, 2002 and 2001

Personal Computing Division
A Division of International Business Machines Corporation
Combined Financial Statements

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
300 Madison Avenue
New York NY 10017
Telephone (646) 471-3000

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of International Business Machines Corporation:

In our opinion, the accompanying Combined Financial Statements and related footnotes appearing on pages I-3 through I-38 present fairly, in all material respects, the financial position of the Personal Computing Division ("PCD" or the "Business"), a division of International Business Machines Corporation, at June 30, 2004, December 31, 2003, December 31, 2002 and December 31, 2001, and the results of its operations and cash flows for the six-month period ended June 30, 2004 and for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Business' management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As disclosed in Note D, the Business and its parent, International Business Machines Corporation engage in extensive intercompany transactions, and the Business relies on its parent for substantially all of its operational and administrative support for which it is allocated costs on a basis that management believes is appropriate in the circumstances. The amounts recorded for these transactions and allocations are not necessarily representative of the amounts that would have been reflected in the financial statements had the Business been an entity operated independently of the parent.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
New York, New York
December 16, 2004

Personal Computing Division
A Division of International Business Machines Corporation
Combined Statement of Operations

	NOTES	FOR THE SIX MONTHS ENDED JUNE 30 2004	2003 (UNAUDITED)	FOR THE YEAR ENDED DECEMBER 31 2003	2002	2001
		(US dollars in millions)				
NET REVENUE:						
External sales		$5,003	$4,160	$9,288	$8,962	$9,745
Sales to IBM	D	214	136	278	275	333
Total net revenue		5,217	4,296	9,566	9,237	10,078
COST OF REVENUE:						
External sales		4,492	3,668	8,327	8,066	8,815
Sales to IBM	D	214	136	278	275	333
Total cost of revenue		4,706	3,804	8,605	8,341	9,148
Gross profit		511	492	961	896	930
EXPENSE AND OTHER INCOME:						
Selling, general and administrative	N	511	489	1,013	1,038	1,201
Research, development and engineering	O	70	72	139	138	179
Intellectual property income		(27)	(30)	(75)	(118)	(134)
Other (income) and expense		1	(4)	1	(94)	(23)
TOTAL EXPENSE AND OTHER INCOME		555	527	1,078	964	1,223
LOSS BEFORE INCOME TAXES, MINORITY INTERESTS AND CHANGE IN ACCOUNTING PRINCIPLE		(44)	(35)	(117)	(68)	(293)
Provision for income taxes	M	74	51	115	86	77
Minority interests	J	21	11	26	17	17
Net loss before change in accounting principle		(139)	(97)	(258)	(171)	(387)
Effect of change in accounting principle	C	—	—	—	—	10
NET LOSS		$(139)	$(97)	$(258)	$(171)	$(397)

The accompanying notes on pages I-8 through I-38 are an integral part of the combined financial statements.

Personal Computing Division
A Division of International Business Machines Corporation
Combined Statement of Financial Position

	NOTES	AT JUNE 30 2004	AT DECEMBER 31 2003	2002	2001
			(US dollars in millions)		
ASSETS					
Current assets:					
Cash		$297	$211	$199	$110
Accounts receivable — trade (net of allowances of US$7 million in 2004, US$7 million in 2003, US$9 million in 2002 and US$14 million in 2001)		398	470	425	443
Inventories, net	F	279	235	216	322
Prepaid expenses and other current assets		192	120	118	151
Total current assets		1,166	1,036	958	1,026
Plant and other property	G	806	968	1,129	1,149
Less: Accumulated depreciation	G	498	607	728	718
Plant and other property, net	G	308	361	401	431
Investments and sundry assets	H	60	61	58	38
TOTAL ASSETS		$1,534	$1,458	$1,417	$1,495
LIABILITIES AND INVESTED EQUITY/(DEFICIT)					
Current liabilities:					
Taxes	M	$21	$35	$18	$17
Accounts payable		1,441	1,457	1,168	956
Compensation accruals		30	41	51	53
Deferred revenue		21	24	47	30
Warranty accruals		289	237	196	181
Rebates and returns accrual		175	193	176	191
Software royalties payable		159	166	145	107
Other accrued expenses and liabilities		57	43	47	40
Total current liabilities		2,193	2,196	1,848	1,575
Warranty accruals non-current		229	191	144	133
Minority interests and other long-term liabilities	J	87	62	53	53
TOTAL LIABILITIES		2,509	2,449	2,045	1,761
Contingencies and commitments	L				
IBM's net investment		(973)	(984)	(613)	(288)
Accumulated other comprehensive income/(loss)	K	(2)	(7)	(15)	22
TOTAL INVESTED EQUITY/(DEFICIT)		(975)	(991)	(628)	(266)
TOTAL LIABILITIES AND INVESTED EQUITY/ (DEFICIT)		$1,534	$1,458	$1,417	$1,495

The accompanying notes on pages I-8 through I-38 are an integral part of the combined financial statements.

Personal Computing Division
A Division of International Business Machines Corporation
Combined Statement of Invested Equity/(Deficit)

	IBM'S NET INVESTMENT	ACCUMULATED OTHER COMPREHENSIVE INCOME/(LOSS)	TOTAL
		(US dollars in millions)	
2001			
Invested equity/(deficit), January 1, 2001	$(182)	$—	$(182)
Net investment by IBM	291	—	291
Net loss plus gains and (losses) included in other comprehensive income/(loss):			
Net loss	(397)	—	(397)
Gains and (losses) included in other comprehensive income/(loss) (net of tax):			
Net unrealized gains on SFAS No. 133 cash flow hedge derivatives during 2001 (net of tax)	—	17	17
Foreign currency translation adjustments (net of tax)	—	5	5
Invested equity/(deficit), December 31, 2001	(288)	22	(266)
2002			
Net investment by IBM	(155)	—	(155)
Net loss plus gains and (losses) included in other comprehensive income (loss):			
Net loss	(171)	—	(171)
Gains and (losses) included in other comprehensive income/(loss) (net of tax):			
Net unrealized losses on SFAS No. 133 cash flow hedge derivatives during 2002 (net of tax)	—	(24)	(24)
Foreign currency translation adjustments (net of tax)	—	(13)	(13)
Tax effect — stock transactions	1	—	1
Invested equity/(deficit), December 31, 2002	(613)	(15)	(628)
2003			
Net investment by IBM	(113)	—	(113)
Net loss plus gains and (losses) included in other comprehensive income/(loss):			
Net loss	(258)	—	(258)
Gains and (losses) included in other comprehensive income/(loss) (net of tax):			
Net unrealized losses on SFAS No. 133 cash flow hedge derivatives during 2003 (net of tax)	—	1	1
Foreign currency translation adjustments (net of tax)	—	7	7
Invested equity/(deficit), December 31, 2003	$(984)	$(7)	$(991)

The accompanying notes on pages I-8 through I-38 are an integral part of the combined financial statements.

Personal Computing Division
A Division of International Business Machines Corporation
Combined Statement of Invested Equity/(Deficit)

	IBM'S NET INVESTMENT	ACCUMULATED OTHER COMPREHENSIVE INCOME/(LOSS)	TOTAL
		(US dollars in millions)	
Invested equity/(deficit), December 31, 2003	$(984)	$(7)	$(991)
2004			
Net investment by IBM	150	—	150
Net loss plus gains and (losses) included in other comprehensive income/(loss):			
Net loss	(139)	—	(139)
Gains and (losses) included in other comprehensive income/(loss) (net of tax):			
Net unrealized gains on SFAS No. 133 cash flow hedge derivatives during first six months of 2004 (net of tax)	—	7	7
Foreign currency translation adjustments (net of tax)	—	(2)	(2)
Invested equity/(deficit), June 30, 2004	$(973)	$(2)	$(975)

The accompanying notes on pages I-8 through I-38 are an integral part of the combined financial statements

Personal Computing Division
A Division of International Business Machines Corporation
Combined Statement of Cash Flows

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003 (UNAUDITED)	2003	2002	2001
	(US dollars in millions)				
CASH FLOW FROM OPERATING ACTIVITIES:					
Net loss	$(139)	$(97)	$(258)	$(171)	$(397)
Adjustments to reconcile net loss to cash provided by operating activities:					
Depreciation	28	31	61	64	83
Deferred income taxes	—	1	2	4	(3)
Net loss/(gain) on asset sales and other	1	(4)	(2)	(93)	—
Minority interest expense	21	11	26	17	17
Change in operating assets and liabilities:					
Receivables	68	34	(24)	29	303
Inventories	(46)	(68)	(34)	76	230
Other assets	(56)	(13)	17	27	55
Accounts payable	(14)	37	268	175	(502)
Other liabilities	66	(28)	115	77	15
NET CASH (USED IN)/PROVIDED BY OPERATING ACTIVITIES	(71)	(96)	171	205	(199)
CASH FLOW FROM INVESTING ACTIVITIES:					
Payments for plant and other property	(36)	(71)	(97)	(86)	(107)
Proceeds from disposition of plant and other property	5	72	73	163	2
Transfers of assets at net book value to/(from) IBM	41	15	7	(10)	95
Distributions to joint venture minority interest holders	(4)	(4)	(31)	(32)	(28)
Proceeds from disposition of other investments	—	1	2	3	2
NET CASH PROVIDED BY/(USED IN) INVESTING ACTIVITIES	6	13	(46)	38	(36)
CASH FLOW FROM FINANCING ACTIVITIES:					
Net IBM investment	150	25	(113)	(155)	291
Proceeds from receipts of short-term financing	—	12	—	—	—
NET CASH PROVIDED BY/(USED IN) FINANCING ACTIVITIES	150	37	(113)	(155)	291
Effect of exchange rate changes on cash	1	—	—	1	—
Net change in cash	86	(46)	12	89	56
Cash at January 1	211	199	199	110	54
CASH AT JUNE 30, AND DECEMBER 31	$297	$153	$211	$199	$110

The accompanying notes on pages I-8 through I-38 are an integral part of the combined financial statements.

NOTES TO COMBINED FINANCIAL STATEMENTS

A. Description of Business and Basis of Presentation

The Personal Computing Division ("PCD" or the "Business") is a division of International Business Machines Corporation ("IBM"). The Business develops, manufactures and markets personal computer products including a wide variety of notebook and desktop computers and related accessories. The Business operates worldwide through three primary sales/distribution channels including: direct/large enterprise customers; distributors, remarketers and resellers; and internet/direct order channels.

IBM facilitates the financing of product purchases from the Business, including, but not limited to, providing commercial loans and lease financing to IBM's "business partners" which include distributors, resellers, and other remarketers of PCD's products. In addition, IBM provides end-user financing, including leasing, installment loans and other facilities to end-users of personal computer equipment, including customers of IBM's business partners.

The Combined Financial Statements have been derived from the accounting records of IBM using the historical bases of assets and liabilities of PCD. The June 30, 2003 data contained in these Combined Financial Statements is unaudited and presented for comparative purposes. Management believes the assumptions underlying the Combined Financial Statements are reasonable. However, the Combined Financial Statements included herein may not necessarily reflect the Business' results of operations, financial position and cash flows in the future or what its results of operations, financial position and cash flows would have been had the Business operated as a stand-alone entity during the periods presented.

The Business and its parent, IBM, engage in extensive intercompany transactions, and the Business relies on its parent for substantially all of its operational and administrative support for which it is allocated costs on a basis that management believes is appropriate in the circumstances. The amounts recorded for these transactions and allocations are not necessarily representative of the amounts that would have been reflected in the financial statements had the Business been an entity operated independently of the parent.

The Combined Financial Statements include allocations of certain IBM corporate expenses, including centralized research, legal, human resources, payroll, accounting, employee benefits, real estate, insurance, information technology, telecommunications, treasury and other IBM corporate and infrastructure costs. The expense and cost allocations have been determined on bases that IBM and the Business consider to be a reasonable reflection of the utilization of services provided or the benefit received by the Business during the periods presented. In addition to the allocated costs, the Business also receives charges based on agreements between the Business and other entities within IBM for operational and functional support in critical areas such as the following: direct sales and marketing; manufacturers' warranty (including fulfilling obligations under product warranties); brand marketing; procurement; financing; information technology; logistics and fulfillment services; site management and real estate; research and development; licensing of brand names, trademarks, know-how, and other intellectual property; human resources; tax-related services; intellectual property management and royalty settlement services.

IBM uses a centralized approach to cash management and financing of its operations. Transactions relating to the Business are accounted for through the IBM net investment account for the Business. Accordingly, none of the IBM cash, cash equivalents or debt at the corporate level has been assigned to the Business in the Combined Financial Statements. Cash in the Combined Financial Statements represents amounts held locally by the Business' operations in China and South Korea. See note T, "Subsequent Events," on page I-33 for a description of the September, 2004 agreement to dissolve the Business' joint venture in South Korea.

See note D, "Transactions with IBM" on pages I-15 to I-18 for further description of the relationships the Business has with IBM.

Risks and Uncertainties

The Business has from inception operated as an integrated part of IBM and within the IBM infrastructure. As a consequence, the Business has not operated as a stand-alone business. The Business benefits from centralized IBM functions, such as global procurement and integrated supply chain. The historical financial statements may, therefore not reflect the results of operations, financial position or cash flows that would have resulted had the Business been operated as a separate entity.

The Business purchases all of its microprocessors from a single supplier and a significant amount of its personal computer products are shipped preloaded with software from a single supplier.

The Business currently sources a significant amount (over 40 percent in the first six months of 2004 and over 50 percent in 2003) of its products from one external supplier. If this supplier were unable to deliver products for an extended period of time, the Business would be required to find replacement products from an alternative supplier or suppliers, which may not be available on a timely or cost effective basis.

Additionally, greater than 50 percent (in the first six months of 2004) and greater than 30 percent (in 2003) of the Business' products are manufactured as part of joint ventures with third parties, primarily in Asia. These relationships are important to the Business meeting its production commitments. See note T, "Subsequent Events," on page I-33 for a description of the September, 2004 agreement to dissolve the Business' joint venture in South Korea.

During the periods presented, the Business experienced quality issues with certain components of the product set. The warranty costs associated with these quality issues were charged to Cost of revenue External sales. The Business had total warranty costs of US$365 million and US$226 million for the periods ended June 30, 2004 and 2003, respectively, and US$586 million, US$430 million and US$452 million in the years ended December 31, 2003, 2002 and 2001, respectively.

In addition, a significant portion of the Business' customers finance their purchases through commercial loans from IBM's financing operations. This financing component is an integral part of the relationship which the Business has with its customers and business partners.

Liquidity

The Business has a history of recurring losses, negative working capital and an accumulated deficit. The ability to settle obligations as they come due is dependent on IBM funding the operations on an ongoing basis. IBM is committed to funding the operations as necessary to meet the obligations of the Business as they come due, for as long as the Business is owned and controlled by IBM.

B. Significant Accounting Policies

Principles of Combination

The Combined Financial Statements have been prepared for the Business as it was historically managed within IBM's management and measurement system and includes the global historical assets, liabilities and operations for which management is responsible, including certain joint venture investments, adjusted as necessary to conform with accounting principles generally accepted in the United States of America (GAAP). All significant intra-company transactions within the Business have been eliminated. All significant transactions between the Business and other entities of IBM are included in these Combined Financial Statements. All intercompany transactions are considered to be effectively settled for cash in the Combined Statement of Cash Flows at the time the transaction is recorded. Certain assets and liabilities of the Business, which are included in these Combined Financial Statements may, or may not, be indicative of the Business on a stand-alone basis.

Use of Estimates

The preparation of Combined Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts that are reported in the Combined Financial Statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions that the Business may undertake in the future, actual results may be different from the estimates. These estimates include, but are not limited to, allowance for price protection, returns and other vendor support arrangements, allowance for doubtful accounts, realization of deferred tax assets, inventory valuation allowances, warranty obligations and employee compensation accruals.

Revenue

The Business recognizes revenue when it is realized or realizable and earned. The Business considers revenue realized or realizable and earned when it has persuasive evidence of an arrangement, delivery has occurred, the sales price is fixed or determinable and collectibility is reasonably assured. Delivery is considered to have occurred upon transfer of title and risk of loss to the customer, generally at shipment, and revenue is recognized provided there are no unfulfilled business obligations that affect customers' final acceptance of the arrangement. Any cost of these obligations is accrued when the corresponding revenue is recognized. The Business and IBM allocate revenue from multiple-element arrangements on a relative fair value basis in accordance with Emerging Issues Task Force (EITF) Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." The Business estimates and records incentive offerings, including price protection, promotions, and other volume-based incentives, and expected returns as reductions of revenue.

Expense and Other Income

Selling, General and Administrative

Selling, general and administrative (SG&A) expense is charged to operations as incurred. Expenses of promoting and selling products and services are classified as selling expense and include such items as advertising, sales commissions and travel. General and administrative expense includes such items as executive salaries, office supplies, non-income taxes, insurance and office rental. In addition, general and administrative expense includes other operating items such as a provision for doubtful accounts and workforce accruals for contractually obligated payments to employees terminated in the ongoing course of business.

Research, Development and Engineering

Research, development and engineering (RD&E) costs are expensed as incurred.

Intellectual Property Income

As part of the Business' ongoing business investment in research and development (R&D), the Business licenses the rights to certain of IBM's intellectual property (IP) including internally-developed patents through licensing/royalty-based arrangements. Licensing/royalty-based arrangements involve transfers in which the Business earns the income over time, or the amount of income is not fixed or determinable until the licensee sells future related products (i.e., variable royalty, based upon licensee's revenue).

Other (Income) and Expense

Other (income) and expense includes principally gains from sales of manufacturing operations, interest income and foreign currency transaction gains and losses.

Depreciation and Amortization

Plant and other property are carried at cost and are depreciated over their estimated useful lives using the straight-line method. Plant and other property are included in the Combined Statement of Financial Position when they are managed by the Business i.e., "landlord-tenant basis" and are not necessarily reflective of ownership. Depreciation charges for Plant and other property managed by the Business which are utilized by other IBM units are recovered in occupancy/usage billings to such IBM units resulting in a cost/expense reduction to the Business. Refer to Note D, "Transactions with IBM," on pages I-15 to I-18. The estimated useful lives of depreciable properties generally are as follows: buildings, 50 years; building equipment, 20 years; land improvements, 20 years; plant, laboratory and office equipment, 2 to 15 years; and computer equipment, 1.5 to 5 years.

Retirement-Related Benefits

The Business' employees and IBM employees that provide direct support to the Business participate in certain defined benefit pension plans, certain defined contribution plans and certain nonpension postretirement benefit plans, all of which are sponsored by IBM. The Business accounts for costs related to defined benefit pension and nonpension postretirement benefit plans on a multi-employer plan basis as a participant, in accordance with Statement of Financial Accounting Standards (SFAS) No. 87, "Employers' Accounting for Pensions," and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," respectively. SFAS No. 87 provides that an employer that participates in a multi-employer defined benefit plan is not required to report a liability beyond the contributions currently due and unpaid to the plan. As a consequence, no assets or liabilities relative to these retirement-related plans have been included in the Combined Statement of Financial Position. See note R, "Retirement-Related Benefits," on pages I-28 and I-29 for further information regarding the plans in which the Business' employees participate.

Stock-Based Compensation

The Business' employees participate in IBM's various incentive award plans. The Business applies the provisions of Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees," and related Interpretations in accounting for stock-based compensation arrangements. Accordingly, the Business records expense for grants of employee stock-based compensation awards equal to the excess of the market price of the underlying IBM shares at the date of grant over the exercise price of the stock-related award, if any (known as the intrinsic value). Generally, all employee stock options are issued with an exercise price equal to or greater than the market price of the underlying shares at grant date and therefore, no compensation expense is recorded. In addition, no compensation expense is recorded for purchases of IBM stock made by the Business' employees under the IBM Employee Stock Purchase Program (ESPP) in accordance with APB No. 25. Additionally, the intrinsic value of restricted stock units and certain other stock-based awards issued to employees as of the date of grant is amortized to compensation expense over the vesting period. To the extent there are performance criteria that could result in an employee receiving more or less (including zero) IBM shares than the number of units granted, the unamortized compensation is marked to market during the performance period based upon the intrinsic value at the end of each quarter.

The following table summarizes the pro forma operating results of the Business, had compensation cost for stock- based awards granted and employee stock purchases under the ESPP (see note Q, "Stock-Based Compensation Plans" on pages I-26 and I-27) been determined in accordance with the fair value-based method prescribed by SFAS No. 123, "Accounting for Stock-Based Compensation."

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
Net loss, as reported	$(139)	$(97)	$(258)	$(171)	$(397)
Add: Stock-based employee compensation expense included in reported net loss, net of related tax effects	3	2	3	5	5
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	13	16	29	35	32
Pro forma net loss	$(149)	$(111)	$(284)	$(201)	$(424)

The pro forma amounts that are disclosed in accordance with SFAS No. 123 reflect the portion of the estimated fair value of awards that was earned for the periods present above. The fair value of stock option grants was estimated using a Black-Scholes option-pricing model with the assumptions listed in the table below. The assumptions used and fair values of such awards are indicative of an IBM stock option and may not necessarily be representative of the value of a comparable award granted by the Business.

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
Option term (years)	5	5	5	5	5
Volatility	38.6%	39.9%	39.9%	40.4%	37.7%
Risk-free interest rate (zero coupon U.S. treasury note)	3.4%	2.6%	2.9%	2.8%	4.4%
Dividend yield	0.7%	0.7%	0.7%	0.7%	0.5%
Weighted-average fair value per option (in US dollars)	$36	$29	$30	$32	$42

Income Taxes

The Business' income taxes as presented are calculated on a separate tax return basis, although the Business' operations have historically been included in IBM's U.S. federal and state tax returns or non-U.S. jurisdictions tax returns. IBM's global tax model has been developed based on its entire portfolio of businesses. Accordingly, the Business' tax results as presented are not reflective of the results that the Business would have generated on a stand-alone basis.

Income tax expense is based on reported income before income taxes. Deferred income taxes reflect the effect of temporary differences between asset and liability amounts that are recognized for financial reporting purposes and the amounts that are recognized for income tax purposes. These deferred taxes are measured by applying currently enacted tax laws. Valuation allowances are recognized to reduce deferred tax assets to the amount that is more likely than not to be realized.

Translation of Non-U.S. Currency Amounts

Assets and liabilities of non-U.S. operations that conduct business in a local currency environment are translated to U.S. dollars at year-end exchange rates for the periods ending December 31, 2003, 2002 and 2001, and at June 30, 2004 exchange rates for the six months ended June 30, 2004. Income and expense items are translated at weighted-average rates of exchange prevailing during the year or the six month periods as presented. Translation adjustments are recorded within Invested equity/(deficit).

For operations that conduct business in U.S. dollars, or whose economic environment is highly inflationary, Inventories, Plant and other property, net and other non-monetary assets and liabilities are translated at approximate exchange rates prevailing when the Business acquired the assets or liabilities. All other assets and liabilities of these entities are translated at year-end exchange rates for the periods ending December 31, 2003, 2002 and 2001, and at June 30, 2004 exchange rates for the six months ended June 30, 2004. Cost of revenue and depreciation are translated at historical exchange rates. All other income and expense items are translated at the weighted-average rates of exchange prevailing during the year or the six month periods as presented. Gains and losses that result from translation are included in net loss.

Derivatives

The Business recognizes derivative instruments including designated hedging transactions in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," and SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," (SFAS No. 133). All derivatives are recognized at fair value and are reported in Investments and sundry assets or Minority interests and other long-term liabilities in the Combined Statement of Financial Position.

The Business' primary derivative usage is designated as hedging the variability of cash flows of forecasted transactions based on changes in foreign currency rates. Changes in value of effective cash flow hedges are recorded net of applicable taxes, in Accumulated other comprehensive income/(loss), a component of Invested equity/(deficit). These accumulated amounts are reclassified to Cost of revenue in the period that Net loss is affected by the variability of the underlying cash flow. The reclassified amount is the applicable offsetting amount of the gain or loss deferred in Invested equity/(deficit) relating to the cash flows impacting that period's Net loss. Changes in the value of derivatives that are not designated as hedges at inception or after designation of a previously designated hedge, as well as changes in the value of derivatives designated as hedges that do not offset the underlying hedged item throughout the designated hedge period, are recorded in Net loss each period and in Other (income) and expense.

The Business reports cash flows resulting from the Business' derivative financial instruments consistent with the classification of cash flows from the underlying hedged items as Cash flow from operating activities within the Combined Statement of Cash Flows.

See note I, "Derivatives and Hedging Transactions," on pages I-19 and I-20 for a description of the derivative instruments used by the Business.

Inventories

Raw materials, work in process and finished goods are stated at the lower of average cost or net realizable value. Included in inventory are those goods which are located at third party manufacturers for which the Business retains risk of loss.

Allowance for Uncollectible Receivables

An allowance for uncollectible trade receivables is recorded based on a combination of write-off history, aging analysis, and any specific known troubled accounts.

Factoring

The Business applies the provisions of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities" when accounting for the sale of certain receivables to its parent company, IBM. In accordance with the provisions of SFAS No. 140, these transactions have been accounted for as sales and are not subject to recourse. As a result the related receivables have been excluded from the accompanying Combined Statement of Financial Position. For such receivable sales, the Business retains the obligation to dealers and remarketers for price protection, stock rotation and related vendor support and has reflected this as a liability in the Combined Financial Statements.

Royalties

The Business has royalty-bearing license agreements with vendors that allow the Business to sell certain products which are protected by patent, copyright or license. Royalty costs are included in Cost of revenue when the products are delivered.

Product Warranties

The Business records warranty liabilities for the estimated costs that may be incurred under its basic warranty for which the Business is obligated to perform. The Business estimates its warranty costs based on historical warranty claim experience for eligible products under warranty. Estimated costs for warranties applicable to revenue recognized in the current period are charged to Cost of revenue. These costs primarily include technical support, parts, and labor associated with warranty repair and service actions. The warranty accrual is reviewed quarterly to verify that it properly reflects the remaining obligation based on the anticipated expenditures over the balance of the obligation period. Adjustments are made when actual warranty claim experience differs from estimates. Extended post-warranty service contracts are excluded from these financial statements as these contracts are managed by a separate IBM business entity.

C. Accounting Changes

Standards Implemented

In January 2003, the FASB issued FASB Interpretation Number 46 (FIN 46), "Consolidation of Variable Interest Entities," (effective for the year ended December 31, 2003) and amended it by issuing FIN 46-R in December 2003. Such guidance addresses consolidation by business enterprises of variable interest entities (VIEs) that either: (1) do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) have equity investors that lack an essential characteristic of a controlling financial interest. The company chose to apply the guidance of FIN 46-R, as of March 31, 2004 in accordance with the Interpretation's transition provisions. Neither of these accounting pronouncements had a material impact on the Business' Combined Financial Statements.

On January 1, 2003, the Business adopted SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 provides accounting and reporting guidance for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction or normal operation of a long-lived asset. SFAS 143 requires the recording of an asset and a liability equal to the present value of the estimated costs associated with the retirement of long-lived assets for which a legal or contractual obligation exists. The asset is required to be depreciated over the life of the related equipment or facility, and the liability is required to be accreted each year based on a present value interest rate. The adoption of the standard did not have a material effect on the Business' Combined Financial Statements.

In 2003, the EITF reached a consensus relating to the accounting for multiple-element arrangements: Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." EITF No. 00-21 was adopted effective July 1, 2003 and did not have a material impact on the Business' Combined Financial Statements.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," which addresses the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. FIN 45 also requires the recognition of a liability by a guarantor at the inception of certain guarantees that are entered into or modified after December 31, 2002. The Business has adopted the disclosure requirements of FIN 45 (see note B, "Significant Accounting Policies," on page I-13 under "Product Warranties," and note L "Contingencies and Commitments," on pages I-21 to I-23) and applied the recognition and measurement provisions for all material guarantees entered into or modified in periods beginning January 1, 2003. The initial adoption of the recognition and measurement provisions of FIN 45 did not have a material impact on the Business' Combined Financial Statements.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 addresses significant issues relating to the implementation of SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and develops a single accounting model, based on the framework established in SFAS No. 121 for long-lived assets to be disposed of by sale, whether such assets are or are not deemed to be a business. SFAS No. 144 also modifies the accounting and disclosure rules for discontinued operations. The standard was adopted on January 1, 2002, and did not have a material impact on the Business' Combined Financial Statements.

On January 1, 2001, the Business adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedge Activities," and SFAS No. 149, "Amendments of Statement 133 on Derivative Instruments and Hedging Activities," (SFAS No. 133). SFAS No. 133 establishes accounting and reporting standards for derivative instruments. As of January 1, 2001, the adoption of the new standard resulted in a cumulative effect charge of US$10 million included in the effect of change in accounting principle in the Combined Statement of Operations.

Effective January 1, 2001, the Business adopted SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities — a replacement of SFAS No. 125." This statement provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. It also revises the accounting standards for securitizations and transfers of financial assets and collateral. The adoption did not have a material effect on the Business' Combined Financial Statements. The standard also requires new disclosures that are not applicable to the Business.

D. Transactions with IBM

Revenue/Cost of Revenue

The Business derived revenue from IBM of US$214 million and US$136 million, during the six months ended June 30, 2004 and 2003, respectively. In addition, the Business derived revenue from IBM of US$278 million, US$275 million and US$333 million, during each of the years ended December 31, 2003, 2002 and 2001, respectively. The revenue stream is valued at manufacturer's cost, consistent with how these product transactions were recorded within IBM. In addition, there is no stated or implied warranty on these transactions, i.e. the IBM user is responsible for any repair costs.

IBM Global Financing

IBM Global Financing (IGF, a division of IBM) is in the business of financing customer purchases of IBM products and services. IGF facilitates customer purchases of the Business' products through commercial lending and end-user leasing or loan arrangements. In this regard, certain dealers and remarketers obtain commercial loans and certain end-users obtain leases or loans to finance their purchases of products from the Business. IGF financing arrangements are conducted on an arms-length basis with customers and IGF regularly secures its interests in or takes title to financed products.

IGF originations of commercial loans to finance dealer and remarketer purchases of products from the Business approximated US$3,628 million and US$3,024 million for the six months ended June 30, 2004 and 2003, respectively. In addition, IGF originations of commercial loans approximated US$6,651 million, US$6,043 million, and US$7,103 million in 2003, 2002 and 2001, respectively. For such financed purchases, the Business retains the obligations to the dealers and remarketers for price protection, stock rotation, and related vendor support. This is recorded in the Rebates and returns accrual line in the Combined Statement of Financial Position.

IGF originations of leases to finance end-user customer purchases of products from the Business or from dealers and remarketers approximated US$393 million and US$488 million for the six months ended June 30, 2004 and 2003, respectively. In addition, IGF originations of leases to finance end-user customer purchases approximated US$1,054 million, US$1,164 million, and US$1,703 million in 2003, 2002 and 2001, respectively. IGF originations of customer loans to finance end-user customer purchases of products from the Business approximated US$16 million and US$18 million for the six months ended June 30, 2004 and 2003, respectively. IGF originations of customer loans to finance end-user customer purchases were US$68 million, US$46 million and US$179 million in 2003, 2002 and 2001, respectively.

Where concentrations with a particular dealer, remarketer or end-user customer exceed established IBM credit limits, or in certain other circumstances relating to credit quality, IGF requires an indemnification from the Business prior to the extension of credit. In these situations, the Business assumes the repayment risk on credit extended by IGF on its behalf. The amount of outstanding receivables due to IGF for such indemnifications was less than US$1 million as of June 30, 2004 and December 31, 2003. The Business did not realize significant losses through such indemnifications during the periods presented.

As compensation to IGF for providing commercial lending facilities to the dealers and remarketers of the Business' products and in addition to the returns earned by IGF on commercial lending and end-user leasing transactions, IGF charges the Business annually, market-rate based fees. Such fees, included in the income statement under Selling, general and administrative expense, amounted to US$33 million and US$29 million for the six months ended June 30, 2004 and 2003, respectively. Such fees were US$63 million, US$57 million and US$64 million during 2003, 2002 and 2001, respectively.

Working Capital Management

As part of the Business' working capital and liquidity management, the Business has entered into certain sales of receivables contracts with IBM. These sales transfer all rights, title and interest in the receivables to IBM at formulaically determined prices (factoring). The Business retains no residual credit exposure to the factored receivables. The Business does have a continued responsibility to service the receivables and remit collections to IBM.

Without this factoring program, the Business' gross accounts receivable would have been US$156 million higher at June 30, 2004 and US$161 million, US$126 million and US$139 million higher at December 31, 2003, 2002 and 2001, respectively.

Allocated Costs/Expenses

The Business receives support from IBM for certain corporate expenses, including centralized research and development, legal, human resources, payroll, accounting, information technology services, telecommunications, treasury and other IBM corporate and sales support/ infrastructure costs. The costs of providing these services have been allocated to the Business on bases that management considers to be appropriate and provide a reasonable reflection of the utilization of services provided or benefits received by the Business during the periods presented on a consistent basis. The allocation bases used include gross profit, revenue and operating expenses.

Allocated costs included in the accompanying Combined Statement of Operations follow:

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
Cost of revenue	$4	$6	$11	$1	$(7)
Selling, general and administrative	187	150	321	344	382
Research, development and engineering	6	4	9	11	10
Other (income) and expense	4	5	10	(2)	(7)

Agreements With IBM

The Business has entered into various agreements to procure certain services from IBM. Prices and rates for such services are based on predetermined or otherwise negotiated amounts between IBM divisions. The following table, followed by a brief description, details the cost of services provided by IBM to the Business under such agreements:

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
Services provided by IBM:					
Cost of revenue:					
Warranty costs	$238	$200	$421	$347	$361
Hardware costs	56	59	115	352	613
Overhead costs	74	58	134	122	135
IT services	45	57	105	85	91
Product distribution costs	31	37	73	80	100
Technology support costs	11	8	14	13	19
Software costs	3	4	7	6	6
Other	9	12	21	17	14
Total cost of revenue	$467	$435	$890	$1,022	$1,339
Selling, general and administrative	$170	$162	$337	$268	$308
Research, development and engineering	$13	$15	$29	$32	$34
Other (income) and expense	$—	$(10)	$(10)	$(41)	$(31)

Cost of revenue: These charges to the Business primarily include warranty, hardware, overhead, IT services, product distribution, technology support, and software costs. Warranty costs are charged based on each occurrence. Generally, component hardware costs are charged based on internally established transfer prices between IBM divisions. Overhead costs include employee benefits and occupancy costs related to the Business' manufacturing employees and procurement expenses. IT services are charged based on a combination of factors including usage and headcount. Product distribution costs are charged based on actual usage of freight carriers. Technology support costs are charged based on direct expenses including occupancy costs, salaries and benefits. Software costs are charged based on other IBM divisions' royalty and software development charges.

Selling, general and administrative: These charges to the Business primarily include IT services, fees paid to IGF for commercial lending activities, direct channel fees, marketing and sales programs, employee benefits, occupancy costs, customer fulfillment costs, administrative support, and human resources support. IT services are charged based on a combination of factors including usage and headcount. IT services charged to the Business were US$25 million and US$27 million for each of the six month periods ended June 30, 2004 and 2003, respectively and US$54 million, US$57 million, and US$62 million during each of the years ended December 31, 2003, 2002 and 2001, respectively. Direct channel fees are charged to the Business based on direct expenses including occupancy costs, salaries and benefits. Marketing and sales programs are charged based on direct expenses including marketing materials and development costs, occupancy costs, salaries and benefits. Employee benefits and occupancy costs for the Business' employees are charged from IBM. Customer fulfillment costs are charged based on direct expenses including occupancy costs, salaries and benefits. Administrative and human resources support are charged based on direct expenses including occupancy costs, salaries and benefits. As noted under the IBM Global Financing section on page I-15, fees paid as compensation to IGF for providing commercial lending facilities to the dealers and remarketers of the Business' products were US$33 million and US$29 million for each of the six month periods ended June 30, 2004 and 2003, respectively and US$63 million, US$57 million and US$64 million during each of the years ended December 31, 2003, 2002 and 2001, respectively.

Research, development and engineering services: The costs of providing these services are charged to the Business based on employee benefits and occupancy costs for the Business' employees performing research, development and engineering services. Additionally, the direct development expenses of other IBM divisions including occupancy costs, salaries and benefits, and IT services are charged from IBM.

Other (income) and expense: These amounts primarily include credits transferred to the Business from IBM that compensate the Business for taking certain low or negative margin contracts.

The Business passes through costs for amounts charged by IBM and its entities that are related to other IBM divisions. Additionally the Business has various agreements to provide services to other IBM divisions. The following table details the annual pass through costs and charges for services provided to other IBM divisions followed by a brief description.

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	**2003**	**2003**	**2002**	**2001**
	(US dollars in millions)				
Costs and charges for services provided to other IBM divisions (reductions of the following categories):					
Cost of revenue:					
Hardware costs	$16	$14	$24	$34	$38
Overhead costs	55	59	106	117	170
Software costs	7	9	17	19	12
Product distribution costs	4	3	7	12	30
Technology support costs	1	4	7	26	26
Other	17	17	30	21	24
Total cost of revenue	$100	$106	$191	$229	$300
Selling, general and administrative	$61	$54	$119	$132	$235
Research, development and engineering	$3	$3	$6	$16	$4

Cost of revenue: These charges to IBM divisions primarily include both pass through costs and services provided to other IBM divisions for hardware, overhead, software, product distribution and technology support. The Business sources certain hardware components from its suppliers for other IBM divisions. Overhead costs charged to other IBM divisions primarily include procurement expenses, manufacturing employees' salaries and benefits, and occupancy costs. Software costs are charged based on external software developers' royalty related to other IBM divisions' products. Product distribution costs are charged based on actual usage of freight carriers. Technology support costs are charged based on direct expenses including occupancy costs, salaries and benefits. These costs have been included as a reduction of Cost of revenue.

Selling, general and administrative: These charges to IBM primarily include both pass through costs and services provided to other IBM divisions for marketing and sales programs, administrative support, human resources support and legal support. Marketing and sales programs are charged based on direct expenses including marketing materials and development costs, occupancy costs, salaries and benefits. Administrative and human resources support are charged based on direct expenses including occupancy costs, salaries and benefits. These costs have been included as a reduction of Selling, general and administrative expense.

Research, development and engineering services: These charges are primarily for research, development and engineering services activities provided by the Business to other IBM divisions and include direct development expenses, occupancy costs, salaries and benefits.

E. Sale of Manufacturing Operations

In January 2002, the Business sold certain of its North American and European desktop personal computer manufacturing operations to Sanmina SCI. Along with the sale, the Business entered into a three year outsourcing agreement with Sanmina SCI to manufacture personal computers for the Business. As a result of this transaction, the company sold fixed assets and inventory valued at approximately US$65 million and a US$91 million gain was recorded in Other (income) and expense in the Combined Statement of Operations. In January of 2003, the Business sold additional fixed assets and inventory valued at approximately US$61 million, as well as certain of its mobile personal computer manufacturing operations processes to Sanmina SCI. The result of this transaction was a US$5 million gain recorded in Other (income) and expense in the Combined Statement of Operations.

F. Inventories, net

	AT JUNE 30 2004	AT DECEMBER 31 2003	2002	2001
	(US dollars in millions)			
Finished goods	$172	$152	$141	$194
Work in process and raw materials	107	83	75	128
Total	$279	$235	$216	$322

G. Plant and Other Property, net

	AT JUNE 30 2004*	AT DECEMBER 31 2003	2002	2001
	(US dollars in millions)			
Land and land improvements	$38	$42	$50	$50
Buildings and building improvements	407	490	526	513
Plant, laboratory and office equipment	361	436	553	586
	806	968	1,129	1,149
Less: Accumulated depreciation	498	607	728	718
Total	$308	$361	$401	$431

* *Effective May 1, 2004, the Business no longer manages the Guadalajara, Mexico site. As a result of this change in management, Plant and other property, net was reduced by US$33 million. This is reflected in the Combined Statement of Cash Flows in Transfer of assets at net book value to/(from) IBM.*

H. Investments and Sundry Assets

	AT JUNE 30	AT DECEMBER 31		
	2004	2003	2002	2001
	(US dollars in millions)			
Deferred taxes	$32	$32	$24	$20
Goodwill	19	18	18	13
Other assets	9	11	16	5
Total	$60	$61	$58	$38

I. Derivatives and Hedging Transactions

In the normal course of operations, the Business is exposed to foreign currency fluctuations. The Business limits these risks by following established risk management policies and procedures including the use of derivatives. The Business does not use derivatives for trading or speculative purposes. Further, the Business has a policy of only entering into contracts with carefully selected major financial institutions based upon their credit ratings and other factors, and maintains strict dollar and term limits that correspond to the institution's credit rating.

The Business' operations generate non-functional currency, and generate and remit non-functional currency for third party vendor payments and intercompany payments for goods and services with IBM. In anticipation of these foreign currency cash flows and in view of the volatility of the currency markets, the business selectively employs foreign exchange forward and option contracts to manage its currency risk. At December 31, 2003 and June 30, 2004, the maximum remaining maturity of these derivative instruments was approximately 3 months.

At June 30, 2004, the assets recorded in the Combined Statement of Financial Position related to cash flow hedges was US$1.0 million.

At December 31, 2003, the net liabilities recorded in the Combined Statement of Financial Position related to cash flow hedges was US$5.3 million and consisted of US$0.1 million of assets and US$5.4 million of liabilities. At December 31, 2002, the net liabilities recorded in the Combined Statement of Financial Position related to cash flow hedges was US$5.8 million and consisted of US$0.2 million of assets and US$6.0 million of liabilities. At December 31, 2001, the assets recorded in the Combined Statement of Financial Position related to cash flow hedges was US$19.8 million.

The Business has recorded approximately US$6.4 million of net losses in Accumulated other comprehensive income/(loss) as of December 31, 2003, net of tax, the entire balance of which is expected to be reclassified to net income within the next year, providing an offsetting economic impact against the underlying anticipated cash flows hedged. There were no net gains or losses recorded in Accumulated other comprehensive income/(loss) at June 30, 2004.

The following table summarizes activity in the Accumulated other comprehensive income/(loss) section of the Combined Statement of Invested Equity/(Deficit) related to all derivatives classified as cash flow hedges held by the Business during the periods January 1, 2001 (the date of the Business' adoption of SFAS No. 133) through June 30, 2004:

	DEBIT/ (CREDIT) *(US dollars in millions, net of tax)*
Beginning balance as of January 1, 2001	$—
Net gains reclassified into operations from Invested equity/(deficit) during 2001	6
Changes in fair value of derivatives in 2001	(23)
December 31, 2001	(17)
Net losses reclassified into operations from Invested equity/(deficit) during 2002	(20)
Changes in fair value of derivatives in 2002	44
December 31, 2002	7
Net losses reclassified into operations from Invested equity/(deficit) during 2003	(26)
Changes in fair value of derivatives in 2003	25
December 31, 2003	6
Net losses reclassified into operations from Invested equity/(deficit) during 2004	3
Changes in fair value of derivatives in 2004	(9)
June 30, 2004	$—

At June 30, 2004 and December 31, 2003, there were no significant gains or losses on derivative transactions or portions thereof that were either ineffective as hedges, excluded from the assessment of hedge effectiveness, or associated with an underlying exposure that did not occur; nor are there any anticipated in the normal course of business.

Derivative operations are provided through the centralized risk management and treasury functions of IBM. In addition to the specific direct hedge program above, the Business' Combined Statement of Operations includes an allocation of gains/losses related to IBM's global hedging programs. See note D, "Transactions with IBM", on pages I-15 to I-18 for further information regarding the allocation of certain IBM costs to the Business.

J. Minority Interests and Other Long-Term Liabilities

The Business has investments in joint ventures whose assets, liabilities and operations are included in the Combined Financial Statements. The Business manages the operations of the joint ventures. The joint ventures have both personal computer (PC) operations and non-personal computer operations. The results of the joint ventures' non-personal computer operations have been excluded from the results of the Business. Included in the Combined Statement of Operations are the results of the joint ventures' PC operations offset by minority interest expense (net of tax) of US$21 million and US$11 million, for the six month periods ended June 30, 2004 and June 30, 2003, respectively, and US$26 million, US$17 million and US$17 million for the years ended December 31, 2003, 2002 and 2001, respectively.

Additionally, dividend distributions to parties holding a minority interest totaled US$4 million for the six month periods ended June 30, 2004 and 2003, and US$31 million, US$32 million and US$28 million for the years ended December 31, 2003, 2002 and 2001, respectively. Such amounts are included in the Combined Statement of Cash Flows as Investing Activities.

At December 31, 2003, 2002 and 2001, included in the Combined Statement of Financial Position is minority interest in joint ventures of US$56 million, US$48 million and US$48 million, respectively, which reflects the original investment by parties holding a minority interest in such joint ventures, along with their proportional share of the joint venture earnings, losses and distributions. At June 30, 2004, minority interest in joint ventures totaled US$77 million, of which US$16 million represents the amount related to the Business' South Korean joint venture.

See note T, "Subsequent Events," on page I-33 for a description of the 2004 agreement to dissolve the Business' joint venture in South Korea.

K. Comprehensive Income/(Loss*)

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
Net loss	$(139)	$(97)	$(258)	$(171)	$(397)
Net unrealized gains/(losses) on cash flow hedge activities	7	7	1	(24)	17
Foreign currency translation adjustment	(2)	7	7	(13)	5
Comprehensive income/(loss)	$(134)	$(83)	$(250)	$(208)	$(375)

* *Net of tax.*

L. Contingencies and Commitments

The Business is involved in a variety of claims, suits, investigations and proceedings that arise from time to time in the ordinary course of its business, including actions with respect to contracts, intellectual property (IP), product liability, employment, and environmental matters. The following is a discussion of some of the more significant legal matters involving the Business.

On July 31, 2003, the U.S. District Court for the Southern District of Illinois, in Cooper et al. vs. The IBM Personal Pension Plan and IBM Corporation, held that IBM's pension plan violated the age discrimination provisions of the Employee Retirement Income Security Act of 1974 (ERISA). On September 29, 2004, IBM announced that IBM and plaintiffs agreed in principle to resolve certain claims in the litigation. Under the terms of the agreement, plaintiffs will receive an incremental pension benefit in exchange for the settlement of some claims, and a stipulated remedy on remaining claims if plaintiffs prevail on appeal. Under the terms of the settlement, the judge will issue no further rulings on remedies. This settlement, together with a previous settlement of a claim referred to as the partial plan termination claim resulted in IBM taking a one-time charge of US$320 million in the third quarter of 2004.

This agreement ends the litigation on all but two claims, which are associated with IBM's cash balance formula. IBM will appeal the rulings on these claims. IBM continues to believe that its pension plan formulas are fair and legal. The company has reached this agreement in the interest of the business and IBM shareholders, and to allow for a review of its cash balance formula by the Court of Appeals. IBM continues to believe it is likely to be successful on appeal.

The agreement stipulates that if IBM is not successful on appeal of the two remaining claims, the agreed remedy will be increased by up to US$1.4 billion — a US$780 million remedy for the claim that IBM's cash balance formula is age discriminatory, and a US$620 million remedy for the claim that transition arrangements regarding opening account balances during the 1999 conversion were also age discriminatory (referred to as the "always cash balance" claim). The maximum additional liability the company could face as a result of the claims being appealed in this case is therefore capped at US$1.4 billion.

In the coming months, class members will receive formal notice of the settlement and the judge will hold a fairness hearing. Once the settlement is approved, IBM will appeal the liability rulings for the cash balance claims. As a result, the entire process could take over 2 years before reaching final conclusion.

On June 2, 2003 IBM announced that it received notice of a formal, nonpublic investigation by the Securities and Exchange Commission (SEC). The SEC is seeking information relating to revenue recognition in 2000 and 2001 primarily concerning certain types of client transactions. IBM believes that the investigation arises from a separate investigation by the SEC of Dollar General Corporation, a client of IBM's Retail Stores Solutions unit, which markets and sells point of sale products.

On January 8, 2004, IBM announced that it received a "Wells Notice" from the staff of the SEC in connection with the staff's investigation of Dollar General Corporation, which as noted above, is a client of IBM's Retail Stores Solutions unit. It is IBM's understanding that an employee in IBM's Sales & Distribution unit also received a Wells Notice from the SEC in connection with this matter. The Wells Notice notifies IBM that the SEC staff is considering recommending that the SEC bring a civil action against IBM for possible violations of the U.S. securities laws relating to

Dollar General's accounting for a specific transaction, by participating in and aiding and abetting Dollar General's misstatement of its 2000 results. In that transaction, IBM paid Dollar General US$11 million for certain used equipment as part of a sale of IBM replacement equipment in Dollar General's 2000 fourth fiscal quarter. Under the SEC's procedures, IBM responded to the SEC staff regarding whether any action should be brought against IBM by the SEC. The separate SEC investigation noted above, relating to the recognition of revenue by IBM in 2000 and 2001 primarily concerning certain types of client transactions, is not the subject of this Wells Notice.

In January 2004, the Seoul District Prosecutors Office in South Korea announced it had brought criminal bid rigging charges against several companies, including IBM Korea and LG IBM (a joint venture between IBM Korea and LG Electronics) and had also charged employees of some of those entities with, among other things, bribery of certain officials of government-controlled entities in Korea, and bid rigging. IBM Korea and LG IBM cooperated fully with authorities in these matters. A number of individuals, including former IBM Korea and LG IBM employees, were subsequently found guilty and sentenced. IBM Korea and LG IBM were also required to pay fines. Effective October 1, 2004, IBM Korea was debarred from doing business directly with certain government controlled entities in Korea until August 31, 2005. That order does not prohibit IBM Korea from selling products and services to business partners who sell to government controlled entities in Korea. In addition, the U.S. Department of Justice and the SEC have both contacted IBM in connection with this matter.

In accordance with SFAS No. 5, "Accounting for Contingencies," the Business records a provision with respect to a claim, suit, investigation or proceeding when it is probable that a liability has been incurred and the amount of the loss can reasonably be estimated. Any provisions are reviewed at least quarterly and are adjusted to reflect the impact and status of settlements, rulings, advice of counsel and other information pertinent to a particular matter. Any recorded liabilities for the above items, including any changes to such liabilities during each of the three years in the period ended December 31, 2003 were not material to the Combined Financial Statements. Based on its experience, the Business believes that the damage amounts claimed in the matters referred to above are not a meaningful indicator of the potential liability.

Litigation is inherently uncertain and it is not possible to predict the ultimate outcome of the matters discussed above. While the Business will continue to defend itself vigorously in all such matters, it is possible that the Business' financial condition, results of operations, or cash flows could be affected in any particular period by the resolution of one or more of these matters. Whether any losses, damages or remedies finally determined in any such claim, suit, investigation or proceeding could reasonably have a material effect on the Business' financial condition, results of operations, or cash flow will depend on a number of variables, including the timing and amount of such losses or damages, the structure and type of any such remedies, the significance of the impact any such losses, damages or remedies may have on the Combined Financial Statements, and the unique facts and circumstances of the particular matter which may give rise to additional factors.

Commitments

The Business generally offers three-year warranties for its products. The company estimates the amount and cost of future warranty claims for its current period sales. These estimates are used to record accrued warranty cost for current period shipments. The company uses historical warranty claim information, as well as recent trends that might suggest that past cost information may differ from future claims.

Changes in the Business' warranty liability balance are illustrated in the following table:

	2004	**2003**	**2002**	**2001**
	(US dollars in millions)			
Balance at January 1	$428	$340	$314	$275
Current period accruals	218	381	298	295
Accrual adjustments to reflect actual experience	90	107	40	55
Charges incurred	(218)	(400)	(312)	(311)
Balance at June 30, 2004 and December 31, 2003, 2002 and 2001	$518	$428	$340	$314

Warranty costs disclosed on page I-9 in the Risks and Uncertainties section, includes items that are charged directly to Cost of revenue, External sales in the current year, and are not reflected in the warranty liability balance above.

In the ordinary course of its business, the Business enters into agreements that obligate it to purchase all or a portion of its requirements of a specific product, commodity or service from a supplier or vendor. These agreements are generally entered into in order to secure pricing or other negotiated terms and may or may not specify fixed or minimum quantities to be purchased. The Business has entered into several agreements that include commitments to purchase goods and services of either a fixed or minimum quantity that meet any of the following criteria: (1) non-cancelable, (2) the Business would incur a cancellation penalty, or (3) the Business must make specified minimum payments even if it does not take delivery of the contracted products or services. If the obligation to purchase goods or services is non-cancelable, the entire value of the contract was included in the table below. If the obligation is cancelable, but the Business would incur a penalty if cancelled, the dollar amount of the penalty was included as a purchase obligation. Contracted minimum amounts specified in take-or-pay contracts are also included in the table below as they represent the portion of each contract that is a firm commitment.

	Total Contractual Payment Stream	Payments Due In 2004	2005	2006	2007
		(US dollars in millions)			
Purchase obligations as of June 30, 2004	$1,465	$102	$437	$451	$475

The Business has a purchase commitment with Hitachi, Ltd. (Hitachi) for the purchase of hard drives for its notebook and desktop computer products. The purchase commitment specifies a minimum purchase requirement of US$32 million in 2004 of its hard drives. For 2005 through 2007, the purchase commitment requires the Business to source 70 percent and 50 percent of its 2.5" and 3.5" hard drives, respectively. The Business has estimated this purchase commitment to be US$426 million, US$449 million, and US$475 million for 2005, 2006, and 2007, respectively, based on its forecasted sales, volume growth, and anticipated average purchase price for each year.

M. Taxes

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
Income before income taxes:					
U.S. operations	$(307)	$(230)	$(448)	$(302)	$(382)
Non-U.S. operations	263	195	331	234	89
Total income before income taxes	$(44)	$(35)	$(117)	$(68)	$(293)

The provision for income taxes by geographic operations is as follows:

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
U.S. operations	$25	$17	$41	$31	$29
Non-U.S. operations	49	34	74	55	48
Total provision for income taxes	$74	$51	$115	$86	$77

The components of the provision for income taxes by taxing jurisdiction are as follows:

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
U.S.:					
Current	$—	$—	$—	$—	$—
Deferred	—	—	—	—	—
	$—	$—	$—	$—	$—
Non-U.S.:					
Current	$74	$50	$113	$84	$79
Deferred	—	1	2	2	(2)
Total provision for income taxes	$74	$51	$115	$86	$77

Differences between the income tax computed at the U.S. federal statutory tax rate of 35 percent and the income tax provision are as follows:

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
Income tax (benefit) at statutory rate	$(15)	$(14)	$(41)	$(24)	$(106)
Foreign tax differential	(107)	(67)	(148)	(67)	(20)
Valuation allowance	196	132	304	177	203
Total provision for income taxes	$74	$51	$115	$86	$77

The Business' operating results have historically been included in IBM's consolidated U.S. federal and state income tax returns, or non-U.S. jurisdictions tax returns. The provision for income taxes in the Combined Financial Statements has been determined on a separate return basis. The Business is required to assess the realization of its deferred tax assets and the need for a valuation allowance on a separate return basis, and exclude from that assessment any utilization of those losses by IBM. This assessment requires judgment on the part of management with respect to benefits that could be realized from future taxable income, as well as other positive and negative factors influencing the realization of deferred tax assets. Due to cumulative losses incurred in the U.S. and certain non-U.S. locations, a valuation allowance has been recorded against any net deferred tax assets in these jurisdictions.

The significant components of activities that gave rise to deferred tax assets and liabilities that are recorded in the Combined Statement of Financial Position were as follows:

DEFERRED TAXES	AT JUNE 30, 2004	AT DECEMBER 31, 2003	2002	2001
	(US dollars in millions)			
Federal, state and local tax loss carryforwards	$572	$459	$286	$159
Foreign tax loss carryforwards	210	182	75	36
Foreign tax credits	173	135	75	44
Miscellaneous expense accruals	135	151	155	136
Bad debt, inventory and warranty reserves	79	46	80	73
Gross deferred tax assets	1,169	973	671	448
Less: Valuation allowance	(1,125)	(929)	(625)	(399)
Net deferred tax assets	$44	$44	$46	$49

The deferred tax assets related to tax loss and credit carryforwards represent the tax effect of operational results relating solely to the six month period ended June 30, 2004 and the three years ended December 31, 2001 through 2003 as calculated on a separate return basis. Information regarding tax loss and credit carryforwards from periods prior to the year ended December 31, 2001 has not been provided. All tax return attributes generated by the Business as calculated under the separate return methodology and not utilized by IBM historically will be retained by IBM.

As described in note D, "Transactions with IBM", on pages I-15 to I-18 the Business and IBM engaged in extensive intercompany transactions. Certain of these transactions are currently subject to review by U.S. and non-U.S. tax authorities as part of several ongoing tax audits of IBM. While the Business believes that its relevant transactions with IBM were conducted in accordance with the "arms'-length" standard, any adjustments related to the Business could result in additional taxes that might have a material affect on the income tax provision and net income in the period or periods that determination is made.

Excluding the impact of those jurisdictions with deficits in retained earnings, undistributed earnings of non-U.S. subsidiaries, which reflect full provision for non-U.S. income taxes, are indefinitely reinvested in non-U.S. operations.

N. Advertising and Promotional Expense

Direct advertising and promotional expense, which includes media, agency and promotional expense, was US$59 million and US$69 million for the six months ended June 30, 2004 and June 30, 2003, respectively, and is recorded in Selling, general and administrative expense. Direct advertising and promotional expense was US$132 million, US$127 million and US$146 million in 2003, 2002 and 2001, respectively. These expenses are net of supplier coadvertising rebates. In addition, the Business receives allocations from IBM for advertising and promotional expense as discussed in note D, "Transactions with IBM" on page I-16.

O. Research, Development and Engineering

Total RD&E expense was US$70 million and US$72 million for the six months ended June 30, 2004 and June 30, 2003, respectively. Total RD&E expense was US$139 million in 2003, US$138 million in 2002 and US$179 million in 2001. Included in these amounts are allocations the Business receives from IBM for RD&E expenses as discussed in note D, "Transactions with IBM" on page I-16.

The Business incurred expense of US$66 million and US$68 million for the six months ended June 30, 2004 and June 30, 2003, respectively, for scientific research and the application of scientific advances to the development of new and improved products and their uses. Included in these amounts are allocations from IBM for research related costs of US$6 million and US$4 million, respectively. The Business incurred expense of US$131 million, US$129 million and US$161 million in 2003, 2002 and 2001, respectively, for scientific research and the application of scientific advances to the development of new and improved products and their uses. Included in these amounts are allocations from IBM for research related costs of US$9 million in 2003, US$11 million in 2002, and US$10 million in 2001.

Expense for product-related engineering was US$4 million for the six month periods ended June 30, 2004 and June 30, 2003, and US$8 million, US$9 million and US$18 million in 2003, 2002 and 2001, respectively.

P. Rental Expense and Lease Commitments

Rental expense for the six months ending June 30, 2004 and 2003 was US$5 million and US$4 million, respectively. Rental expense was US$9 million in 2003, US$12 million in 2002 and US$15 million in 2001. The table below depicts gross minimum rental commitments under non-cancelable leases, where the Business manages the lease relationship as of June 30, 2004. Although the Business manages the lease relationship, not all of the space is utilized by the Business, so a portion of the expense associated with these leases is charged to other IBM tenants. The amounts below reflect activities primarily related to office space on a managed basis.

	2004	2005	2006	2007	2008	BEYOND 2008
			(US dollars in millions)			
Gross minimum rental commitments as of June 30, 2004	$16	$24	$11	$5	$4	$1

Q. Stock-Based Compensation Plans

The Business' employees and the IBM employees that provide direct support to the Business participate in IBM's various incentive award plans. The following is a description of the terms of such plans.

Incentive Plans

Incentive awards are provided to the Business' employees under the terms of the IBM's plans (the Plans). Employee awards are administered by the Executive Compensation and Management Resources Committee of the IBM Board of Directors (the Committee). The Committee determines the type and terms of the awards to be granted to employees, including vesting provisions. Awards under the Plans may include stock options, stock appreciation rights, restricted stock, cash or stock awards, or any combination thereof. Awards under the Plans resulted in compensation expense of approximately US$3 million, US$5 million and US$5 million for the years ended December 31, 2003, 2002 and 2001, respectively, and US$3 million and US$2 million for the six months ended June 30, 2004 and 2003, respectively. Such amounts are based on allocations received by the Business as discussed in note D, "Transactions with IBM" on pages I-15 to I-18.

Stock Option Grants

Stock options are granted to employees at an exercise price equal to the fair market value of IBM stock at the date of grant. Generally, options vest 25 percent per year, are fully vested four years from the grant date and have a term of ten years. The following tables summarize option activity under the Plans for the Business' employees and IBM employees that provide direct support to the Business during the six months ended June 30, 2004 and for the years ended December 31, 2003, 2002 and 2001:

	SIX MONTHS ENDED JUNE 30, 2004		FOR THE YEAR ENDED DECEMBER 31, 2003		FOR THE YEAR ENDED DECEMBER 31, 2002		FOR THE YEAR ENDED DECEMBER 31, 2001	
	WTD. AVG. PRICE	NO. OF SHARES UNDER OPTION	WTD. AVG. PRICE	NO. OF SHARES UNDER OPTION	WTD. AVG. PRICE	NO. OF SHARES UNDER OPTION	WTD. AVG. PRICE	NO. OF SHARES UNDER OPTION
Balance at beginning of period	US$90	2,587,896	US$85	2,133,518	US$82	1,986,628	US$75	3,733,339
Options granted	100	189,918	82	427,140	85	468,130	110	499,057
Options exercised	50	27,214	20	133,790	19	96,306	46	239,840
Options canceled/expired	—	—	100	2,000	83	5,100	124	6,700
Transfers in/(out)*	81	(74,084)	82	163,028	104	(219,834)	92	(1,999,228)
Balance at end of period	US$91	2,676,516	US$90	2,587,896	US$85	2,133,518	US$82	1,986,628
Exercisable at end of period	US$91	1,688,879	US$89	1,443,419	US$72	1,091,637	US$55	905,838

* *Represents transfers of employees between the Business and other IBM businesses.*

The shares under option at June 30, 2004 and December 31, 2003, were in the following exercise price ranges:

AT JUNE 30, 2004

	OPTIONS OUTSTANDING			OPTIONS CURRENTLY EXERCISABLE	
EXERCISE PRICE RANGE (in US dollars)	WTD. AVG. PRICE	NO. OF OPTIONS	WTD. AVG. REMAINING CONTRACTUAL LIFE (IN YEARS)	WTD. AVG. PRICE	NO. OF OPTIONS
$18–$60	US$42	366,106	3	US$42	363,518
$61–$85	77	680,956	8	75	233,204
$86–$105	99	751,998	7	99	377,575
$106 and over	116	877,456	6	118	714,582
	US$91	2,676,516	7	US$91	1,688,879

AT DECEMBER 31, 2003

	OPTIONS OUTSTANDING			OPTIONS CURRENTLY EXERCISABLE	
EXERCISE PRICE RANGE (in US dollars)	WTD. AVG. PRICE	NO. OF OPTIONS	WTD. AVG. REMAINING CONTRACTUAL LIFE (IN YEARS)	WTD. AVG. PRICE	NO. OF OPTIONS
$18–$60	US$42	409,311	3	US$42	406,723
$61–$85	77	688,931	9	71	89,980
$86–$105	98	599,648	7	98	300,630
$106 and over	116	890,006	7	118	646,086
	US$90	2,587,896	7	US$89	1,443,419

Employees Stock Purchase Plan

The Business' employees and IBM employees that provide direct support to the Business participate in the IBM Employees Stock Purchase Plan (ESPP). The ESPP enables substantially all regular employees of the Business to purchase full or fractional shares of IBM common stock through payroll deductions of up to 10 percent of eligible compensation. The ESPP provides for semi-annual offerings, and continues as long as shares remain available under the ESPP, unless terminated earlier at the discretion of the IBM Board of Directors. The share price paid by an employee equals the lesser of 85 percent of the average market price of IBM common stock on the first business day of each offering period or 85 percent of the average market price on the last business day of each pay period. Individual ESPP participants are restricted from purchasing more than US$25,000 of IBM common stock in one calendar year or 1,000 shares in an offering period.

Pro Forma Disclosure

See "Stock-Based Compensation" on pages I-11 and I-12, in note B, "Significant Accounting Policies," for the pro forma disclosures of operating results required under SFAS No. 123.

R. Retirement-Related Benefits

The Business' employees and IBM employees that provide direct support to the Business participate in IBM's defined benefit pension plans, defined contribution pension plans, as well as nonpension postretirement benefit plans primarily consisting of retiree medical benefits. These benefits form an important part of the Business' total compensation and benefits program that is designed to attract and retain highly skilled and talented employees.

The following table provides the principle components of total retirement-related benefit plans' impact on loss before income taxes of the Business.

FOR THE SIX MONTH PERIOD ENDED JUNE 30	U.S. 2004	U.S. 2003	NON-U.S. 2004	NON-U.S. 2003	TOTAL 2004	TOTAL 2003
	(US dollars in millions)					
Total retirement-related plans — cost/(income)	$3	$—	$2	$1	$5	$1
Comprise:						
Defined benefit and contribution pension plans — cost/(income)	$1	$(2)	$2	$1	$3	$(1)
Nonpension postretirement benefits — cost	2	2	—	—	2	2

FOR THE YEAR ENDED DECEMBER 31	U.S. 2003	U.S. 2002	U.S. 2001	NON-U.S. 2003	NON-U.S. 2002	NON-U.S. 2001	TOTAL 2003	TOTAL 2002	TOTAL 2001
	(US dollars in millions)								
Total retirement-related plans — cost/(income)	$—	$(6)	$(22)	$3	$(2)	$(5)	$3	$(8)	$(27)
Comprise:									
Defined benefit and contribution pension plans — (income)/cost	$(4)	$(14)	$(42)	$2	$(2)	$(5)	$(2)	$(16)	$(47)
Nonpension postretirement benefits — cost	4	8	20	1	—	—	5	8	20

Defined Benefit Pension Plans

Substantially all employees of the Business and IBM employees that provide direct support to the Business participate in IBM's defined benefit pension plans. Benefits provided to participants under IBM's defined benefit pension plans include benefits provided to employees of the Business under defined benefit pension plans as well as certain U.S. executives of the Business that participate in IBM's Supplemental Executive Retention Plan. The Business accounts for all defined benefit pension plans as multi-employer plans. IBM charges the Business for the costs of these plans as determined by actuarial valuations. The assumptions underlying the actuarial valuations for the multi-employer pension plans are listed below.

The plans assets are generally invested in diversified portfolios that consist primarily of equity securities and debt securities. Assumptions used to determine the net periodic pension (income)/cost for IBM's principal pension plans during the year follow:

WEIGHTED-AVERAGE ASSUMPTIONS FOR YEARS ENDED DECEMBER 31:	U.S. PLAN 2003	U.S. PLAN 2002	U.S. PLAN 2001	NON-U.S. PLANS 2003	NON-U.S. PLANS 2002	NON-U.S. PLANS 2001
Discount rate	6.75%	7.0%	7.25%	4.25–6.5%	4.5–7.1%	4.5–7.1%
Expected long-term return on plan assets	8.0%	9.5%	10.0%	5.0–8.0%	5.0–9.25%	5.0–10.0%
Rate of compensation increase	4.0%	6.0%	6.0%	2.2–5.0%	2.0–6.1%	2.6–6.1%

For the periods ending June 30, 2004 and 2003, the assumptions used to value net periodic (income)/cost for IBM's principal pension plans were consistent with the assumptions used to value the previous year-end net period (income)/cost.

Nonpension Postretirement Benefit Plans

The Business provides postretirement benefits through IBM's nonpension postretirement benefit plans. These benefits primarily consist of medical and dental benefits as well as life insurance for retirees and eligible dependents. The Business accounts for all nonpension postretirement benefit plans as multi-employer plans. IBM charges the Business for the costs of these plans as determined by actuarial valuations. The assumptions underlying the actuarial valuations for the multi-employer nonpension postretirement benefit plans include the assumptions used to value IBM's defined benefit pension plan (above) as well as additional assumptions listed below.

The nonpension postretirement benefit plans' assets for all periods presented are generally comprised of short-term fixed-income investments. These plans are not funded. The Business makes payments from the Business' funds as contributions to the multi-employer plans become due.

The benefit obligation was determined by applying the terms of medical, dental and life insurance plans, including the effects of established maximums on covered costs, together with relevant actuarial assumption.

WEIGHTED-AVERAGE DISCOUNT RATE ASSUMPTIONS USED TO DETERMINE	2003	2002	2001
Year-end benefit obligation at December 31	6.0%	6.75%	7.0%
Net periodic postretirement benefit costs for years ended December 31	6.75%	7.0%	7.25%

The assumptions used at June 30, 2004 and 2003 to determine the benefit obligation and related benefit cost were consistent with the assumptions used to determine the previous year-end benefit obligation and related benefit cost.

Defined Contribution Pension Plans

Substantially all employees of the Business and employees that provide direct support to the Business are eligible to participate in IBM's defined contribution pension plans. The Business' contribution to the defined contribution pension plans consists of a matching of employee contributions up to 50 percent of the employees' contribution up to the first 6 percent of the employees' compensation.

Recently Enacted Legislation

The Medicare Prescription Drug Improvement and Modernization Act of 2003 (the Act) was signed into law on December 8, 2003. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a prescription drug benefit that is at least actuarially equivalent to Medicare Part D.

The method of determining whether a sponsor's plan will qualify for actuarial equivalency is pending until the U.S. Department of Health and Human Services (HHS) completes its interpretative work on the Act. Based on the current interpretation of the guidance provided in the Act and in relation to the current plan design, any savings are expected to be immaterial.

FASB Staff Position 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," issued in the second quarter of 2004, provides guidance on the accounting for the effects of the Act, including the accounting for and disclosure of any federal subsidy provided by the Act.

The enactment of the Act was not a "significant event" as defined by paragraph 73 of SFAS No. 106 "Employers' Accounting for Postretirement Benefits Other than Pensions" for the nonpension postretirement benefit plans (the Plans), in which the Business participates on a multi-employer basis. As a result, IBM's plans' assets and obligations were not remeasured. As discussed above, any federal subsidy related to prescription drug benefits provided under the Plans is expected to be immaterial, based on the current interpretation of the Act. As a result, the accumulated pension benefit obligations and the net periodic postretirement benefit costs were not impacted by the Act. Any changes to participation rates and other healthcare cost assumptions, as a result of the Act, will be reflected in the Plans' valuation at the next measurement date. The impact of any such change is not expected to have a material impact on the Business' Combined Financial Statements.

S. Segment Information

The Business conducts operations worldwide and is managed in three geographic segments: the Americas, Europe Middle-East and Africa (EMEA) and Asia Pacific. The Americas region covers the U.S., Canada, South America and Latin America. The Asia Pacific region covers Japan, China, South Korea, Australia, New Zealand, Association of South East Asian Nations (ASEAN), Hong Kong and Taiwan.

The following tables reflect the segment results of operations of the Business consistent with the Business' management system. Performance measurement is based on Loss before income taxes, minority interests and change in accounting principle (pre-tax (loss)/income). These results are used, in part, by management, both in evaluating the performance of, and in allocating resources to, each of the segments.

Management System Segment View

	AMERICAS	ASIA PACIFIC	EUROPE/ MIDDLE EAST/ AFRICA	TOTAL SEGMENTS
	(US dollars in millions)			
FOR THE SIX MONTH PERIOD ENDED JUNE 30				
2004:				
Total net revenue	$2,016	$1,717	$1,484	$5,217
Pre-tax (loss)/income	(49)	48	(42)	(43)
Total net revenue year-to-year change	13.3%	26.3%	28.3%	21.4%
Pre-tax (loss)/income year-to-year change	(2.1)%	(47.3)%	(23.5)%	nm
Pre-tax (loss)/income margin	(2.4)%	2.8%	(2.8)%	(0.8)%
2003:				
Total net revenue	$1,780	$1,359	$1,157	$4,296
Pre-tax (loss)/income	(48)	91	(34)	9
Pre-tax (loss)/income margin	(2.7)%	6.7%	(2.9)%	0.2%
FOR THE YEAR ENDED DECEMBER 31				
2003:				
Total net revenue	$3,971	$2,917	$2,678	$9,566
Pre-tax (loss)/income	(138)	150	(114)	(102)
Total net revenue year-to-year change	(6.1)%	13.1%	10.2%	3.6%
Pre-tax (loss)/income year-to-year change	19.3%	177.8%	(72.7)%	44.3%
Pre-tax (loss)/income margin	(3.5)%	5.1%	(4.3)%	(1.1)%
2002:				
Total net revenue	$4,227	$2,579	$2,431	$9,237
Pre-tax (loss)/income	(171)	54	(66)	(183)
Total net revenue year-to-year change	(7.0)%	(12.3)	(6.3)	(8.3)%
Pre-tax (loss)/income year-to-year change	24.7%	307.7%	53.2%	53.6%
Pre-tax (loss)/income margin	(4.0)%	2.1%	(2.7)%	(2.0)%
2001:				
Total net revenue	$4,543	$2,941	$2,594	$10,078
Pre-tax loss	(227)	(26)	(141)	(394)
Pre-tax loss margin	(5.0)%	(0.9)%	(5.4)%	(3.9)%

nm — not meaningful

Reconciliation to as Reported Amount

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
Pre-tax (loss)/income:					
Total reportable segments	$(43)	$9	$(102)	$(183)	$(394)
Eliminations and unallocated amounts	(1)	(44)	(15)	115	101
Total PCD Combined	$(44)	$(35)	$(117)	$(68)	$(293)

Segment Assets and Other Items

The Business' assets are comprised primarily of cash, receivables, inventory and plant, property and equipment. To accomplish the efficient use of IBM's space and equipment, it usually is necessary for IBM to have several divisions share plant, property and equipment assets. Where assets are shared, landlord ownership of the assets is assigned to one division and is not allocated to each user division. The PCD division has both landlord and tenant relationships with other IBM divisions. This is consistent with IBM's management system and is reflected accordingly in the schedule below. In those cases, there will not be a precise correlation between the Business' pre-tax income and the Business' assets.

Similarly, the depreciation amounts reported by the Business are based on the assigned landlord ownership and may not be consistent with the amounts that are included in the segments' pre-tax income. The amounts that are included in pre-tax income reflect occupancy charges from the landlord segment and are not specifically identified by the management reporting system. Capital expenditures that are reported by the Business are in line with the landlord ownership basis of asset assignment. It should be noted that the depreciation amounts reported in the Combined Statement of Cash Flows on page I-7 are net of transfers and recoveries to IBM.

Management System Segment View

	AMERICAS	ASIA PACIFIC	EUROPE/ MIDDLE EAST/ AFRICA	TOTAL SEGMENTS
	(US dollars in millions)			
At June 30, 2004:				
Assets	$458	$736	$211	$1,405
Depreciation	24	13	3	40
Capital expenditures	17	17	1	35
Interest income	—	2	—	2
At December 31, 2003:				
Assets	$537	$515	$282	$1,334
Depreciation	51	25	6	82
Capital expenditures	66	29	1	96
Interest income	—	2	—	2
At December 31, 2002:				
Assets	$544	$487	$271	$1,302
Depreciation	56	24	16	96
Capital expenditures	40	34	11	85
Interest income	—	1	—	1
At December 31, 2001:				
Assets	$654	$416	$297	$1,367
Depreciation	71	19	25	115
Capital expenditures	62	31	17	110
Interest income	—	1	—	1

Reconciliation to as Reported Amount

	AT JUNE 30, 2004	AT DECEMBER 31, 2003	2002	2001
	(US dollars in millions)			
Assets:				
Total reportable segments	$1,405	$1,334	$1,302	$1,367
Unallocated amounts:				
Deferred tax assets	45	44	46	49
Prepaid royalties	62	67	59	21
Other	22	13	10	31
Total PCD Combined	$1,534	$1,458	$1,417	$1,468

Revenue by Classes of Similar Products or Services

	FOR THE SIX MONTHS ENDED JUNE 30 2004	2003	FOR THE YEAR ENDED DECEMBER 31 2003	2002	2001
	(US dollars in millions)				
Mobile	$2,922	$2,166	$5,029	$4,601	$5,167
Desktop	1,426	1,427	2,988	3,226	3,435
Monitors and displays	425	344	769	724	848
Software	383	318	704	622	558
Other	61	41	76	64	70
Total	$5,217	$4,296	$9,566	$9,237	$10,078

Major Customers

No external customer represents 10 percent or more of the Business' total revenue.

Geographic Information

Revenue*

	FOR THE SIX MONTHS ENDED JUNE 30 2004	2003	FOR THE YEAR ENDED DECEMBER 31 2003	2002	2001
	(US dollars in millions)				
United States	$1,583	$1,402	$3,116	$3,272	$3,508
Japan	584	488	986	1,023	1,419
Other countries	3,050	2,406	5,464	4,942	5,151
Total	$5,217	$4,296	$9,566	$9,237	$10,078

* *Revenues are attributed to countries based on location of customer.*

Long-Lived Assets**

	AT JUNE 30, 2004	AT DECEMBER 31, 2003	2002	2001
	(US dollars in millions)			
United States	$228	$239	$238	$261
United Kingdom	28	34	65	73
Mexico	—	38	47	52
Other countries	79	78	84	60
Total	$335	$389	$434	$446

** *Includes all non-current assets except non-current financial instruments and deferred tax assets.*

T. Subsequent Events

On September 14, 2004, IBM and LG Electronics Inc. announced an end to their eight-year alliance. The joint venture formed by the two companies (LG IBM PC Co.) will be dissolved effective January 1, 2005. IBM owns 51 percent of the company which manufactures and markets personal computers in South Korea. LG Electronics, which makes consumer electronics and home appliances, owns the remaining 49 percent. Both companies said they plan to continue exchanging technologies and may jointly implement large-scale projects in the Korean market. Upon dissolution of this joint venture, the Business' Combined Financial Statements will no longer contain the line-by-line consolidated financial results of this alliance. This will impact net revenue by approximately 3-4 percent when compared to the periods presented. There are no other material impacts to the Business' Combined Financial Statements.

The European Commission (EU) has issued two directives which require member states of the EU to meet certain targets for collection, re-use and recovery of waste electrical and electronic equipment. In February 2003, the EU published the Waste Electrical and Electronic Equipment directive, or WEEE (Directive 2002/96/EC, which was amended in December 2003 by Directive 2003/108/EC). The WEEE directive, regulates the collection, re-use and recycling of waste from many electrical and electronic products, and the Restrictions of Hazardous Substances directive, or RoHS (Directive 2002/95/EC), bans the use of certain hazardous materials in electric and electrical equipment. The WEEE directive must be implemented by August 13, 2005. Under the WEEE directive, equipment producers are required to finance the collection, recovery and disposal of electronic scrap. The company is currently evaluating the impact of adopting this guidance. As most member states have yet to issue their implementation requirements, it is not possible to determine the amount of any accruals necessary to comply with the directive. Under the RoHS directive, manufacturers have a transition period until July 1, 2006 to phase out the use of certain hazardous materials from its equipment.

As of August 1, 2004, the Business no longer manages the facility in Raleigh, North Carolina. As a result of this change in management, the Business' gross minimum rental commitments at June 30, 2004 would have been reduced by US$13 million in 2004, US$21 million in 2005, US$10 million in 2006, US$5 million in 2007, US$4 million in 2008 and US$1 million in 2009. In addition, the Business' Plant and other property, net recorded in the Combined Statement of Financial Position was reduced by US$200 million as a result of these changes in management. There was no impact to the Business' Combined Statement of Operations for these changes.

In September, 2004, the Business received US$12 million in payments related to settlements of claims of alleged price-fixing and other anticompetitive conduct among certain of the Business' DRAM suppliers. This settlement was related to parts procured prior to the date of settlements. The US$12 million settlement was recorded in the third-quarter 2004 Combined Statement of Operations.

On December 7, 2004, IBM and the Lenovo Group announced a definitive agreement under which Lenovo will acquire certain assets and liabilities of IBM's Personal Computing Division. The transaction is expected to be completed in the second quarter of 2005.

U. Additional disclosures pursuant to the Hong Kong Companies Ordinance and Main Board Listing Rules of The Stock Exchange of Hong Kong Limited

The following disclosures have been prepared pursuant to the requirements of the Hong Kong Companies Ordinance and Main Board Listing Rules of The Stock Exchange of Hong Kong Limited. Certain required disclosures are explicitly disclosed either in the financial statements, or in the related footnotes or can be readily determined therefrom. In addition, certain required disclosures have been assessed as not applicable to the Business and, as a result, have not been presented below.

(a) *Loss before income taxes, minority interests and change in accounting principle*

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
Loss before income taxes, minority interests and change in accounting principle is stated after charging/(crediting):					
Auditors' remuneration	$nm	$nm	$1	$1	$1
Interest expense on bank loans and overdrafts wholly repayable within five years	$nm	$nm	$nm	$1	$1
Profit on disposal of investments	$—	$(1)	$(1)	$(3)	$(1)
Provision for restructuring	$2	$4	$6	$13	$12

nm — not meaningful or less than US$1 million

(b) *Dividend*

LG IBM PC Company, Limited and International Information Products (Shenzhen) Company Limited, two subsidiaries managed by the Business, paid dividends in the years ended December 31, 2003, 2002, 2001, and the six months ended June 30, 2004 and 2003 as follows:

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
Dividend	$4	$4	$31	$32	$28

(c) *Five highest paid individuals*

The salaries, bonus and benefits payable to the five individuals whose salaries, bonus and benefits were the highest in the Business for the years ended December 31, 2003, 2002, 2001, and the six months ended June 30, 2004 and 2003, respectively, are as follows:

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
	(US dollars in millions)				
Basic salaries, housing allowances, share options, other allowances and benefits in kind	$1	$1	$2	$2	$2
Bonus	nm	nm	1	1	nm
Contribution to pension plans	nm	—	nm	nm	—
	$2	$1	$3	$3	$2

The salaries, bonus and benefits of the five highest paid individuals fell within the following bands:

	Number of individuals				
	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	2003	2003	2002	2001
Salaries, bonus and benefits bands:					
Nil – US$128,000	—	—	—	—	—
US$128,001 – US$192,000	—	—	—	—	—
US$192,001 – US$256,000	1	2	—	—	—
US$256,001 – US$320,000	1	1	—	—	1
US$320,001 – US$384,000	—	2	—	—	2
US$384,001 – US$448,000	1	—	2	2	1
US$448,001 – US$512,000	1	—	—	—	—
US$512,001 – US$576,000	1	—	1	1	1
US$576,001 – US$640,000	—	—	1	—	—
US$640,001 – US$704,000	—	—	—	1	—
US$704,001 – US$768,000	—	—	1	1	—

During the years ended December 31, 2003, 2002, 2001, and the six months ended June 30, 2004 and 2003, no salaries, bonus or benefits were paid by the Business to the five highest individuals as an inducement to join or upon joining the Business or as compensation for loss of office.

(d) *Net current liabilities and total assets less current liabilities*

	AT JUNE 30,	AT DECEMBER 31,		
	2004	2003	2002	2001
	(US dollars in millions)			
Net current liabilities	$(1,027)	$(1,160)	$(890)	$(549)
Total assets less current liabilities	$(659)	$(738)	$(431)	$(80)

(e) *Plant and other property*

	FOR THE SIX MONTHS ENDED JUNE 30		FOR THE YEAR ENDED DECEMBER 31		
	2004	**2003**	**2003**	**2002**	**2001**
	(US dollars in millions)				
Additions, at cost	$36	$71	$97	$86	$107
Disposals					
At cost	$5	$155	$158	$66	$2
Accumulated depreciation	(2)	(111)	(113)	(37)	(2)
Net book value	$3	$44	$45	$29	$—
Transfer (out)/in, net					
At cost	$(108)	$(39)	$(33)	$11	$(196)
Accumulated depreciation	67	24	26	(1)	101
Net book value	$(41)	$(15)	$(7)	$10	$(95)
Write off					
At cost	$82	$33	$86	$84	$47
Accumulated depreciation	(80)	(31)	(81)	(75)	(44)
Net book value	$2	$2	$5	$9	$3

(f) *Land and buildings*

The Business' interests in properties at their net book values are analyzed as follows:

	AT JUNE 30,	AT DECEMBER 31,		
	2004	**2003**	**2002**	**2001**
	(US dollars in millions)			
Freehold land and land improvements, at cost	$38	$42	$50	$50
Accumulated depreciation	(24)	(24)	(32)	(30)
Net book value of land and land improvements	$14	$18	$18	$20
Buildings and building improvements on freehold land, at cost	$407	$490	$526	$513
Accumulated depreciation	(204)	(249)	(287)	(273)
Net book value of buildings and building improvements	$203	$241	$239	$240

(g) *Accounts receivable — trade*

The aging analysis of trade accounts receivable is set out below:

	AT JUNE 30,	AT DECEMBER 31,		
	2004	2003	2002	2001
	(US dollars in millions)			
Less than 90 days	$383	$451	$404	$409
91 – 180 days	11	14	15	23
Greater than 180 days	11	12	15	25
	$405	$477	$434	$457
Allowance for doubtful accounts	7	7	9	14
Total Accounts Receivable — trade, net	$398	$470	$425	$443

The Business provides invoice terms to customers that range from 30 to 90 days. These terms vary by country.

(h) *Accounts payable*

The aging analysis of accounts payable is set out below:

	AT JUNE 30,	AT DECEMBER 31,		
	2004	2003	2002	2001
	(US dollars in millions)			
Not yet due	$1,441	$1,458	$1,159	$956
Overdue 1 – 30 days	—	1	9	—
Overdue 31 – 60 days	—	(2)	—	—
Total Accounts Payable	$1,441	$1,457	$1,168	$956

(i) *Subsidiaries*

The following are details of subsidiaries managed by the Business at June 30, 2004 and up to the date of this report:

Name	Place and date of incorporation and kind of legal entity	Principal activities and place of operation	Particulars of issued share/ registered capital	Effective interest held
LG IBM PC Company, Limited	Seoul, Korea November 22, 1996 Limited liability company	Marketing and sales of personal computer in Korea	4,860,000 ordinary shares of 5,000 KRW each	51%
International Information Products (Shenzhen) Company Limited	China, February 3, 1994, Limited liability company, Chinese-foreign equity joint venture	Manufacture and sales of personal computer in China	Registered capital US$4,900,000	80%

The joint venture interest in LG IBM PC Company, Limited is held by IBM Korea, Inc., a company whose ultimate parent company is International Business Machines Corporation. The joint venture interest in International Information Products (Shenzhen) Company Limited is held by IBM Far East Holdings B.V., a company whose ultimate parent company is International Business Machines Corporation.

The auditors of LG IBM PC Company, Limited and International Information Products (Shenzhen) Company Limited for the years ended December 31, 2003, 2002 and 2001 are Samil PricewaterhouseCoopers and PricewaterhouseCoopers Zhong Tian CPA Limited Company, respectively.

(j) *Ultimate holding company*

International Business Machines Corporation, a company incorporated and listed in the United States of America, is the ultimate holding company of the Business.

(k) *Subsequent financial statements*

No audited financial statements have been prepared for the Business, or any of the subsidiaries of the Business, in respect of any period subsequent to June 30, 2004 and, as disclosed in these financial statements, no dividend or other distribution has been declared by the Business, or any of the subsidiaries of the Business, in respect of any period subsequent to June 30, 2004.

The Audited US Combined Financial Statements of PCD as contained in Appendix I of the circular have been prepared in accordance with PCD's accounting policies which follow US GAAP as detailed in Note B to the Audited US Combined Financial Statements, which differ in certain significant aspects from accounting policies adopted by the Company which follow Hong Kong GAAP. Differences, other than presentational differences, which have a significant effect on the Audited US Combined Financial Statements under US GAAP and the unaudited combined financial information under Hong Kong GAAP are set out below.

(A) UNAUDITED COMBINED FINANCIAL INFORMATION UNDER HONG KONG GAAP

The following unaudited combined statements of operations for the six months ended 30 June 2004 and 2003, and each of the three years ended 31 December 2003, 2002 and 2001 (the "Relevant Periods") and the unaudited combined statements of financial position as at 30 June 2004, and 31 December 2003, 2002 and 2001 (collectively the "Unaudited Hong Kong GAAP Combined Financial Information") of PCD under Hong Kong GAAP, which are prepared by the Directors of the Company, are derived from the Audited US Combined Financial Statements included in Appendix I of the circular. The audited combined statements of cash flows under US GAAP are not restated for Hong Kong GAAP purposes as there are no significant differences except presentational differences. Your attention is drawn to the basis of preparation of the Audited US Combined Financial Statements as stated in the notes to the Audited US Combined Financial Statements and the opinion of IBM's Independent Registered Public Accounting Firm. Your attention is also drawn to the fact that the Unaudited Hong Kong GAAP Combined Financial Information has not been subject to an independent audit. Accordingly, it may not truly present the operations during the Relevant Periods and the financial positions ended on those dates under Hong Kong GAAP.

Unaudited Combined Statements of Operations under Hong Kong GAAP:

(in million of U.S. dollars)		For the six months ended June 30,						For the year ended December 31,								
		2004			2003			2003			2002			2001		
	Notes	Unadjusted US GAAP combined financial statements *Audited*	GAAP adjustments *Unaudited*	Hong Kong GAAP combined financial information *Unaudited*	Unadjusted US GAAP combined financial statements *Unaudited*	GAAP adjustments *Unaudited*	Hong Kong GAAP combined financial information *Unaudited*	Unadjusted US GAAP combined financial statements *Audited*	GAAP adjustments *Unaudited*	Hong Kong GAAP combined financial information *Unaudited*	Unadjusted US GAAP combined financial statements *Audited*	GAAP adjustments *Unaudited*	Hong Kong GAAP combined financial information *Unaudited*	Unadjusted US GAAP combined financial statements *Audited*	GAAP adjustments *Unaudited*	Hong Kong GAAP combined financial information *Unaudited*
NET REVENUE:																
External sales		5,003	—	5,003	4,160	—	4,160	9,288	—	9,288	8,962	—	8,962	9,745	—	9,745
Sales to IBM		214	—	214	136	—	136	278	—	278	275	—	275	333	—	333
Total net revenue		5,217	—	5,217	4,296	—	4,296	9,566	—	9,566	9,237	—	9,237	10,078	—	10,078
COST OF REVENUE:																
External sales	iv	4,492	—	4,492	3,668	—	3,668	8,327	—	8,327	8,066	—	8,066	8,815	10	8,825
Sales to IBM		214	—	214	136	—	136	278	—	278	275	—	275	333	—	333
Total cost of revenue		4,706	—	4,706	3,804	—	3,804	8,605	—	8,605	8,341	—	8,341	9,148	10	9,158
Gross profit		511	—	511	492	—	492	961	—	961	896	—	896	930	(10)	920
EXPENSE AND OTHER INCOME:																
Selling, general and administrative	i, ii, iii	511	(2)	509	489	(1)	488	1,013	(1)	1,012	1,038	(1)	1,037	1,201	(3)	1,198
Research, development and engineering		70	—	70	72	—	72	139	—	139	138	—	138	179	—	179
Intellectual property income		(27)	—	(27)	(30)	—	(30)	(75)	—	(75)	(118)	—	(118)	(134)	—	(134)
Other expense and (income)		1	—	1	(4)	—	(4)	1	—	1	(94)	—	(94)	(23)	—	(23)
TOTAL EXPENSE AND OTHER INCOME		555	(2)	553	527	(1)	526	1,078	(1)	1,077	964	(1)	963	1,223	(3)	1,220
LOSS BEFORE INCOME TAXES, MINORITY INTERESTS AND CHANGE IN ACCOUNTING PRINCIPLE		(44)	2	(42)	(35)	1	(34)	(117)	1	(116)	(68)	1	(67)	(293)	(7)	(300)
Provision for income taxes	v	74	—	74	51	—	51	115	1	116	86	—	86	77	—	77
Minority interests		21	—	21	11	—	11	26	—	26	17	—	17	17	—	17
Net loss before change in accounting principle		(139)	2	(137)	(97)	1	(96)	(258)	—	(258)	(171)	1	(170)	(387)	(7)	(394)
Effect of change in accounting principle	iv	—	—	—	—	—	—	—	—	—	—	—	—	(10)	10	—
NET LOSS		(139)	2	(137)	(97)	1	(96)	(258)	—	(258)	(171)	1	(170)	(397)	3	(394)

Unaudited Combined Statements of Financial Position under Hong Kong GAAP:

(in million of U.S. dollars)

		As at June 30, 2004			As at December 31, 2003			2002			2001		
	Notes	Unadjusted US GAAP combined financial statements *Audited*	GAAP adjustments *Unaudited*	Hong Kong GAAP combined financial information *Unaudited*	Unadjusted US GAAP combined financial statements *Audited*	GAAP adjustments *Unaudited*	Hong Kong GAAP combined financial information *Unaudited*	Unadjusted US GAAP combined financial statements *Audited*	GAAP adjustments *Unaudited*	Hong Kong GAAP combined financial information *Unaudited*	Unadjusted US GAAP combined financial statements *Audited*	GAAP adjustments *Unaudited*	Hong Kong GAAP combined financial information *Unaudited*
ASSETS													
Current assets:													
Cash		297	—	297	211	—	211	199	—	199	110	—	110
Accounts receivable, net		398	—	398	470	—	470	425	—	425	443	—	443
Inventories, net		279	—	279	235	—	235	216	—	216	322	—	322
Prepaid expenses and other current assets	iv	192	—	192	120	1	121	118	1	119	151	3	154
Total current assets		1,166	—	1,166	1,036	1	1,037	958	1	959	1,026	3	1,029
Plant and other properties		806	(13)	793	968	(35)	933	1,129	—	1,129	1,149	—	1,149
Less: Accumulated depreciation		(498)	16	(482)	(607)	37	(570)	(728)	—	(728)	(718)	—	(718)
Plant and other properties, net	ii	308	3	311	361	2	363	401	—	401	431	—	431
Investments and sundry assets	iii, iv	60	(17)	43	61	(14)	47	58	(10)	48	38	(26)	12
TOTAL ASSETS		1,534	(14)	1,520	1,458	(11)	1,447	1,417	(9)	1,408	1,495	(23)	1,472
LIABILITIES AND INVESTED EQUITY/(DEFICIT)													
Current liabilities:													
Taxes		21	—	21	35	—	35	18	—	18	17	—	17
Accounts payable		1,441	—	1,441	1,457	—	1,457	1,168	—	1,168	956	—	956
Compensation accruals		30	—	30	41	—	41	51	—	51	53	—	53
Deferred revenue		21	—	21	24	—	24	47	—	47	30	—	30
Warranty accruals		289	—	289	237	—	237	196	—	196	181	—	181
Rebates and returns accrual		175	—	175	193	—	193	176	—	176	191	—	191
Software royalties payable		159	—	159	166	—	166	145	—	145	107	—	107
Other accrued expenses and liabilities		57	—	57	43	—	43	47	—	47	40	—	40
Total current liabilities		2,193	—	2,193	2,196	—	2,196	1,848	—	1,848	1,575	—	1,575
Warranty accruals non-current		229	—	229	191	—	191	144	—	144	133	—	133
Minority interests and other long-term liabilities	iv, v	87	1	88	62	(4)	58	53	(6)	47	53	—	53
TOTAL LIABILITIES		2,509	1	2,510	2,449	(4)	2,445	2,045	(6)	2,039	1,761	—	1,761
IBM's net investment	i, ii, iii, v	(973)	(14)	(987)	(984)	(13)	(997)	(613)	(10)	(623)	(288)	(6)	(294)
Accumulated other comprehensive income/(loss)	iv	(2)	(1)	(3)	(7)	6	(1)	(15)	7	(8)	22	(17)	5
TOTAL INVESTED EQUITY/(DEFICIT)		(975)	(15)	(990)	(991)	(7)	(998)	(628)	(3)	(631)	(266)	(23)	(289)
TOTAL LIABILITIES AND INVESTED EQUITY/(DEFICIT)		1,534	(14)	1,520	1,458	(11)	1,447	1,417	(9)	1,408	1,495	(23)	1,472

Notes to the Unaudited Combined Statements of Operations and Unaudited Combined Statements of Financial Position under Hong Kong GAAP:

(i) *Recognition of share-based compensation*

Under US GAAP, share options and shares granted to PCD employees by IBM, its sole owner, are accounted for as owner's contribution. Compensation expenses relating to such share options and shares are accounted for in the same manner as that for share options and shares granted by PCD itself as follows:

(1) Share options granted by sole owner

Compensation expense, if any, for certain types of share options granted to PCD employees by IBM is recognized at the date of grant and amortized over the vesting period. PCD accounts for the share option scheme under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations. Accordingly, the amount of compensation expense is determined based on the intrinsic value of share options, i.e. the excess, if any, of the quoted market price of the IBM shares over the exercise price of the options at the date of the grant. Such amount is amortized over the vesting period of the option concerned. Further, under US GAAP, compensation expense recognized by IBM on certain share options granted to PCD employees that resulted from changes in performance conditions for certain awards, are allocated to PCD, and are being recognized in the audited combined statement of operations under US GAAP accordingly.

Statement of Financial Accounting Standards ("SFAS") No. 123 "Accounting for Stock-Based Compensation" ("SFAS 123") and the related amendments under the provisions of SFAS No. 148 "Accounting for Stock-Based Compensation, Transition and Disclosure" ("SFAS 148") allows entities to continue applying the provision of APB 25 and it requires entities to provide pro forma net income or loss and pro forma earnings or loss per share disclosures in the notes to financial statements resulting from the expensing of employee stock options valued using a fair-value based option pricing model as prescribed in SFAS 123 and SFAS 148.

(2) Shares granted by sole owner

Compensation expense for shares granted to PCD employees by IBM is measured by the quoted market price of the shares at the date of grant and is charged to the statement of operations as a compensation expense when the shares become vested. Compensation expense recognized by IBM which resulted from shares granted to PCD employees are allocated to PCD and have been recognized in the audited combined statement of operations under US GAAP accordingly.

Under Hong Kong GAAP, prior to Hong Kong Financial Reporting Standard No. 2 becoming effective on 1 January 2005, there is no specific accounting standard governing the recognition and measurement of share options and shares granted to the PCD employees by IBM. The Company adopts an accounting policy which does not recognize share-based compensation expenses. Accordingly, share-based compensation expenses resulted from share options and shares granted by IBM to the PCD employees totalling approximately US$3 million and US$2 million for the six months ended 30 June 2004 and 2003, respectively, and US$3 million, US$5 million and US$5 million for the years ended 31 December 2003, 2002 and 2001, respectively, are reversed for Hong Kong GAAP purposes.

(ii) *Accounting for investment properties*

Under US GAAP, all properties including investment properties not held for resale are carried at cost less accumulated depreciation and accumulated impairment losses, and are depreciated over their estimated useful lives.

Under Hong Kong GAAP, investment properties are included in the balance sheet at cost less accumulated impairment losses as their aggregate estimated open market value is less than 15 per cent of the carrying amount of the total assets of PCD and the unexpired term of the leases is more than 20 years. In January 2003, PCD entered into certain lease agreements to lease portions of certain building facilities to third-party tenants. Under Hong Kong GAAP, portions of these building facilities let out are classified as investment properties (the "Conversion"). Accordingly, the depreciation charge of approximately US$1 million and US$1 million for the six months ended 30 June 2004 and 2003, respectively, and US$2 million for the year ended 31 December 2003, pertaining to these portions of the properties recorded under US GAAP are reversed for Hong Kong GAAP purposes. Additionally, the related accumulated depreciation charge of approximately US$35 million at the date of the Conversion has been reclassified to offset against the underlying original cost of the properties in order to properly reflect the change in use of the investments properties. In May 2004, certain of these investment properties were transferred to IBM. Accordingly, accumulated depreciation charge of approximately US$13 million at the date of the Conversion pertaining to the remaining investment properties are reclassified as at 30 June 2004.

(iii) *Accounting for goodwill*

Under US GAAP, prior to 1 January 2002, goodwill arising on acquisitions was accounted for as an asset and amortized over the estimated useful life. The useful life of the goodwill identified in the Audited US Combined Financial Statements was 5 years. In addition, assessment for impairment of goodwill involves a comparison of the carrying value of the asset group which includes the goodwill to the total expected undiscounted future cash flows to determine if there is an indication of impairment. If the carrying value exceeds the expected undiscounted future cash flows, an impairment loss is measured using fair value of the asset group and it is charged to the audited combined statement of operations under US GAAP as an expense.

Subsequent to 1 January 2002, PCD adopted SFAS No. 142 "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 142 significantly changed the accounting treatment for goodwill under US GAAP. Under SFAS 142, goodwill is no longer subject to amortization and requires goodwill be tested for impairment upon its first adoption and annually thereafter, or more frequently if events or changes in circumstances indicate that it might be impaired, using a prescribed two-step process. The first step screens for potential impairment of goodwill if the fair value of the reporting unit is less than its carrying value, while the second step measures the amount of goodwill impairment, if any, by comparing the implied fair value of goodwill to its carrying value.

Under Hong Kong GAAP, Statement of Standard Accounting Practice No. 30 "Business Combinations", which became effective for financial periods beginning on or after 1 January 2001, requires goodwill to be capitalized and amortized on a straight-line basis over its estimated useful life. The amortization charge for each period is recognized as an expense. Generally, goodwill is tested for impairment whenever there are indications that impairment may exist. An impairment loss is recognized in the statement of operations whenever the carrying amount of a cash generating unit to which goodwill belongs exceeds its recoverable amount, which is defined as the higher of net selling price and value-in-use, estimated at each balance sheet date. According to the Company's accounting policy, goodwill is subject to amortization for Hong Kong GAAP purposes and is being amortized over its estimated useful life of 5 years. Accordingly, accumulated amortization of the goodwill amounted to approximately US$4 million as at 1 January 2001, and amortization charge of approximately US$2 million and US$2 million for the six months ended 30 June 2004 and 2003, respectively, US$4 million, US$4 million, US$2 million for the years ended 31 December 2003, 2002 and 2001, respectively, have been accounted for under Hong Kong GAAP. Goodwill is included in "investments and sundry assets" in the audited US GAAP combined statement of position.

(iv) *Derivative instruments and hedging transactions*

Under US GAAP, PCD adopted SFAS No. 133 "Accounting for Derivative Instruments and Hedge Activities", as amended by SFAS No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities", and SFAS No. 149, "Amendments of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS No. 133"), which requires all financial instruments and derivatives be recognized on the balance sheet at fair value. SFAS No. 133 establishes accounting and reporting standards for derivative instruments.

PCD's primary derivative usage is designated as hedging the variability of cash flows of forecasted transactions based on changes in foreign currency rates. Changes in value of effective cash flow hedges are recorded net of applicable taxes, in "accumulated other comprehensive income/(loss)", a component of invested equity/(deficit) until the expiration of the derivative contract. Upon expiration of the derivative contract, cumulative changes in value of these derivatives are reclassified to "cost of revenue" in the period that "net loss" is affected by the variability of the underlying cash flows. The reclassified amount is the applicable offsetting amount of the gain or loss previously deferred in "invested equity/(deficit)" relating to the cash flows impacting that period's "net loss". Changes in the value of derivatives that are not designated as hedges at inception as well as changes in the value of derivatives designated as hedges that do not offset the underlying hedged item throughout the designated hedge period, are recorded in "net loss" each period and in "other (income) and expense". The discount or premium on certain types of derivative instruments is deferred in "accumulated other comprehensive income/(loss)" until the end of the contract period in the Audited US Combined Financial Statements.

Under Hong Kong GAAP, prior to Hong Kong Accounting Standard No. 39 becoming effective on 1 January 2005, there is no specific accounting standard governing the recognition and measurement of derivative instruments and hedging transactions except for the gain or loss and discount or premium on foreign currency forward contracts. The Company adopts the following policies in accounting for derivative instruments and hedging transactions under Hong Kong GAAP:

- Derivative financial instruments are not recognized in the financial statements; and

- Where a non-speculative foreign currency forward contract is used as a hedge of a firm commitment, the gain or loss on the contract will be added to, or deducted from, the amount of the relevant transaction at the end of commitment period. The discounts or premiums will be deferred with the gain or loss.

On 1 January 2001, upon the adoption of SFAS No. 133 under US GAAP, PCD recorded a cumulative effect charge of approximately US$10 million and is included in the "effect of change in accounting principle" in the audited combined statement of operations under US GAAP. This charge is reversed as there has been no change in accounting policy under Hong Kong GAAP.

Net assets or (liabilities) of the fair value of the foreign currency forward contracts recognized in the Audited US Combined Financial Statements under US GAAP of approximately US$1 million, US$(5) million, US$(6) million and US$20 million as at 30 June 2004, 31 December 2003, 2002 and 2001, respectively, have been reversed for Hong Kong GAAP purposes. Additionally, unamortized net premium paid amounted to approximately US$1 million, US$1 million and US$3 million in respect to these derivative instruments as at 31 December 2003, 2002 and 2001, respectively, are reclassified from "accumulated other comprehensive income/(loss)" to "prepaid expenses and other current assets" in the Unaudited Hong Kong GAAP Combined Financial Information.

(v) *Deferred taxation*

In general, accounting requirements for deferred taxation under Hong Kong GAAP and US GAAP are similar. However, as a result of the consequential deferred tax effect for the GAAP differences mentioned above, there are differences in the deferred income tax recognized under Hong Kong GAAP and US GAAP.

(B) RECENT CHANGES IN ACCOUNTING STANDARDS

The Unaudited Hong Kong GAAP Combined Financial Information has been prepared in accordance with accounting policies adopted by the Company which follow Hong Kong GAAP.

The Hong Kong Institute of Certified Public Accountants ("HKICPA") has issued a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, herein collectively referred to as HKFRS, which are effective for accounting periods beginning on or after 1 January 2005. These standards, inter alia, cover investment properties, financial instruments, share-based payment, business combinations, insurance contracts and non-current assets held for sale and discontinued operations, and are applicable to the Company since its financial year ending 31 March 2006. The preparation and presentation of the Company's results and financial position will be affected by these standards since the Company's financial year ending 31 March 2006.

(C) REPORT ON HONG KONG GAAP RECONCILIATION

The following is the text of a report received from the Company's independent auditors, PricewaterhouseCoopers Hong Kong, Certified Public Accountants, for inclusion in this circular.

PRICEWATERHOUSECOOPERS

羅兵咸永道會計師事務所

PricewaterhouseCoopers
22/F, Prince's Building
Central, Hong Kong

31 December 2004

The Directors
Lenovo Group Limited

Dear Sirs

We have examined the adjustments made in arriving at and computation of the Unaudited Hong Kong GAAP Combined Financial Information of the Personal Computing Division of International Business Machines Corporation ("IBM") ("PCD") as at 30 June 2004, 31 December 2003, 2002 and 2001, and for the six months ended 30 June 2004 and 2003 and for each of the three years ended 31 December 2003, 2002 and 2001 (the "Unaudited Hong Kong GAAP Combined Financial Information") as set out in Appendix II "Unaudited Combined Financial Information of PCD under Hong Kong GAAP" in the circular of Lenovo Group Limited (the "Company") dated 31 December 2004 (the "Circular"), in connection with the proposed acquisition of PCD by the Company pursuant to the asset purchase agreement dated 7 December 2004 between the Company and IBM ("Asset Purchase Agreement").

Responsibilities

The Unaudited Hong Kong GAAP Combined Financial Information is arrived at after making adjustments to the Audited US Combined Financial Statements of PCD under US GAAP (the "Audited US Combined Financial Statements") as set out in Appendix I of the Circular, which have been prepared in accordance with US GAAP and audited by the Independent Registered Public Accounting Firm of IBM in accordance with the standards of the Public Company Accounting Oversight Board (United States). The Audited US Combined Financial Statements are the responsibility of PCD's management. The Directors of the Company are responsible for the adjustments made in arriving at and computation of the Unaudited Hong Kong GAAP Combined Financial Information to show the financial position and the results of PCD in accordance with the accounting policies of the Company which follow Hong Kong GAAP.

It is our responsibility to form an opinion, based on our examination, on the adjustments made in arriving at and computation of the Unaudited Hong Kong GAAP Combined Financial Information and to report our opinion to you.

Basis of opinion

We conducted our work in accordance with Standard on Assurance Engagements issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA"). Our work consisted primarily of comparing the unadjusted US GAAP combined financial statements set out in Appendix II of the Circular with the Audited US Combined Financial Statements set out in Appendix I of the Circular, considering the evidence supporting the adjustments which include reviewing the differences between PCD's accounting policies and the Company's accounting policies and checking the arithmetic accuracy of the computation of the Unaudited Hong Kong GAAP Combined Financial Information. The engagement did not involve independent examination of any of the underlying financial information.

In connection with the adjustments, we have carried out such additional procedures as are necessary with reference to the Auditing Guideline 3.340 "Prospectuses and the Reporting Accountant" issued by the HKICPA. Our work does not constitute an audit in accordance with Statements of Auditing Standards issued by the HKICPA, and accordingly, we do not provide any assurance on the truth and fairness of the Unaudited Hong Kong GAAP Combined Financial Information.

Opinion

Based on the foregoing, in our opinion:

(a) the unadjusted US GAAP combined financial statements set out in Appendix II of the Circular are properly extracted from the Audited US Combined Financial Statements set out in Appendix I of the Circular;

(b) the adjustments made in arriving at the Unaudited Hong Kong GAAP Combined Financial Information reflect, in all material respects, differences between PCD's accounting policies and the Company's accounting policies; and

(c) the computation of the Unaudited Hong Kong GAAP Combined Financial Information is arithmetically accurate.

Yours faithfully
PricewaterhouseCoopers
Certified Public Accountants
Hong Kong

The following is a summary of the audited financial information of the Lenovo Group for the three financial years ended 31 March 2004 and unaudited financial information for the six months ended 30 September 2004, and the audited accounts of the Lenovo Group for the two financial years ended 31 March 2004. The accounts of the Lenovo Group have been prepared in accordance with Hong Kong GAAP and comply with accounting standards issued by the Hong Kong Institute of Certified Public Accountants.

THREE YEARS AND SIX MONTHS FINANCIAL SUMMARY

Consolidated profit and loss accounts

	Six months ended 30 September		Year ended 31 March		
	2004	**2003**	**2004**	**2003**	**2002**
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
	(unaudited)	(unaudited)	(audited)	(audited)	(audited)
Turnover	11,532,708	11,589,140	23,175,944	20,233,290	20,853,254
Earnings before interest, taxation, depreciation and amortization expenses	608,114	602,170	1,125,129	1,174,720	1,008,938
Depreciation expenses	(101,888)	(97,336)	(211,161)	(160,304)	(143,048)
Amortization of intangible assets	(15,891)	(15,234)	(34,999)	(15,246)	—
Impairment of assets	(51,364)	—	—	—	—
Gains/(losses) on disposal of investments	164,382	6,002	47,558	(26,802)	164,240
Finance income	41,646	40,049	93,368	77,233	67,360
Profit from operation	644,999	535,651	1,019,895	1,049,601	1,097,490
Finance costs	(3,500)	—	(2,881)	(20)	(11,785)
	641,499	535,651	1,017,014	1,049,581	1,085,705
Share of (losses)/profits of jointly controlled entities	(10,110)	(13,539)	(39,053)	(34,756)	8,468
Share of (losses)/profits of associated companies	(246)	5,379	16,891	13,826	(12,979)
Profit before taxation	631,143	527,491	994,852	1,028,651	1,081,194
Taxation	(24,905)	1,326	20,150	(26,018)	(23,092)
Profit after taxation	606,238	528,817	1,015,002	1,002,633	1,058,102
Minority interests	20,633	10,601	37,883	14,519	(13,202)
Profit attributable to shareholders	626,871	539,418	1,052,885	1,017,152	1,044,900
Dividends	179,357	149,436	373,704	747,412	383,088
Earnings per share					
— Basic (HK cents)	8.39	7.22	14.09	13.55	13.86
— Fully diluted (HK cents)	8.38	7.19	13.99	13.54	13.79

Consolidated balance sheet

	As at 30 September 2004	As at 31 March 2004	2003	2002
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
	(unaudited)	(audited)	(audited)	(audited)
Non-current assets	2,018,221	2,242,141	1,514,546	1,337,182
Current assets	7,143,996	6,099,900	5,241,050	4,354,555
Current liabilities	3,850,075	3,297,440	2,507,004	2,002,323
Non-current liabilities	391,341	526,547	330	330
Minority interests	30,800	29,330	59,741	7,050
Net assets	4,890,001	4,488,724	4,188,521	3,682,034

AUDITED ACCOUNTS OF THE GROUP FOR THE YEAR ENDED 31 MARCH 2004

Consolidated profit and loss account

For the year ended 31 March 2004

	Note	2004 *HK$'000*	2003 *HK$'000*
Turnover	3	23,175,944	20,233,290
Earnings before interest, taxation, depreciation and amortization expenses		1,125,129	1,174,720
Depreciation expenses		(211,161)	(160,304)
Amortization of intangible assets		(34,999)	(15,246)
Gains/(losses) on disposal of investments		47,558	(26,802)
Finance income		93,368	77,233
Profit from operation	4	1,019,895	1,049,601
Finance costs	6	(2,881)	(20)
		1,017,014	1,049,581
Share of losses of jointly controlled entities		(39,053)	(34,756)
Share of profits of associated companies		16,891	13,826
Profit before taxation	5	994,852	1,028,651
Taxation	7	20,150	(26,018)
Profit after taxation		1,015,002	1,002,633
Minority interests		37,883	14,519
Profit attributable to shareholders	10	1,052,885	1,017,152
Dividends	11	373,704	747,412
Earnings per share			
— Basic	12	14.09 HK cents	13.55 HK cents
— Fully diluted	12	13.99 HK cents	13.54 HK cents

Balance sheets
As at 31 March 2004

		Group		Company	
		2004	**2003**	**2004**	**2003**
	Note	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Non-current assets					
Intangible assets	13	646,986	120,621	—	—
Tangible fixed assets	14	987,272	845,976	32,115	41,000
Construction-in-progress	15	260,377	174,138	—	—
Investments in subsidiaries	16(a)	—	—	2,327,875	2,327,875
Investment in a jointly controlled entity	17	124,124	198,549	—	—
Investments in associated companies	18	112,682	101,613	—	—
Investment securities	19	75,982	73,649	—	37,890
Deferred tax assets	20	34,718	—	—	—
		2,242,141	1,514,546	2,359,990	2,406,765
Current assets					
Inventories	21	1,393,018	1,269,051	—	—
Amounts due from subsidiaries	16(b)	—	—	3,218,602	2,188,544
Trade receivables	22(a)	1,230,944	553,516	—	—
Notes receivable	22(b)	520,321	383,412	—	—
Deposits, prepayments and other receivables		301,513	226,748	81,548	89,737
Tax recoverable		4,033	—	—	—
Cash and cash equivalents	23	2,650,071	2,808,323	1,107,976	1,813,751
		6,099,900	5,241,050	4,408,126	4,092,032
Current liabilities					
Amounts due to subsidiaries	16(b)	—	—	115,511	87,431
Trade payables	24(a)	2,155,057	1,588,632	—	—
Notes payable	24(b)	356,531	279,381	—	—
Accruals and other payables		616,897	630,779	15,189	15,427
Amount due to a jointly controlled entity	17	108,471	—	—	—
Tax payable		5,031	8,212	—	—
Current portion of long term liabilities	25	55,453	—	—	—
		3,297,440	2,507,004	130,700	102,858
Net current assets		2,802,460	2,734,046	4,277,426	3,989,174
Total assets less current liabilities		5,044,601	4,248,592	6,637,416	6,395,939
Financed by:					
Share capital	26	186,890	186,934	186,890	186,934
Reserves	28	4,301,834	4,001,587	6,450,526	6,208,701
Shareholders' funds		4,488,724	4,188,521	6,637,416	6,395,635
Minority interests		29,330	59,741	—	—
Deferred tax liabilities	20	—	330	—	304
Long-term liabilities	25	526,547	—	—	—
		5,044,601	4,248,592	6,637,416	6,395,939

Consolidated cash flow statement
For the year ended 31 March 2004

	Note	2004 HK$'000	2003 HK$'000
Operating activities			
Net cash inflow generated from operations	33	748,993	1,150,075
Finance income		93,368	77,233
Finance costs		(2,881)	(20)
Tax paid		(21,696)	(17,410)
Net cash inflow from operating activities		817,784	1,209,878
Investing activities			
Purchase of tangible fixed assets		(96,218)	(125,708)
Sale of tangible fixed assets		8,059	29,727
Payment for construction-in-progress		(268,135)	(169,000)
Payment for patent acquired		(4,912)	(42,453)
Purchase of investment securities		(43,552)	(200,237)
Sale of investment securities		79,845	140,517
Net cash inflow in respect of acquisition of subsidiaries	36	5,449	4,847
Proceeds from partial disposal of a subsidiary		11,792	—
Payment for acquisition of business		—	(54,613)
Investment in an associated company		—	(2,670)
Investment in jointly controlled entities		—	(24,289)
Repayment of advance from an associated company		—	50,034
Proceeds from disposal of an associated company		5,660	27,286
Dividend received from associated companies		5,490	6,892
Net cash outflow from investing activities		(296,522)	(359,667)
Net cash inflow before financing		521,262	850,211
Financing activities	34		
Exercise of share options and issue of new shares		28,736	1,887
Repurchase of shares		(28,394)	(79,399)
Capital injection from minority shareholders		11,604	—
Dividends paid		(761,814)	(405,276)
Dividend paid to minority shareholders		(4,594)	—
Loan from a minority shareholder		75,000	—
Net cash outflow from financing		(679,462)	(482,788)
(Decrease)/Increase in cash and cash equivalents		(158,200)	367,423
Cash and cash equivalents at the beginning of the year		2,808,323	2,441,169
Effect of foreign exchange rate changes		(52)	(269)
Cash and cash equivalents at the end of the year		2,650,071	2,808,323

Consolidated statement of changes in equity
For the year ended 31 March 2004

	Note	**2004** *HK$'000*	**2003** *HK$'000*
Total equity at the beginning of the year		4,188,521	3,682,034
Surplus/(deficit) in fair market value of investment securities	28	20,144	(20,891)
Exchange differences arising from translation of subsidiaries, associated companies and a jointly controlled entity	28	270	156
Net gains/(losses) not recognised in the consolidated profit and loss account		20,414	(20,735)
Profit for the year		1,052,885	1,017,152
Reserves realised upon disposal of investment securities	28	(11,624)	(7,120)
Total recognised gains		1,061,675	989,297
Goodwill written off arising from disposal of subsidiaries	28	—	(22)
Exercise of share options	28	28,736	1,887
Repurchase of shares	28	(28,394)	(79,399)
Dividends paid	28	(761,814)	(405,276)
Total equity at the end of the year		4,488,724	4,188,521

Notes to the accounts

1. BASIS OF PREPARATION

The accounts have been prepared in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). They have been prepared under the historical cost convention except that, as disclosed in the accounting policies below, investment securities are stated at fair value.

In the current year, the Group adopted SSAP 12 "Income Taxes" issued by the Hong Kong Society of Accountants which are effective for accounting periods commencing on or after 1 January 2003.

The changes to the Group's accounting policies and the effect of adopting these new policies are set out below.

2. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these consolidated accounts are set out below:

(a) Basis of consolidation

(i) The consolidated accounts include the accounts of the Company and its subsidiaries made up to 31 March. Subsidiaries are those entities in which the Company, directly or indirectly, controls the composition of the board of directors, controls more than half the voting power or holds more than half of the issued share capital.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from the effective date of acquisition or up to the effective date of disposal, as appropriate.

The gain or loss on the disposal of a subsidiary represents the difference between the proceeds of the sale and the Group's share of its net assets together with any unamortized goodwill or negative goodwill taken to reserve and which was not previously charged or recognized in the consolidated profit and loss account and any related accumulated exchange reserve.

(ii) All significant intercompany transactions and balances within the Group are eliminated on consolidation.

(iii) Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

(iv) In the Company's balance sheet, the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

(b) Joint ventures

(i) A joint venture is a contractual arrangement whereby the Group and other parties undertake an economic activity which is subject to joint control and none of the participating parties has unilateral control over the economic activity.

(ii) The consolidated profit and loss account includes the Group's share of the results of jointly controlled entities for the year, and the consolidated balance sheet includes the Group's share of the net assets of the jointly controlled entities and goodwill/negative goodwill (net of accumulated amortization) on acquisition.

(iii) In the Company's balance sheet, the investments in jointly controlled entities are stated at cost less provision for impairment losses. The results of jointly controlled entities are accounted for by the Company on the basis of dividends received and receivable.

(c) Associated companies

(i) An associated company is a company, not being a subsidiary or a joint venture, in which an equity interest is held for the long-term and significant influence is exercised in its management.

(ii) The consolidated profit and loss account includes the Group's share of the results of associated companies for the year, and the consolidated balance sheet includes the Group's share of the net assets of the associated companies and goodwill/negative goodwill (net of accumulated amortization) on acquisition.

(iii) Equity accounting is discontinued when the carrying amount of the investment in an associated company reaches zero, unless the Group has incurred obligations or guaranteed obligations in respect of the associated company.

(iv) Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are eliminated unless the transaction provides evidence of an impairment of the assets transferred.

(v) In the Company's balance sheet the investments in associated companies are stated at cost less provision for impairment losses. The results of associated companies are accounted for by the Company on the basis of dividends received and receivable.

(d) 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 at 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 balance sheet of subsidiaries, jointly controlled entities and associated companies expressed in foreign currencies are translated at the rates of exchange ruling at the balance sheet date whilst the profit and loss account is translated at an average rate. Exchange differences are dealt with as a movement in reserves.

(e) Tangible fixed assets

(i) *Land use rights, leasehold land and buildings/improvements*

Land use rights, leasehold land and buildings/improvements are stated at cost less accumulated amortization or depreciation and accumulated impairment losses.

Land use rights are amortised on a straight-line basis over the land use rights periods ranging from 20 to 50 years.

Amortization of leasehold land is calculated to write off its cost to its estimated residual value over the unexpired period of the lease or their expected useful lives to the Group of 50 years whichever is shorter. The principal annual rates used for this purpose are 2% to 5%.

Depreciation on buildings is calculated to write off their cost to their estimated residual value over the unexpired period of the leases or their expected useful lives to the Group of 50 years whichever is shorter. The principal annual rates used for this purpose are 2% to 5%.

Depreciation of leasehold improvements is calculated to write off their cost to their estimated residual value on the straight-line basis over their expected useful lives to the Group of 5 to 10 years or unexpired periods of the leases whichever is shorter. The principal annual rate used for this purpose is 10% to 20%.

(ii) *Other tangible fixed assets*

Other tangible fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses. Depreciation on other tangible fixed assets is calculated to write off their cost to their estimated residual value on the straight-line basis over their expected useful lives to the Group. The principal annual rates used for this purpose are 20% to 33%.

(iii) *Impairment of tangible fixed assets*

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that assets included in construction-in-progress and tangible fixed assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the profit and loss account.

(iv) *Gain or loss on disposal of tangible fixed assets*

Gain or loss on disposal of a tangible 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.

(v) *Cost of restoring and improving tangible fixed assets*

Major costs incurred in restoring tangible 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.

(f) Construction-in-progress

Construction-in-progress is stated at cost. Cost comprises all direct and indirect costs of acquisition or construction of buildings and plant and machinery as well as interest expenses and exchange differences on the related funds borrowed during the construction, installation and testing periods and prior to the commencement date, less any accumulated impairment losses. No depreciation is provided for on construction-in-progress. On completion, the building and plant and machinery are transferred to tangible fixed assets at cost less accumulated impairment losses.

(g) Intangible assets

(i) *Goodwill*

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiaries, jointly controlled entities and associated companies at the date of acquisition.

Goodwill on acquisition occurring on or after 1 January 2001 is included in intangible assets and is amortised using the straight-line method over its estimated useful life. Goodwill arising on major strategic acquisitions of the Group to expand its product or geographical market coverage is amortised over a maximum period of 20 years. For all other acquisitions goodwill is generally amortised over 3 to 10 years.

SSAP 31 prescribes procedures to be applied to ensure that assets are carried at not more than their recoverable amounts. The recoverable amount of an asset is defined to be the higher of its net selling price and its value in use. The Group determines the value in use of its assets (including fixed assets, goodwill arising on business combinations accounted for using the purchase method and intangible assets) as the present value of estimated future cash flows together with estimated disposal proceeds at the end of its useful life. The Group is required to assess at each balance sheet date whether there are any indications that assets may be impaired, and if there are such indications, the recoverable amount of the assets is to be determined. Any resulting impairment losses identified are charged to the consolidated profit and loss account.

In accordance with the provisions of interpretation 13, assessments of impairment of goodwill also apply to goodwill previously eliminated against reserves which will not be reinstated at the time of adoption of SSAP 30. Any impairment loss identified in respect of goodwill previously eliminated against reserves is to be recognised as an expense in the consolidated profit and loss account.

(ii) *Patents and marketing rights*

Expenditure on acquired patents and marketing rights is capitalised and amortised on a systematic basis over their useful lives, but not exceeding 20 years. Patents and marketing rights are not revalued as there is no active market for these assets.

(iii) *Impairment of intangible assets*

Where an indication of impairment exists, the carrying amount of any intangible asset, including goodwill previously written off against reserves, is assessed and written down immediately to its recoverable amount.

(h) Investment securities

Investments which are held for non-trading purpose are stated at fair value at the balance sheet date. Changes in the fair value of individual securities are credited or debited to the investment revaluation reserve until the security is sold, or is determined to be impaired. Upon disposal, the cumulative gain or loss representing the difference between the net sales proceeds and the carrying amount of the relevant security, together with any surplus/deficit transferred from the investment revaluation reserve, is dealt with in the profit and loss account.

Individual investments are reviewed regularly to determine whether they are impaired. When an investment is considered to be impaired, the cumulative loss recorded in the revaluation reserve is taken to the profit and loss account.

Transfers from the investment revaluation reserve to the profit and loss account as a result of impairments are written back in the profit and loss account when the circumstances and events leading to the impairment cease to exist.

(i) Inventories

Inventories are valued at the lower of cost and net realisable value. Cost is determined on a weighted average basis, and in the case of work-in-progress and finished goods (except for trading products), cost comprises direct materials, direct labour and an attributable proportion of production overheads. For trading products, cost represents invoiced value on purchases, less purchase returns and discounts. Net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

(j) Accounts receivable

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

(k) Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the cash flow statement, cash and cash equivalents mainly comprise cash on hand, deposits held at call with banks and highly liquid investment which are subject to an insignificant risk of changes in value.

(l) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The Group recognises a provision for repairs or replacement of products still under warranty at the balance sheet date. The provision is calculated based on past history of the level of repairs and replacements.

(m) Contingent liabilities

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, it will then be recognized as a provision.

(n) Deferred taxation

Deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

In prior years, deferred taxation was 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 an asset was expected to be payable or recoverable in the foreseeable future. The effect of this change is not significant to the accounts of prior years.

(o) 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. Rental applicable to such operating leases are charged to the profit and loss account on a straight-line basis over the lease term.

(p) Revenue

Revenue from the sale of goods is recognised on the transfer of ownership, which generally coincides with the time of shipment. Revenue from provision of systems integration service is recognized when services are rendered. Revenue from provision of information technology technical service is recognized when services are rendered. Interest income is accrued on a time proportion basis on the principal amounts outstanding and at the rates applicable. Dividend income is recognised when the right to receive payment is established.

(q) Employee benefits

(i) *Employee leave entitlements*

Employee entitlements to annual leave, sick leave and maternity leave are not recognized until the time of leave.

(ii) *Pension obligations*

The Group's contributions to the defined contribution retirement scheme for qualified Hong Kong employees are expensed as incurred and are reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions. The assets of the scheme are held separately from those of the Group in an independently administered fund.

In addition, the Group's contributions to a local municipal government retirement scheme in Chinese mainland are expensed as incurred while the local municipal government in Chinese mainland undertakes to assume the retirement benefit obligations of the qualified employees in Chinese mainland.

(iii) *Share options*

No employee benefits cost is recognized when options are granted. When the options are exercised, equity is increased by the amount of the proceeds received.

(r) Segment reporting

In accordance with the Group's internal financial reporting, the Group has determined that geographical segments be presented as the primary reporting format and business as the secondary reporting format.

Segment assets of geographical segments consist primarily of tangible fixed assets, construction-in-progress, inventories, trade receivables and notes receivable, and mainly exclude intangible assets, investments in jointly controlled entities, investments in associated companies, investment securities, deferred tax assets, other receivables, tax recoverable and cash and cash equivalents. Segment liabilities comprise operating liabilities and exclude tax payable and liabilities payable for acquisition of intangible assets. Capital expenditure mainly comprises additions to tangible fixed assets (Note 14) and construction-in-progress (Note 15).

In presenting information on the basis of business segments, intangible assets, tangible fixed assets and construction-in-progress are excluded from segment assets.

3. TURNOVER, REVENUE AND SEGMENT INFORMATION

The Group is principally engaged in the provision of advanced information technology ("IT") products and services. Revenues recognized during the year are as follows:

	2004	**2003**
	HK$'000	*HK$'000*
Corporate IT business	11,925,240	10,803,311
Consumer IT business	7,760,668	6,822,633
Handheld device business	2,050,164	1,440,328
IT service business	547,780	183,800
Contract manufacturing business	892,092	983,218
	23,175,944	20,233,290

Primary reporting format — geographical segments

The Group operates, through its subsidiaries, jointly controlled entities and associated companies, in four major geographical regions — the People's Republic of China, including Chinese mainland and Hong Kong (the "PRC"), Asia Pacific (excluding PRC), North America and Europe. The later three regions are grouped as "others" for presentation purpose.

There are no material sales or other transactions among the geographical segments.

In presenting information on the basis of geographical segments, segment turnover and segment operating results are based on the geographical location of customers. Segment assets are based on the geographical location of the assets. The segment turnover and segment operating results, if based on geographical location of assets, are all categorised under PRC operations.

Secondary reporting format — business segments

The Group is categorised into five main business segments:

- Corporate IT business
- Consumer IT business
- Handheld device business
- IT service business
- Contract manufacturing business

There are no material sales or other transactions among the business segments.

(a) Primary reporting format — geographical segments

	PRC 2004 *HK$'000*	Others 2004 *HK$'000*	Total 2004 *HK$'000*
Profit and loss account			
Turnover	22,878,303	297,641	23,175,944
Segment operating results	947,125	(33,157)	913,968
Gains on disposal of investments	47,558	—	47,558
Amortization of intangible assets	(34,999)	—	(34,999)
Finance income			93,368
Finance costs			(2,881)
Contribution to operating profit			1,017,014
Share of losses of jointly controlled entities	(39,053)	—	(39,053)
Share of profits of associated companies	16,891	—	16,891
Profit before taxation			994,852
Taxation			20,150
Profit after taxation			1,015,002
Minority interests			37,883
Profit attributable to shareholders			1,052,885
Balance sheet			
Segment assets	4,347,982	43,950	4,391,932
Investments in jointly controlled entities	124,124	—	124,124
Investments in associated companies	112,682	—	112,682
Investment securities	75,982	—	75,982
Unallocated assets			3,637,321
Consolidated total assets			8,342,041
Segment liabilities	3,300,576	11,380	3,311,956
Unallocated liabilities			512,031
Consolidated total liabilities			3,823,987
Capital expenditure	364,353	—	364,353
Depreciation	209,520	1,641	211,161

	PRC 2003 HK$'000	Others 2003 HK$'000	Total 2003 HK$'000
Profit and loss account			
Turnover	19,738,075	495,215	20,233,290
Segment operating results	1,011,204	3,212	1,014,416
Losses on disposal of investments	(26,802)	—	(26,802)
Amortization of intangible assets	(15,246)	—	(15,246)
Finance income			77,233
Finance costs			(20)
Contribution to operating profit			1,049,581
Share of losses of jointly controlled entities	(34,756)	—	(34,756)
Share of profits of associated companies	13,826	—	13,826
Profit before taxation			1,028,651
Taxation			(26,018)
Profit after taxation			1,002,633
Minority interests			14,519
Profit attributable to shareholders			1,017,152
Balance sheet			
Segment assets	3,184,037	42,056	3,226,093
Investments in jointly controlled entities	198,549	—	198,549
Investments in associated companies	101,613	—	101,613
Investment securities	71,392	2,257	73,649
Unallocated assets			3,155,692
Consolidated total assets			6,755,596
Segment liabilities	2,492,220	6,572	2,498,792
Tax liabilities			8,542
Consolidated total liabilities			2,507,334
Capital expenditure	337,161	—	337,161
Depreciation	158,985	1,319	160,304

(b) Secondary reporting format — business segments

	Turnover 2004 *HK$'000*	Contribution to operating profit 2004 *HK$'000*	Consolidated total assets 2004 *HK$'000*
Corporate IT business	11,925,240	777,698	1,560,895
Consumer IT business	7,760,668	466,814	753,854
Handheld device business	2,050,164	(74,565)	431,377
IT service business	547,780	(58,009)	241,564
Contract manufacturing business	892,092	(95,208)	156,593
Amortization of goodwill	—	(25,274)	—
Gains on disposal of investments	—	47,558	—
Others	—	(22,000)	—
Investment in a jointly controlled entity	—	—	124,124
Investments in associated companies	—	—	112,682
Investment securities	—	—	75,982
Unallocated assets	—	—	4,884,970
	23,175,944	1,017,014	8,342,041

	Turnover 2003 *HK$'000*	Contribution to operating profit 2003 *HK$'000*	Consolidated total assets 2003 *HK$'000*
Corporate IT business	10,803,311	744,153	1,270,124
Consumer IT business	6,822,633	363,527	384,831
Handheld device business	1,440,328	29,017	316,471
IT service business	183,800	(61,405)	78,111
Contract manufacturing business	983,218	8,554	156,442
Amortization of goodwill	—	(7,463)	—
Losses on disposal of investments	—	(26,802)	—
Investments in jointly controlled entities	—	—	198,549
Investments in associated companies	—	—	101,613
Investment securities	—	—	73,649
Unallocated assets	—	—	4,175,806
	20,233,290	1,049,581	6,755,596

4. PROFIT FROM OPERATION

(a)

	2004 *HK$'000*	2003 *HK$'000*
Turnover	23,175,944	20,233,290
Cost of sales	(19,787,944)	(17,234,746)
Gross profit	3,388,000	2,998,544
Finance income	93,368	77,233
Gains/(losses) on disposal of investments	47,558	(26,802)
	3,528,926	3,048,975
Distribution expenses	(1,686,932)	(1,393,990)
Administrative expenses	(343,306)	(328,736)
Other operating expenses	(443,794)	(261,402)
Amortization of intangible assets	(34,999)	(15,246)
Total operating expenses *(Note (b))*	(2,509,031)	(1,999,374)
Profit from operations	1,019,895	1,049,601

(b) Analysis of total operating expenses by nature:

	2004 *HK$'000*	2003 *HK$'000*
Selling expenses	(558,124)	(379,842)
Promotional and advertising expenses	(395,905)	(425,143)
Staff costs (including directors' emoluments) *(Note 8)*	(851,476)	(688,519)
Other expenses	(668,527)	(490,624)
Amortization of intangible assets	(34,999)	(15,246)
Total operating expenses	(2,509,031)	(1,999,374)

5. PROFIT BEFORE TAXATION

	2004 *HK$'000*	2003 *HK$'000*
Profit before taxation is stated after (crediting)/charging the following:		
Auditors' remuneration	2,689	2,698
Depreciation of owned tangible fixed assets	211,161	160,304
Amortization of intangible assets	34,999	15,246
Cost of inventories sold	19,604,591	16,965,244
Rental expenses under operating leases	67,023	67,900
Research and development expenses	499,572	314,182
Loss on disposal of tangible fixed assets	2,308	3,110
Net exchange (gain)/loss	(7,379)	13,346

6. FINANCE COSTS

	2004	2003
	HK$'000	*HK$'000*
Interest payable on bank loans and overdrafts	2,365	20
Other interest	516	—
Total finance cost	2,881	20

7. TAXATION

The amount of taxation (credited)/charged to the consolidated profit and loss account represents:

	2004	2003
	HK$'000	*HK$'000*
Current taxation:		
— Taxation outside Hong Kong	14,482	23,730
— Overprovision in prior years	—	(339)
Deferred taxation relating to the origination and reversal of temporary differences	(35,048)	—
	(20,566)	23,391
Share of taxation attributable to:		
Jointly controlled entities	84	1,416
Associated companies	332	1,211
Taxation (credit)/charge	(20,150)	26,018

The taxation on the Group's profit before taxation differs from the theoretical amount that would arise using the taxation rate of Hong Kong as follows:

	2004	2003
	HK$'000	*HK$'000*
Profit before taxation	994,852	1,028,651
Calculated at a taxation rate of 17.5% (2003: 16%)	174,099	164,584
Effect of different taxation rates in other countries	(117,494)	(121,286)
Income not subject to taxation	(103,801)	(27,351)
Expenses not deductible for taxation purposes	14,240	14,762
Utilisation of previously unrecognised tax losses	—	(3,269)
Recognition of deferred taxes previously not recognised	(29,067)	—
Tax credit for capital expenditure	(1,271)	(6,526)
Overprovision in prior years	—	(339)
Net deferred tax assets not recognised	43,144	5,443
Taxation (credit)/charge	(20,150)	26,018

No provision for Hong Kong profits tax has been made in the accounts as the Company and its subsidiaries have no estimated assessable profits for the year (2003: Nil). In 2003, the Government of Hong Kong Special Administrative Region enacted a change in the profit tax rate from 16% to 17.5% for the fiscal year 2003/04.

Taxation outside Hong Kong represents tax charges on the assessable profits of subsidiaries, operating outside Hong Kong including the Chinese mainland, calculated at rates applicable in the respective jurisdictions.

Pursuant to various approval documents issued by the Chinese mainland tax authority, certain Chinese mainland subsidiaries of the Group are entitled to preferential Chinese mainland income tax treatments.

Lenovo (Beijing) Limited was entitled to preferential Chinese mainland income tax rate of 7.5% for the three years ended 31 December 2003. From 1 January 2004 onwards, it is subject to income tax rate of 10% up to 31 December 2006.

Lenovo Mobile Communication Co., Ltd., Shanghai Lenovo Electronic Co., Ltd. and Lenovo Computer System and Technology Service Co., Ltd. are exempted from Chinese mainland income tax for two years commencing 1 January 2002 and a 50% Chinese mainland tax reduction for the following three years.

Other major Chinese mainland subsidiaries of the Group in Shenzhen, Beijing and Huiyang are exempted from Chinese mainland income tax for two to three years commencing 1 January 2001 and a 50% Chinese mainland income tax reduction for the following three years.

8. STAFF COSTS

	2004	**2003**
	HK$'000	*HK$'000*
Wages, salaries and bonuses	672,562	581,465
Social security costs	72,892	42,858
Pension costs *(Note (b))*	58,797	41,216
Others	125,776	89,898
	930,027	755,437

(a) Included in the above balance are staff costs of HK$851,476,000 (2003: HK$688,519,000) which are included in operating expenses (Note 4(b)).

(b) The Group contributes to respective local municipal government retirement schemes which are available to all qualified employees in Chinese mainland. Contributions to these schemes are calculated with reference to the employees' salaries, bonuses and monthly average salaries as set out by the local municipal government.

Prior to 1 December 2000, the Group provided all qualified Hong Kong employees with a defined contribution retirement scheme. Commencing 1 December 2000, the Group's Hong Kong employees are required to contribute 5% of their basic salary plus cash allowances (subject to the ceiling under the requirements set out in the Mandatory Provident Fund legislation) whereas the employer's contribution is at 7.5% and 10% respectively after completion of five and ten years of service. The Group's contributions to the scheme were reduced by contributions forfeited by those employees who leave the scheme prior to vesting fully in the contributions. Forfeited contributions totalling HK$812,638 (2003: HK$352,811) were utilised during the year leaving no amount available at the year end to reduce further contributions. The assets of the defined contribution scheme are held separately from those of the Group in an independently administered fund.

The retirement benefit scheme cost charged to the consolidated profit and loss account represents contributions payable by the Group to the schemes.

9. EMOLUMENTS OF DIRECTORS AND HIGHEST PAID INDIVIDUALS

(a) The aggregate amounts of emoluments payable to directors of the Company during the year are as follow:

	Directors		Independent non-executive directors	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Fees	—	—	540	375
Other emoluments:				
Basic salaries, allowances and benefits-in-kind	26,037	20,667	—	—
Retirement benefit costs	352	339	—	—
	26,389	21,006	540	375

Certain directors of the Company have been granted options to acquire shares of the Company.

The emoluments of the directors disclosed above do not include the benefits derived or to be derived from the options granted under the Company's share option schemes.

(b) The number of directors whose emoluments fall within the following bands is as follows:

	Directors		Independent non-executive directors	
HK$	2004	2003	2004	2003
From 0 to 1,000,000	—	—	3	3
From 2,000,001 to 2,500,000	—	1	—	—
From 2,500,001 to 3,000,000	1	—	—	—
From 4,000,001 to 4,500,000	—	1	—	—
From 4,500,001 to 5,000,000	1	—	—	—
From 5,500,001 to 6,000,000	—	1	—	—
From 6,000,001 to 6,500,000	1	—	—	—
From 8,000,001 to 8,500,000	—	1	—	—
From 12,000,001 to 12,500,000	1	—	—	—
	4	4	3	3

(c) Among the five highest paid employees, three (2003: four) are directors whose remunerations are included in the directors' emoluments above. The emoluments payable to the remaining two (2003: one) individuals during the year are as follows:

	2004	2003
	HK$'000	*HK$'000*
Basic salaries, allowances and benefits-in-kind	6,458	2,079
Retirement benefit costs	25	158
	6,483	2,237

(d) The number of employees whose emoluments fall within the following bands is as follows:

HK$	**2004**	**2003**
From 2,000,001 to 2,500,000	—	1
From 3,000,001 to 3,500,000	2	—
	2	1

10. PROFIT ATTRIBUTABLE TO SHAREHOLDERS

Included in the profit of HK$1,052,885,000 (2003: HK$1,017,152,000) attributable to shareholders of the Company is the profit of HK$1,001,070,000 (2003: HK$1,095,610,000), which is dealt with in the Company's own accounts.

11. DIVIDENDS

	2004 *HK$'000*	**2003** *HK$'000*
Interim dividend of 2.0 HK cents per share (2003: 1.8 HK cents)	149,436	135,034
Proposed final dividend of 3.0 HK cents per share (2003: 3.0 HK cents)	224,268	224,040
Special dividend of 5.2 HK cents per share for 2003	—	388,338
	373,704	747,412

At a board meeting held on 2 June 2004, the directors recommended a final dividend of 3.0 HK cents per share. The proposed dividend is not reflected as a dividend payable in these accounts, but will be reflected as an appropriation of retained earnings for the year ending 31 March 2005.

12. EARNINGS PER SHARE

The calculation of basic and diluted earnings per share is based on the following data:

	2004	**2003**
Earnings for the purposes of basic and diluted earnings per share (HK$'000)	1,052,885	1,017,152
Weighted average number of shares for the purposes of basic earnings per share	7,471,766,157	7,504,340,579
Effect of potential dilutive shares	53,541,036	9,827,387
Weighted average number of shares for the purposes of diluted earnings per share	7,525,307,193	7,514,167,966

13. INTANGIBLE ASSETS

	Group			
	Goodwill	Patent	Marketing right	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Year ended 31 March 2004				
Opening net book amount	85,951	34,670	—	120,621
Additions	—	4,912	507,000	511,912
Acquisition of a subsidiary	49,452	—	—	49,452
Amortization charge	(25,274)	(9,725)	—	(34,999)
Closing net book amount	110,129	29,857	507,000	646,986
As at 31 March 2004				
Cost	142,866	47,365	507,000	697,231
Accumulated amortization	(32,737)	(17,508)	—	(50,245)
Net book amount	110,129	29,857	507,000	646,986
As at 31 March 2003				
Cost	93,414	42,453	—	135,867
Accumulated amortization	(7,463)	(7,783)	—	(15,246)
Net book amount	85,951	34,670	—	120,621

14. TANGIBLE FIXED ASSETS

	Group						
	Land use rights, leasehold land and buildings *(Note (a))*	Leasehold improvements	Plant and machinery	Furniture and fixtures	Office equipment	Motor vehicles	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Costs							
At 1 April 2003	469,557	138,065	90,676	17,109	474,120	24,824	1,214,351
Exchange adjustment	—	—	—	466	218	199	883
Additions	—	8,369	10,590	4,256	71,203	1,800	96,218
Acquisition of subsidiaries	—	3,513	61,990	225	18,330	330	84,388
Transfer from construction-in-progress	80,669	44,611	16,989	—	39,627	—	181,896
Disposals	—	(1,954)	(4,849)	(981)	(21,710)	(1,521)	(31,015)
At 31 March 2004	550,226	192,604	175,396	21,075	581,788	25,632	1,546,721
Accumulated depreciation							
At 1 April 2003	68,397	41,152	29,868	8,445	205,971	14,542	368,375
Exchange adjustment	—	—	—	339	152	70	561
Charge for the year	20,252	43,588	21,318	4,404	118,799	2,800	211,161
Disposals	—	(1,750)	(2,459)	(603)	(14,675)	(1,161)	(20,648)
At 31 March 2004	88,649	82,990	48,727	12,585	310,247	16,251	559,449
Net book value							
At 31 March 2004	461,577	109,614	126,669	8,490	271,541	9,381	987,272
At 31 March 2003	401,160	96,913	60,808	8,664	268,149	10,282	845,976

	Company				
	Leasehold improvements	Furniture and fixtures	Office equipment	Motor vehicles	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Costs					
At 1 April 2003	2,325	658	39,778	1,562	44,323
Additions	27	23	5,017	1,280	6,347
Disposals	—	—	(38)	—	(38)
At 31 March 2004	2,352	681	44,757	2,842	50,632
Accumulated depreciation					
At 1 April 2003	319	315	2,403	286	3,323
Charge for the year	832	150	13,837	404	15,223
Disposals	—	—	(29)	—	(29)
At 31 March 2004	1,151	465	16,211	690	18,517
Net book value					
At 31 March 2004	1,201	216	28,546	2,152	32,115
At 31 March 2003	2,006	343	37,375	1,276	41,000

The net book value of land use rights, leasehold land and buildings comprises:

	Group					
	2004			2003		
	Hong Kong	Chinese mainland	Total	Hong Kong	Chinese mainland	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Medium leases (less than 50 years but not less than 10 years)	—	461,577	461,577	—	401,160	401,160

15. CONSTRUCTION-IN-PROGRESS

Construction-in-progress comprises:

	Group					
	Buildings under development		Others		Total	
	2004	2003	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At the beginning of the year	130,107	24,453	44,031	19,413	174,138	43,866
Additions	180,611	123,226	87,524	45,774	268,135	169,000
Transfer to tangible fixed assets	(109,720)	(17,572)	(72,176)	(21,156)	(181,896)	(38,728)
At the end of the year	200,998	130,107	59,379	44,031	260,377	174,138

No interest expenses were capitalised in construction-in-progress at the balance sheet date.

16. SUBSIDIARIES

(a) Investments in subsidiaries

	Company 2004	Company 2003
	HK$'000	*HK$'000*
Unlisted shares, at cost	2,327,875	2,327,875

The following includes the principal subsidiaries of the Company which were directly and indirectly held by the Company and, in the opinion of the directors, significant to the results of the year or form a substantial portion of the net assets of the Group. The directors consider that giving details of other subsidiaries would result in particulars of excessive length.

Company name	Place of incorporation/ establishment	Issued and fully paid up capital	Effective percentage holding 2004	Effective percentage holding 2003	Principal activities
Held directly:					
Lenovo (Beijing) Limited*	Chinese mainland	HK$78,000,000	100%	100%	Manufacturing and distribution of IT products and provision of IT services
Lenovo (Shanghai) Co., Ltd.*	Chinese mainland	HK$10,000,000	100%	100%	Distribution of IT products and provision of IT services
Held indirectly:					
Beijing Lenovo Software Limited*	Chinese mainland	HK$5,000,000	100%	100%	Provision of IT services and distribution of IT products
Han Consulting (China) Limited*	Chinese mainland	US$6,000,000	51%	51%	Provision of IT services and distribution of IT products
Huiyang Lenovo Industry Property Limited*	Chinese mainland	US$2,045,500	100%	100%	Property holding and property management
Lenovo Al Computer Technology Co., Ltd.*	Chinese mainland	RMB10,000,000	70%	70%	Provision of IT services
Lenovo (Chengdu) Limited*	Chinese mainland	RMB12,000,000	100%	100%	Provision of IT services and distribution of IT products
Lenovo Chinaweal System & Service Co., Ltd.*	Chinese mainland	US$6,024,000	95.1%	95.1%	Provision of IT services and distribution of IT products
Lenovo Computer Limited	Hong Kong	HK$2	100%	100%	Procurement agent and distribution of IT products

Company name	Place of incorporation/ establishment	Issued and fully paid up capital	Effective percentage holding 2004	2003	Principal activities
Lenovo Computer System and Technology Service Co., Ltd.*	Chinese mainland	RMB50,000,000	100%	100%	Provision of IT services and distribution of IT products
Lenovo (Huiyang) Electronic Industrial Co., Ltd.*	Chinese mainland	HK$16,000,000	100%	100%	Manufacturing of IT products
Lenovo Industrial Development Co., (Daya Bay) Ltd.*	Chinese mainland	US$10,000,000	100%	100%	Property holding and property management
Lenovo Mobile Communication Co., Ltd.*	Chinese mainland	RMB187,500,000	80.8%	80.8%	Manufacturing and distribution of mobile handsets
Lenovo Networks (Shenzhen) Limited*	Chinese mainland	HK$20,000,000	80%	—	Provision of IT services
Lenovo (Shenyang) Limited*	Chinese mainland	RMB10,000,000	100%	100%	Provision of IT services and distribution of IT products
Lenovo (Shenzhen) Electronic Co., Ltd.*	Chinese mainland	RMB10,000,000	100%	100%	Distribution of IT products
Lenovo (Wuhan) Limited*	Chinese mainland	RMB10,000,000	100%	100%	Provision of IT services and distribution of IT products
Lenovo (Xian) Limited*	Chinese mainland	RMB10,000,000	100%	100%	Provision of IT services and distribution of IT products
Shanghai Lenovo Electronic Co., Ltd.*	Chinese mainland	RMB20,000,000	100%	100%	Manufacturing of IT products
QDI Europe B.V.	The Netherlands	EUR18,151	50%	100%	Distribution of IT products
QDI Technology (HK) Limited	Hong Kong	HK$2	50%	—	Procurement agent and distribution of IT products
QDI Technology (Huizhou) Limited*	Chinese mainland	HK$50,000,000	50%	50%	Manufacturing of IT products
QDI Technology (Shenzhen) Limited*	Chinese mainland	HK$8,300,000	50%	—	Distribution of IT products

Company name	Place of incorporation/ establishment	Issued and fully paid up capital	Effective percentage holding 2004	2003	Principal activities
Quantum Designs (H.K.) Limited	Hong Kong	HK$2 ordinary and HK$1,000,000 non-voting deferred	100%	100%	Procurement agent and distribution of IT products
Sunny Information Technology Service (Beijing) Co., Ltd.*	Chinese mainland	RMB20,000,000	100%	100%	Provision of repair services for computer hardware and software systems

Notes:

(i) All of the above subsidiaries operate principally in their respective places of incorporation or establishment.

(ii) All the Chinese mainland subsidiaries are limited liability companies. They have adopted 31 December as their financial year end date for statutory reporting purposes. For preparation of the consolidated accounts, accounts of these subsidiaries for the 12 months ended 31 March 2003 and 2004 have been used.

(iii) The company whose English name with a "*" is a direct transliteration of its Chinese registered name.

(b) Amounts due from/(to) subsidiaries

The amounts are interest-free, unsecured and have no fixed terms of repayment.

17. INVESTMENT IN A JOINTLY CONTROLLED ENTITY

	Group 2004	2003
	HK$'000	*HK$'000*
Share of net assets	124,124	198,549
Amount due to a jointly controlled entity *(Note)*	(108,471)	—
	15,653	198,549

Note: The amount due to a jointly controlled entity is interest-free, unsecured and have no fixed terms of repayment.

The details of the jointly controlled entity at 31 March 2004 are as follows:

Company name	Place of incorporation/ establishment	Interest held indirectly 2004	2003	Principal activity
Leby Technology Company Limited	British Virgin Islands	50%	50%	Dormant

18. INVESTMENTS IN ASSOCIATED COMPANIES

	Group 2004	Group 2003
	HK$'000	*HK$'000*
Share of net assets	110,882	99,813
Unsecured loan repayable on demand *(Note)*	1,800	1,800
	112,682	101,613

Note: The loan to an associated company is interest-free.

The following is a list of the principal associated companies at 31 March 2004:

Company name	Place of incorporation/ establishment	Interest held indirectly 2004	Interest held indirectly 2003	Principal activities
Beijing CA — Legend Software Co., Ltd.*	Chinese mainland	20%	20%	Software development
Legend Kingsoft Holdings Limited	British Virgin Islands	30%	30%	Distribution and development of software
Techwise Circuits Company Limited	Hong Kong	30.5%	30.5%	Manufacturing and distribution of printed circuit boards

Notes:

(i) The associated companies operate principally in their respective places of incorporation or establishment, except for Legend Kingsoft Holdings Limited which operates principally in the PRC.

(ii) The company whose English name with a "*" is a direct transliteration of its Chinese registered name.

19. INVESTMENT SECURITIES

	Group 2004	Group 2003	Company 2004	Company 2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
Equity securities, at fair value				
Listed in Hong Kong	12,239	52,172	—	37,890
Listed outside Hong Kong	48,716	2,257	—	—
	60,955	54,429	—	37,890
Unlisted	15,027	19,220	—	—
	75,982	73,649	—	37,890

20. DEFERRED TAXATION

Deferred taxation is calculated in full on temporary differences under the liability method using the rates applicable in the respective jurisdictions.

The movement on the deferred assets/(liabilities) account is as follows:

	Group 2004	Group 2003
	HK$'000	*HK$'000*
At the beginning of the year	(330)	(330)
Deferred taxation credited to consolidated profit and loss account *(Note 7)*	35,048	—
At the end of the year	34,718	(330)

Deferred income tax assets are recognised for tax losses carry forward to the extent that realisation of the related tax benefit through the future taxable profits is probable. The Group has unrecognised tax losses of HK$140,356,107 (2003: HK$5,229,967) to carry forward against future taxable income. These tax losses will expire up to fiscal year 2008/09.

The movement in deferred tax assets and liabilities (prior to offsetting of balances within the same taxation jurisdiction) during the year is as follows:

Deferred tax assets

	Provisions		Tax depreciation allowance		Total	
	2004	2003	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
At the beginning of the year	—	—	—	—	—	—
Credited to consolidated profit and loss account	34,171	—	547	—	34,718	—
At the end of the year	34,171	—	547	—	34,718	—

Deferred tax liabilities

	Tax depreciation allowance		Total	
	2004	2003	2004	2003
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*
At the beginning of the year	330	330	330	330
Credited to consolidated profit and loss account	(330)	—	(330)	—
At the end of the year	—	330	—	330

The following amounts, determined after appropriate offsetting, are shown in the consolidated balance sheet:

	2004	2003
	HK$'000	*HK$'000*
Deferred tax assets	34,718	—
Deferred tax liabilities	—	(330)
	34,718	(330)

21. INVENTORIES

	Group	
	2004	**2003**
	HK$'000	*HK$'000*
Raw materials	896,177	873,090
Work-in-progress	13,369	26,975
Finished goods	483,472	368,986
	1,393,018	1,269,051

At 31 March 2004, the carrying amount of inventories that are carried at net realisable value amounted to HK$136,066,000 (2003: HK$79,785,000).

22. ACCOUNTS RECEIVABLE

(a) Trade receivables

At 31 March 2004, the ageing analysis of the trade receivables was as follows:

	Group	
	2004	**2003**
	HK$'000	*HK$'000*
0–30 days	944,212	490,851
31–60 days	84,481	27,213
61–90 days	20,862	10,680
Over 90 days	181,389	24,772
	1,230,944	553,516

Customers for trading business are generally granted credit terms of 30 days. Credit terms for customers of systems integration business normally range from 30 days to 180 days.

(b) Notes receivable are bills of exchange mainly with maturity dates of within six months.

23. CASH AND CASH EQUIVALENTS — GROUP

Included in the cash and cash equivalents of the Group are Renminbi cash and cash equivalents in the Chinese mainland of approximately HK$1,335,636,000 (2003: HK$802,124,000).

24. ACCOUNTS PAYABLE

(a) Trade payables

At 31 March 2004, the ageing analysis of the trade payables was as follows:

	Group	
	2004	**2003**
	HK$'000	*HK$'000*
0–30 days	1,791,869	1,339,852
31–60 days	210,993	149,535
61–90 days	27,554	20,870
Over 90 days	124,641	78,375
	2,155,057	1,588,632

(b) Notes payable are mainly repayable within three months.

25. LONG-TERM LIABILITIES

	Group 2004	2003
	HK$'000	*HK$'000*
Loan from a minority shareholder of a subsidiary *(Note (a))*	75,000	—
Amount payable for marketing right *(Note (b))*	507,000	—
Current portion payable within one year	(55,453)	—
	451,547	—
	526,547	—

Notes:

(a) The loan from a minority shareholder of a subsidiary is unsecured and not repayable within next 12 months. Included in the balance is an amount of HK$52,879,000 which is bearing interest at the rate of LIBOR + 1.5% per annum. The remaining balance of HK$22,121,000 is interest free.

(b) On 5 February 2004, the Group has entered into an agreement with the International Olympic Committee and the United States Olympic Committee regarding participation in The Olympic Partner Programme. Pursuant to which, the Group will pay a total amount of US$65,000,000 (equivalent to approximately HK$507,000,000) in cash and value in kind to obtain marketing rights which include the use of Olympic intellectual property rights and exclusive worldwide marketing opportunities in its products, technology and service categories from 1 January 2005 to 31 December 2008. The amount is payable in installments up to 10 November 2008.

26. SHARE CAPITAL

	2004		2003	
	Number of shares	*HK$'000*	*Number of shares*	*HK$'000*
Authorized:				
At the beginning and the end of the year	20,000,000,000	500,000	20,000,000,000	500,000
Issued and fully paid:				
At the beginning of the year	7,477,364,108	186,934	7,508,038,108	187,701
Exercise of share options *(Note 27)*	10,580,000	265	656,000	16
Repurchase of shares *(Note)*	(12,350,000)	(309)	(31,330,000)	(783)
At the end of the year	7,475,594,108	186,890	7,477,364,108	186,934

Note: During the year, the Company repurchased 12,350,000 shares of HK$0.025 each on the Stock Exchange of Hong Kong at an aggregate consideration of HK$28,394,000.

27. SHARE OPTIONS

Under the Company's employee share option scheme adopted on 18 January 1994 ("Old Option Scheme"), the Company granted options to employees (including directors) of the Company or its subsidiaries to subscribe for shares in the Company, subject to a maximum of 10% of the issued share capital of the Company from time to time. Options granted are exercisable at any time during a period of ten years from the date upon which the option is accepted. The subscription price of the option shares is the higher of the nominal value of the shares and an amount which is 80% of the average of the closing prices of the shares on the five trading days immediately preceding the date on which the offer is made. The Old Option Scheme was terminated on 26 April 2002. Despite the fact that no further options may be granted thereunder, all other provisions of the Old Option Scheme will remain in force to govern the exercise of all the options previously granted.

On 25 March 2002, an ordinary resolution approving the adoption of a new share option scheme ("New Option Scheme") was passed by shareholders at an extraordinary general meeting of the Company.

Under the New Option Scheme, the Company may grant options to qualified participants as defined in the Directors' Report to subscribe for shares in the Company, subject to a maximum of 10% of the issued share capital of the Company as at the date of adoption of the New Option Scheme. Options granted are exercisable at any time during a period of ten years from the date upon which the option is accepted. The subscription price of the option shares is the highest of the closing price of the shares on the date of grant; the average of the closing prices of the shares for the five trading days immediately preceding the date of grant; and the nominal value of the shares.

	2004	**2003**
	Number of shares	*Number of shares*
At the beginning of the year	345,142,000	292,992,000
Granted during the year *(Note (a))*	136,572,000	52,806,000
Exercised during the year *(Note (b))*	(10,580,000)	(656,000)
Lapsed during the year *(Note (c))*	(1,656,000)	—
At the end of the year *(Note (d))*	469,478,000	345,142,000

(a) Share options granted during the year:

Exercise period	**Exercise price**	**2004**	**2003**
	HK$	*Number of shares*	*Number of shares*
New Option Scheme			
10.10.2002 to 09.10.2012	2.435	—	52,806,000
26.04.2003 to 25.04.2013	2.245	136,572,000	—
		136,572,000	52,806,000

(b) Details of share options exercised during the year are as follows:

(i) Year 2004

Exercise date	**Exercise price**	**Market value per share at exercise date**	**Number of shares**	**Proceeds received**
	HK$	*HK$*		*HK$*
28.08.2003	2.876	3.08	20,000	57,520
10.09.2003 to 24.09.2003	2.876	3.15–3.43	1,676,000	4,820,176
02.10.2003 to 21.10.2003	2.876	3.05–3.80	342,000	983,592
03.11.2003 to 25.11.2003	2.876	3.13–3.18	520,000	1,495,520
01.12.2003 to 25.12.2003	2.876	3.15–3.40	2,666,000	7,667,416
02.01.2004 to 16.01.2004	2.876	3.40–3.70	1,640,000	4,716,640
19.02.2004 to 21.02.2004	2.876	3.35–3.43	66,000	189,816
23.07.2003 to 31.07.2003	2.245	2.88–3.05	46,000	103,270
11.08.2003 to 18.08.2003	2.245	3.00–3.23	46,000	103,270
23.09.2003	2.245	3.23	66,000	148,170
17.10.2003	2.245	3.45	110,000	246,950
08.12.2003 to 17.12.2003	2.245	3.18–3.40	122,000	273,890
08.01.2004	2.245	3.63	6,000	13,470
01.03.2004 to 09.03.2004	2.245	3.20–3.28	34,000	76,330
17.06.2003 to 25.06.2003	2.435	2.60–2.86	16,000	38,960
08.07.2003 to 31.07.2003	2.435	2.88–3.05	122,000	297,070
06.08.2003 to 23.08.2003	2.435	2.88–3.03	68,000	165,580
10.09.2003 to 24.09.2003	2.435	3.14–3.43	588,000	1,431,780
02.10.2003 to 24.10.2003	2.435	3.05–3.73	664,000	1,616,840
03.11.2003 to 24.11.2003	2.435	3.10–3.75	282,000	686,670
01.12.2003 to 26.12.2003	2.435	3.18–3.40	348,000	847,380
02.01.2004 to 15.01.2004	2.435	3.48–3.70	384,000	935,040
02.02.2004 to 24.02.2004	2.435	3.25–3.75	698,000	1,699,630
01.03.2004 to 09.03.2004	2.435	3.20–3.30	50,000	121,750
			10,580,000	28,736,730

(ii) Year 2003

Exercise date	**Exercise price**	**Market value per share at exercise date**	**Number of shares**	**Proceeds received**
02.04.2002	2.876	3.33	88,000	253,088
08.05.2002	2.876	3.35	270,000	776,520
10.06.2002	2.876	3.20	298,000	857,048
			656,000	1,886,656

(c) Details of share options lapsed during the year were as follows:

Exercise period	**Exercise price**	**2004**	**2003**
	HK$	*Number of shares*	*Number of shares*
New Option Scheme			
10.10.2002 to 09.10.2012	2.435	1,656,000	—

(d) Details of share options at the balance sheet date were as follows:

Exercise period	**Exercise price**	**2004**	**2003**
	HK$	*Number of shares*	*Number of shares*
Old Option Scheme			
28.01.2000 to 27.01.2010	4.038	7,712,000	7,712,000
15.01.2001 to 14.01.2011	4.312	127,162,000	127,162,000
16.04.2001 to 15.04.2011	4.072	35,550,000	35,550,000
29.08.2001 to 28.08.2011	2.904	832,000	832,000
31.08.2001 to 30.08.2011	2.876	114,150,000	121,080,000
		285,406,000	292,336,000
New Option Scheme			
10.10.2002 to 09.10.2012	2.435	47,930,000	52,806,000
26.04.2003 to 25.04.2013	2.245	136,142,000	—
		184,072,000	52,806,000

28. SHARE CAPITAL AND RESERVES

	Group							
	Share capital	Share premium	Surplus arising on consolidation	Exchange reserve	Investment revaluation reserve	Share redemption reserve	Accumulated losses	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
As at 1 April 2003	186,934	4,734,055	27,871	4,311	(14,496)	2,589	(752,743)	4,188,521
Surplus in fair market value of investment securities	—	—	—	—	20,144	—	—	20,144
Exchange differences	—	—	—	270	—	—	—	270
Reserves realized upon disposal of investment securities	—	—	—	—	(11,624)	—	—	(11,624)
Profit for the year	—	—	—	—	—	—	1,052,885	1,052,885
Exercise of share options	265	28,471	—	—	—	—	—	28,736
Repurchase of shares	(309)	—	—	—	—	309	(28,394)	(28,394)
Dividends paid	—	—	—	—	—	—	(761,814)	(761,814)
As at 31 March 2004	186,890	4,762,526	27,871	4,581	(5,976)	2,898	(490,066)	4,488,724
Representing:								
2004 final dividend proposed							224,268	
Others							(714,334)	
Accumulated losses as at 31 March 2004							(490,066)	
Company and subsidiaries	186,890	4,762,526	27,871	4,581	(5,976)	2,898	(549,378)	4,429,412
Jointly controlled entities	—	—	—	—	—	—	7,236	7,236
Associated companies	—	—	—	—	—	—	52,076	52,076
As at 31 March 2004	186,890	4,762,526	27,871	4,581	(5,976)	2,898	(490,066)	4,488,724

Group

	Share capital HK$'000	Share premium HK$'000	Surplus arising on consolidation HK$'000	Exchange reserve HK$'000	Investment revaluation reserve HK$'000	Share redemption reserve HK$'000	Accumulated losses HK$'000	Total HK$'000
As at 1 April 2002	187,701	4,732,184	27,893	4,155	13,515	1,806	(1,285,220)	3,682,034
Deficit in fair market value of investment securities	—	—	—	—	(20,891)	—	—	(20,891)
Exchange differences	—	—	—	156	—	—	—	156
Reserves realized upon disposal of investment securities	—	—	—	—	(7,120)	—	—	(7,120)
Goodwill written off arising from disposal of subsidiaries	—	—	(22)	—	—	—	—	(22)
Profit for the year	—	—	—	—	—	—	1,017,152	1,017,152
Exercise of share options	16	1,871	—	—	—	—	—	1,887
Repurchase of shares	(783)	—	—	—	—	783	(79,399)	(79,399)
Dividends paid	—	—	—	—	—	—	(405,276)	(405,276)
As at 31 March 2003	186,934	4,734,055	27,871	4,311	(14,496)	2,589	(752,743)	4,188,521
Representing:								
2003 final dividend proposed							224,040	
2003 special dividend proposed							388,337	
Others							(1,365,120)	
Accumulated losses as at 31 March 2003							(752,743)	
Company and subsidiaries	186,934	4,734,055	27,871	4,311	(14,496)	2,589	(719,921)	4,221,343
Jointly controlled entities	—	—	—	—	—	—	(27,704)	(27,704)
Associated companies	—	—	—	—	—	—	(5,118)	(5,118)
As at 31 March 2003	186,934	4,734,055	27,871	4,311	(14,496)	2,589	(752,743)	4,188,521

	Share capital	Share premium	Company Investment revaluation reserve	Share redemption reserve	Retained earnings	Total
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
As at 1 April 2003	186,934	4,734,055	(2,183)	2,589	1,474,240	6,395,635
Reserves realised upon disposal of investment securities	—	—	2,183	—	—	2,183
Profit for the year	—	—	—	—	1,001,070	1,001,070
Exercise of share options	265	28,471	—	—	—	28,736
Repurchase of shares	(309)	—	—	309	(28,394)	(28,394)
Dividends paid	—	—	—	—	(761,814)	(761,814)
As at 31 March 2004	186,890	4,762,526	—	2,898	1,685,102	6,637,416
Representing:						
2004 final dividend proposed					224,268	
Others					1,460,834	
Retained earnings as at 31 March 2004					1,685,102	
As at 1 April 2002	187,701	4,732,184	—	1,806	863,305	5,784,996
Deficit in fair market value of investment securities	—	—	(2,183)	—	—	(2,183)
Profit for the year	—	—	—	—	1,095,610	1,095,610
Exercise of share options	16	1,871	—	—	—	1,887
Repurchase of shares	(783)	—	—	783	(79,399)	(79,399)
Dividends paid	—	—	—	—	(405,276)	(405,276)
As at 31 March 2003	186,934	4,734,055	(2,183)	2,589	1,474,240	6,395,635
Representing:						
2003 final dividend proposed					224,040	
2003 special dividend proposed					388,337	
Others					861,863	
Retained earnings as at 31 March 2003					1,474,240	

29. RELATED PARTY TRANSACTIONS

Saved as disclosed elsewhere in this set of accounts, the Group had the following material related party transactions in the normal course of business during the year:

	Group	
	2004	**2003**
	HK$'000	*HK$'000*
Beijing Legend FM Science and Technology Company Limited (a subsidiary of the ultimate holding company):		
Account access fees	—	43,879
Digital China and its subsidiaries (associated companies of the ultimate holding company):		
Rental and management fee	740	2,163
Purchase of goods	27,992	5,414
Sales of goods	—	1,132
Leby Technology Company Limited (a jointly controlled entity):		
Purchase of computers products	178,907	134,262
Manufacturing fee	—	58,284
Sale of computer products	5,149	31,094
Lenovo (Beijing) Technology Co., Ltd. (a former jointly controlled entity):		
Technical consultancy fees	—	2,260
QDI Technology (Huizhou) Limited (a subsidiary of a former jointly controlled entity):		
Rental and management fee	3,126	8,239
Ramaxel Technology Limited (holding company of a minority shareholder of a subsidiary):		
Purchase of goods	180,541	—
Sale of goods	215,333	—
Right Lane Limited (a substantial shareholder):		
Rental and management fee	960	960
Shenzhen Legend Science Park Company Limited (a subsidiary of the ultimate holding company):		
Rental expenses	10,373	14,822
Shenzhen Zhiqin International Freight Forwarding Co., Ltd. (an associated company of the ultimate holding company)		
Logistic services fee	1,064	—
Techwise Circuits Company Limited and its subsidiaries (associated companies):		
Purchase of goods	34,800	51,232
Rental and management fee	10,836	21,903
Xiamen Overseas Chinese Electronics Co., Ltd. (a minority shareholder of a subsidiary):		
Rental expenses	1,144	1,144
Purchase of goods	701	32,368

The directors are of the opinion that the above transactions were conducted on normal commercial terms in the ordinary course of business.

30. BANKING FACILITIES

At 31 March 2004, total banking facilities granted to the Group amounted to approximately HK$3,783,000,000 which were secured by one or more of the following:

(a) Cross guarantees provided by certain subsidiaries; and

(b) Guarantees provided by the Company.

At 31 March 2004, the amount of facilities utilised by the Group amounted to approximately HK$1,139,000,000 (2003: HK$460,000,000).

31. COMMITMENTS

(a) Capital commitments

	Group	
	2004	**2003**
	HK$'000	*HK$'000*
Contracted but not provided for property, plant and equipment	58,911	120,156

(b) Commitments under operating leases

At 31 March 2004, the Group had future aggregate minimum lease payments in respect of land and buildings under non-cancelable operating leases as follows:

	Group	
	2004	**2003**
	HK$'000	*HK$'000*
Not later than one year	36,377	58,255
Later than one year but not later than five years	75,262	78,281
Later than five years	43,146	52,058
	154,785	188,594

(c) Other commitments

(i) On 17 December 2002, two subsidiaries of the Company, China Weal Technology Holding Limited ("CWT") and the shareholders of CWT entered into an agreement in which the Company's subsidiaries have committed to acquire certain business and assets from CWT and its subsidiaries (the "CWT Group"). The business and assets acquired were injected into a newly incorporated Chinese mainland subsidiary of the Company.

Pursuant to the agreement, the Group is required to pay an initial consideration of approximately HK$61,000,000 and an additional consideration which is dependent on, among other things, proper completion of certain recognisation procedures, and the operating results of the above-mentioned new subsidiary of the Company up to 31 March 2008. The maximum amount of additional consideration, if required, of approximately HK$156,000,000 will be settled in phases before 31 October 2008.

(ii) As at 31 March 2004, the Group had outstanding foreign currency forward contracts and options amounted to approximately HK$468,000,000 (2003: HK$46,000,000).

32. CONTINGENT LIABILITIES

(a) The Company has executed guarantees with respect to banking facilities made available to its subsidiaries. As at 31 March 2004, such facilities granted and utilised amounted to approximately HK$2,381,000,000 and HK$552,000,000 respectively (2003: HK$2,620,000,000 and HK$460,000,000).

(b) The Company has issued letters of guarantee to the suppliers and vendors of its subsidiaries. As at 31 March 2004, the guarantee granted and utilised amounted to approximately HK$1,031,160,000 and HK$626,000,000 respectively (2003: HK$941,460,000 and HK$570,000,000).

33. RECONCILIATION OF PROFIT BEFORE TAXATION TO NET CASH INFLOW FROM OPERATIONS

	2004 *HK$'000*	**2003** *HK$'000*
Profit before taxation	994,852	1,028,651
Share of profits of associated companies	(16,891)	(13,826)
Share of losses of jointly controlled entities	39,053	34,756
Finance income	(93,368)	(77,233)
Finance costs	2,881	20
Depreciation of tangible fixed assets	211,161	160,304
Amortization of intangible assets	34,999	15,246
Loss on disposal of tangible fixed assets	2,308	3,110
(Gains)/losses on disposal of investments	(47,558)	26,802
Operating profit before working capital changes	1,127,437	1,177,830
Increase in inventories	(117,942)	(411,997)
Decrease in amounts due from jointly controlled entities	—	194,132
Increase in trade receivables, notes receivable, deposits, prepayments and other receivables	(858,109)	(287,263)
Increase in trade payables, notes payable, accruals and other payables	597,607	477,373
Net cash inflow from operations	748,993	1,150,075

34. ANALYSIS OF CHANGES IN FINANCING

	2004			**2003**		
	Share capital (including premium) *HK$'000*	**Minority interests** *HK$'000*	**Loan from a minority shareholder of a subsidiary** *HK$'000*	**Share capital (including premium)** *HK$'000*	**Minority interests** *HK$'000*	**Loan from a minority shareholder of a subsidiary** *HK$'000*
Balance at the beginning of the year	4,920,989	59,741	—	4,919,885	7,050	—
Minority interests' share of losses	—	(37,883)	—	—	(14,519)	—
Increase in loan from a minority shareholder	—	—	75,000	—	—	—
Acquisition of subsidiaries	—	462	—	—	67,210	—
Issue of new shares	28,736	11,604	—	1,887	—	—
Consideration for the repurchase of shares	(28,394)	—	—	(79,399)	—	—
Repurchase of shares	28,085	—	—	78,616	—	—
Dividend paid to minority shareholders	—	(4,594)	—	—	—	—
Balance at the end of the year	4,949,416	29,330	75,000	4,920,989	59,741	—

35. ACQUISITION OF SUBSIDIARIES

	2004	2003
	HK$'000	*HK$'000*
Net assets acquired		
Tangible fixed assets	84,388	27,027
Inventories	6,025	1,535
Investments	—	3,649
Accounts and notes receivable	29,476	7,788
Deposits, prepayments and other receivables	1,517	25,730
Cash and cash equivalents	56,749	204,788
Accounts payable	(12,202)	(789)
Accruals and other payables	(19,884)	(20,538)
Minority interest	(462)	(67,210)
	145,607	181,980
Goodwill arising from acquisition	49,452	38,801
	195,059	220,781
Satisfied by:		
Cash and cash equivalents	51,300	199,941
Amount payable to a jointly controlled entity	108,471	20,840
Investment in a jointly controlled entity	35,288	—
	195,059	220,781

36. ANALYSIS OF THE NET INFLOW OF CASH AND CASH EQUIVALENTS IN RESPECT OF THE ACQUISITION OF SUBSIDIARIES

	2004	2003
	HK$'000	*HK$'000*
Cash consideration	(51,300)	(199,941)
Cash and cash equivalents acquired	56,749	204,788
Net inflow of cash and cash equivalents in respect of acquisition of subsidiaries	5,449	4,847

37. ULTIMATE HOLDING COMPANY

The directors regard Legend Holdings Limited, a company established in the Chinese mainland, as being the ultimate holding company.

38. APPROVAL OF ACCOUNTS

The accounts were approved by the board of directors on 2 June 2004.

UNAUDITED FINANCIAL STATEMENTS OF THE LENOVO GROUP FOR THE SIX MONTHS ENDED 30 SEPTEMBER 2004

Consolidated profit and loss account

	Notes	3 months ended 30 September 2004 (unaudited) HK$'000	6 months ended 30 September 2004 (unaudited) HK$'000	3 months ended 30 September 2003 (unaudited) HK$'000	6 months ended 30 September 2003 (unaudited) HK$'000
Turnover	3	5,654,798	11,532,708	6,247,401	11,589,140
Earnings before interest, taxation, depreciation and amortization expenses		255,662	608,114	294,842	602,170
Depreciation expenses		(50,463)	(101,888)	(49,139)	(97,336)
Amortization of intangible assets		(7,461)	(15,891)	(8,441)	(15,234)
Impairment of assets		(20,363)	(51,364)	—	—
Gains on disposal of investments		110,294	164,382	6,002	6,002
Finance income		20,895	41,646	19,004	40,049
Profit from operations	4	308,564	644,999	262,268	535,651
Finance costs		(2,776)	(3,500)	—	—
		305,788	641,499	262,268	535,651
Share of losses of jointly controlled entities		(6,090)	(10,110)	(4,910)	(13,539)
Share of (losses)/profits of associated companies		(2,051)	(246)	270	5,379
Profit before taxation		297,647	631,143	257,628	527,491
Taxation	5	(13,593)	(24,905)	(2,079)	1,326
Profit after taxation		284,054	606,238	255,549	528,817
Minority interests		5,992	20,633	5,613	10,601
Profit attributable to shareholders		290,046	626,871	261,162	539,418
Dividend	6	N/A	179,357	N/A	149,436
Earnings per share — basic	7	3.89 HK cents	8.39 HK cents	3.49 HK cents	7.22 HK cents
Earnings per share — fully diluted	7	3.88 HK cents	8.38 HK cents	3.47 HK cents	7.19 HK cents

Consolidated balance sheet

	Notes	As at 30 September 2004 (unaudited) HK$'000	As at 31 March 2004 (audited) HK$'000
Non-current assets			
Intangible assets		552,487	646,986
Tangible fixed assets		867,707	987,272
Construction-in-progress		290,607	260,377
Investments in jointly controlled entities		193,466	124,124
Investments in associated companies		50,891	112,682
Investment securities		28,283	75,982
Deferred tax assets		34,780	34,718
		2,018,221	2,242,141
Current assets			
Inventories		905,195	1,393,018
Trade receivables	8	1,714,639	1,230,944
Notes receivable		646,442	520,321
Deposits, prepayments and other receivables		751,331	301,513
Tax recoverable		—	4,033
Cash and cash equivalents		3,126,389	2,650,071
		7,143,996	6,099,900
Current liabilities			
Trade payables	8	2,479,248	2,155,057
Notes payable		317,475	356,531
Accruals and other payables		688,153	616,897
Amounts due to jointly controlled entities		107,199	108,471
Tax payable		17,341	5,031
Short-term bank loan		125,000	—
Current portion of long-term liabilities		115,659	55,453
		3,850,075	3,297,440
Net current assets		3,293,921	2,802,460
Total assets less current liabilities		5,312,142	5,044,601
Financed by:			
Share capital		186,830	186,890
Reserves		4,703,171	4,301,834
Shareholders' funds		4,890,001	4,488,724
Minority interests		30,800	29,330
Long-term liabilities		391,341	526,547
		5,312,142	5,044,601

Condensed consolidated cash flow statement

	6 months ended 30 September 2004 (unaudited)	6 months ended 30 September 2003 (unaudited)
	HK$'000	*HK$'000*
Net cash inflow from operating activities	598,326	110,401
Net cash outflow from investing activities	(18,532)	(174,014)
Net cash outflow from financing activities	(103,601)	(631,736)
Increase/(decrease) in cash and cash equivalents	476,193	(695,349)
Effect of foreign exchange rate changes	125	(4)
Cash and cash equivalents at the beginning of the period	2,650,071	2,808,323
Cash and cash equivalents at the end of the period	3,126,389	2,112,970

Consolidated statement of changes in equity

	Share capital (unaudited) HK$'000	Share premium (unaudited) HK$'000	Surplus arising on consolidation (unaudited) HK$'000	Exchange reserve (unaudited) HK$'000	Investment revaluation reserve (unaudited) HK$'000	Share redemption reserve (unaudited) HK$'000	Accumulated losses (unaudited) HK$'000	Total (unaudited) HK$'000
Balance as at 1 April 2004	186,890	4,762,526	27,871	4,581	(5,976)	2,898	(490,066)	4,488,724
Deficit in fair market value of investment securities	—	—	—	—	(1,322)	—	—	(1,322)
Exchange differences	—	—	—	13	—	—	—	13
Net gains and losses not recognized in the consolidated profit and loss account	—	—	—	13	(1,322)	—	—	(1,309)
Profit for the period	—	—	—	—	—	—	626,871	626,871
Reserves written off on disposal of subsidiaries	—	—	—	(2,377)	—	—	—	(2,377)
Reserves realized on disposal of investment securities	—	—	—	—	(12,908)	—	—	(12,908)
Impairment of investments	—	—	—	—	19,601	—	—	19,601
Exercise of share options	128	11,556	—	—	—	—	—	11,684
Repurchase of shares	(188)	(16,093)	—	—	—	188	—	(16,093)
Dividend paid	—	—	—	—	—	—	(224,192)	(224,192)
As at 30 September 2004	186,830	4,757,989	27,871	2,217	(605)	3,086	(87,387)	4,890,001
Balance as at 1 April 2003	186,934	4,734,055	27,871	4,311	(14,496)	2,589	(752,743)	4,188,521
Surplus in fair market value of investment securities	—	—	—	—	13,707	—	—	13,707
Exchange differences	—	—	—	(4)	—	—	—	(4)
Net gains and losses not recognized in the consolidated profit and loss account	—	—	—	(4)	13,707	—	—	13,703
Profit for the period	—	—	—	—	—	—	539,418	539,418
Reserves realized on disposal of investment securities	—	—	—	—	(341)	—	—	(341)
Exercise of share options	8	758	—	—	—	—	—	766
Repurchase of shares	(234)	—	—	—	—	234	(20,124)	(20,124)
Dividend paid	—	—	—	—	—	—	(612,378)	(612,378)
As at 30 September 2003	186,708	4,734,813	27,871	4,307	(1,130)	2,823	(845,827)	4,109,565

Notes:

1. BASIS OF PREPARATION

The Board is responsible for the preparation of the Group's unaudited interim financials. These unaudited interim financials have been prepared in accordance with Statement of Standard Accounting Practice No. 25 "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants. These condensed accounts should be read in conjunction with the audited accounts for the year ended 31 March 2004.

2. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies and methods of calculations used in the preparation of these unaudited interim financials are consistent with those used in the annual accounts for the year ended 31 March 2004.

3. TURNOVER, REVENUE AND SEGMENT INFORMATION

3A. Primary reporting format — business segments

(i) For the six months ended 30 September 2004:

	Corporate IT business (unaudited) *HK$'000*	Consumer IT business (unaudited) *HK$'000*	Handheld device business (unaudited) *HK$'000*	Other business (unaudited) *HK$'000*	Total (unaudited) *HK$'000*
Profit and loss account					
Turnover	6,228,287	3,818,778	1,191,327	294,316	11,532,708
Segment operating results	313,188	239,969	1,363	(53,031)	501,489
Amortization of goodwill					(11,154)
Impairment of assets					(51,364)
Gains on disposal of investments					164,382
Finance income					41,646
Finance costs					(3,500)
Contribution to operating profit					641,499
Share of losses of jointly controlled entities					(10,110)
Share of losses of associated companies					(246)
Profit before taxation					631,143
Taxation					(24,905)
Profit after taxation					606,238
Minority interests					20,633
Profit attributable to shareholders					626,871

(ii) For the six months ended 30 September 2003:

	Corporate IT business (unaudited) *HK$'000*	Consumer IT business (unaudited) *HK$'000*	Handheld device business (unaudited) *HK$'000*	Other business (unaudited) *HK$'000*	Total (unaudited) *HK$'000*
Profit and loss account					
Turnover	5,855,356	4,138,201	908,359	687,224	11,589,140
Segment operating results	369,775	237,716	(43,527)	(63,375)	500,589
Amortization of goodwill					(10,989)
Gains on disposal of investments					6,002
Finance income					40,049
Finance costs					—
Contribution to operating profit					535,651
Share of losses of jointly controlled entities					(13,539)
Share of profits of associated companies					5,379
Profit before taxation					527,491
Taxation					1,326
Profit after taxation					528,817
Minority interests					10,601
Profit attributable to shareholders					539,418

3B. Secondary reporting format — geographical segments

As over 90% of the Group's business operations are located in the People's Republic of China, no geographical segment analysis is presented.

4. PROFIT FROM OPERATIONS

		3 months ended 30 September 2004 (unaudited) *HK$'000*	6 months ended 30 September 2004 (unaudited) *HK$'000*	3 months ended 30 September 2003 (unaudited) *HK$'000*	6 months ended 30 September 2003 (unaudited) *HK$'000*
(a)	Turnover	5,654,798	11,532,708	6,247,401	11,589,140
	Cost of sales	(4,874,050)	(9,828,870)	(5,357,790)	(9,864,801)
	Gross profit	780,748	1,703,838	889,611	1,724,339
	Finance income	20,895	41,646	19,004	40,049
	Gains on disposal of investments	110,294	164,382	6,002	6,002
	Impairment of assets	(20,363)	(51,364)	—	—
	Distribution expenses	(399,509)	(818,412)	(446,224)	(832,162)
	Administrative expenses	(75,673)	(170,616)	(88,894)	(181,192)
	Other operating expenses	(100,367)	(208,584)	(108,790)	(206,151)
	Amortization of intangible assets	(7,461)	(15,891)	(8,441)	(15,234)
	Total operating expenses *(see (b))*	(583,010)	(1,213,503)	(652,349)	(1,234,739)
	Profit from operations	308,564	644,999	262,268	535,651
(b)	Analysis of operating expenses by nature:				
	Selling expenses	(129,472)	(285,794)	(147,902)	(291,952)
	Promotional and advertising expenses	(98,193)	(184,141)	(105,109)	(189,345)
	Staff costs	(200,753)	(434,349)	(234,473)	(458,496)
	Other expenses	(147,131)	(293,328)	(156,424)	(279,712)
	Amortization of intangible assets	(7,461)	(15,891)	(8,441)	(15,234)
	Total operating expenses	(583,010)	(1,213,503)	(652,349)	(1,234,739)

5. TAXATION

	3 months ended 30 September 2004 (unaudited) *HK$'000*	6 months ended 30 September 2004 (unaudited) *HK$'000*	3 months ended 30 September 2003 (unaudited) *HK$'000*	6 months ended 30 September 2003 (unaudited) *HK$'000*
Taxation outside Hong Kong	13,154	24,834	5,470	11,554
Deferred taxation	454	(62)	(3,377)	(13,097)
	13,608	24,772	2,093	(1,543)
Share of taxation attributable to:				
jointly controlled entities	(15)	11	—	84
associated companies	—	122	(14)	133
	13,593	24,905	2,079	(1,326)

6. DIVIDEND

	6 months ended 30 September 2004 (unaudited) *HK$'000*	6 months ended 30 September 2003 (unaudited) *HK$'000*
Interim dividend, declared after period end, of 2.4 HK cents (2003/04: 2.0 HK cents) per share	179,357	149,436

7. EARNINGS PER SHARE

The calculation of basic and diluted earnings per share is based on the following data:

	6 months ended 30 September 2004 (unaudited)	6 months ended 30 September 2003 (unaudited)
Earnings for the purposes of basic and diluted earnings per share (HK$'000)	626,871	539,418
Weighted average number of shares for the purposes of basic earnings per share	7,476,022,359	7,469,327,977
Effect of potential dilutive shares	6,162,854	30,914,415
Weighted average number of shares for the purposes of diluted earnings per share	7,482,185,213	7,500,242,392

8. AGEING ANALYSIS

Ageing analysis of trade receivables as at 30 September 2004 is as follow:

	As at 30 September 2004 (unaudited) *HK$'000*	As at 30 June 2004 (unaudited) *HK$'000*	As at 31 March 2004 (audited) *HK$'000*
0–30 days	1,411,565	1,233,249	944,212
31–60 days	176,109	77,050	84,481
61–90 days	12,082	19,358	20,862
Over 90 days	114,883	166,584	181,389
	1,714,639	1,496,241	1,230,944

Customers are generally granted credit terms of 30 days. Credit terms for customers of systems integration business normally range from 30 days to 180 days.

8. AGEING ANALYSIS (CONTINUED)

Ageing analysis of trade payables as at 30 September 2004 is as follow:

	As at 30 September 2004 (unaudited) *HK$'000*	As at 30 June 2004 (unaudited) *HK$'000*	As at 31 March 2004 (audited) *HK$'000*
0–30 days	1,991,482	1,567,468	1,791,869
31–60 days	355,502	335,793	210,993
61–90 days	42,177	69,766	27,554
Over 90 days	90,087	130,210	124,641
	2,479,248	2,103,237	2,155,057

9. CONDENSED BALANCE SHEET OF THE COMPANY

	As at 30 September 2004 (unaudited) *HK$'000*	As at 31 March 2004 (audited) *HK$'000*
Tangible fixed assets	24,505	32,115
Investments	2,334,365	2,327,875
Current assets	4,175,612	4,408,126
Current liabilities	124,438	130,700
Net current assets	4,051,174	4,277,426
Total assets less current liabilities	6,410,044	6,637,416
Share capital	186,830	186,890
Retained earnings	1,462,941	1,685,102
Reserves	4,760,273	4,765,424
	6,410,044	6,637,416

The following unaudited pro forma financial information on the Enlarged Group is prepared by the Directors of the Company.

(A) UNAUDITED PRO FORMA CONSOLIDATED BALANCE SHEET OF THE ENLARGED GROUP

Set out below is an illustrative and unaudited pro forma consolidated balance sheet of the Enlarged Group as at 30 September 2004 which has been prepared for the purpose of illustration as if the Closings had taken place on 30 September 2004.

The unaudited pro forma consolidated balance sheet is based on the unaudited consolidated balance sheet of the Group as at 30 September 2004, and the audited combined statement of financial position of PCD as at 30 June 2004 as extracted from Appendix I to this circular, after making pro forma adjustments that are necessary.

The unaudited pro forma consolidated balance sheet has been prepared to provide the unaudited pro forma financial information on the Enlarged Group as a result of the Closings. As it has been prepared for illustrative purpose only and because of its nature, it may not give a true picture of the financial position of the Enlarged Group as at 30 September 2004 and at any future date.

	The Business as at 30 June 2004 under US GAAP	Pro forma adjustments — excluded assets and liabilities	The Business as at 30 June 2004 under US GAAP and after pro forma adjustments — excluded assets and liabilities	Pro forma adjustment — pension obligation	The Business as at 30 June 2004 under US GAAP after pro forma adjustments	GAAP adjustments	The Business as at 30 June 2004 under HK GAAP after pro forma adjustments	The Business as at 30 June 2004 under HK GAAP after pro forma adjustments	Lenovo Group as at 30 September 2004 (unaudited)	Pro forma consolidation adjustments	Note	Pro forma Enlarged Group
	US$'m (Note 1)	US$'m (Note 2)	US$'m	US$'m (Note 3)	US$'m	US$'m (Note 4)	US$'m	HK$'m (Note 5)	HK$'m	HK$'m (Note 6)	Note	HK$'m
Non-current assets												
Intangible assets	19	(19)	—	—	—	—	—	—	552	14,866	7(iii) &(vii)	15,418
Tangible fixed assets	308	(241)	67	—	67	—	67	523	868	195	7(iv)	1,586
Construction-in-progress	—	—	—	—	—	—	—	—	290	—		290
Investment in a jointly controlled entity	—	—	—	—	—	—	—	—	193	—		193
Investments in associated companies	—	—	—	—	—	—	—	—	51	—		51
Investment securities	—	—	—	—	—	—	—	—	28	—		28
Deferred tax assets	32	(32)	—	—	—	—	—	—	35	—		35
Other non-current assets	9	(8)	1	—	1	(1)	—	—	—	—		—
	368	(300)	68	—	68	(1)	67	523	2,017	15,061		17,601
Current assets												
Inventories	279	(12)	267	—	267	—	267	2,082	905	—		2,987
Trade receivables	398	114	512	—	512	—	512	3,994	1,715	—		5,709
Notes receivable	—	—	—	—	—	—	—	—	646	—		646
Deposits, prepayments and other receivables	192	(104)	88	39	127	—	127	991	751	—		1,742
Cash and cash equivalents	297	(297)	—	—	—	—	—	—	3,126	(1,170)	7(vi)	1,956
	1,166	(299)	867	39	906	—	906	7,067	7,143	(1,170)		13,040
Current liabilities												
Amounts due to jointly controlled entities	—	—	—	—	—	—	—	—	107	—		107
Trade payables	1,441	(52)	1,389	—	1,389	—	1,389	10,834	2,479	—		13,313
Notes payable	—	—	—	—	—	—	—	—	317	—		317
Accruals and other payables	442	(217)	225	—	225	—	225	1,755	688	—		2,443
Tax payable	21	(21)	—	—	—	—	—	—	17	—		17
Short-term bank loan	—	—	—	—	—	—	—	—	125	—		125
Current portion of other long-term liabilities	289	(289)	—	—	—	—	—	—	115	—		115
	2,193	(579)	1,614	—	1,614	—	1,614	12,589	3,848	—		16,437
Net current assets/(liabilities)	(1,027)	280	(747)	39	(708)	—	(708)	(5,522)	3,295	(1,170)		(3,397)
Total assets less current liabilities	(659)	(20)	(679)	39	(640)	(1)	(641)	(4,999)	5,312	13,891		14,204
Non-current liabilities												
Long-term bank loan	—	—	—	—	—	—	—	—	—	3,900	7(v)	3,900
Other long-term liabilities	239	(238)	1	39	40	—	40	312	391	—		703
Minority interests	77	(77)	—	—	—	—	—	—	31	—		31
Net assets/(liabilities)	(975)	295	(680)	—	(680)	(1)	(681)	(5,311)	4,890	9,991		9,570
Financed by/(represented by)												
Share capital	—	—	—	—	—	—	—	—	187	44	7(i)	231
Reserves	—	—	—	—	—	—	—	—	4,703	4,636	7(i)	9,339
IBM's net investment	(973)	295	(678)	—	(678)	—	(678)	(5,288)	—	5,288	7(ii)	—
Accumulated other comprehensive loss	(2)	—	(2)	—	(2)	(1)	(3)	(23)	—	23	7(ii)	—
	(975)	295	(680)	—	(680)	(1)	(681)	(5,311)	4,890	9,991		9,570

Notes to unaudited pro forma consolidated balance sheet

1. The balances are extracted from the Audited US Combined Financial Statements of PCD as set out in Appendix I and have been reclassified to conform with the presentation format of the Group.

2. The pro forma adjustments relate to certain assets and liabilities included in the audited combined statement of financial position of PCD as at 30 June 2004 as per Appendix I and are not to be acquired or assumed by the Group pursuant to the Asset Purchase Agreement ("APA"). For the purpose of this unaudited pro forma financial information, the amounts of these excluded assets and liabilities are in accordance with terms of the APA and are based on the financial position as at 30 June 2004.

   The final amount of these adjustments will be determined on the Closings which may be different from the amounts disclosed in this Appendix.

3. In addition to the excluded assets and liabilities set out in the APA, pursuant to the Employee Matters Agreement which forms part of the APA, the Company agreed to take up pension obligations in respect of the employees of the Business in certain countries and in return receiving a compensation of the same amount from IBM. The adjustment relates to such additional pension obligations and account receivable as at 30 June 2004. The pension obligation is estimated by management of the Company based on actuarial valuation as at 30 June 2004 carried out by an independent actuary. These balances were not ascertained at the date of signing of the APA and hence not taken into account in arriving at the figures in the announcement. The final amount of this adjustment will be determined on the Closings which may be different from the amounts disclosed in this Appendix.

4. Adjustments are made to restate the combined financial statements of the Business under US GAAP, to accounting policies adopted by the Group, which follow Hong Kong GAAP, after taking into account of the effect of pro forma adjustments. Details of the relevant adjustments are set out in Note (iv) of Section A headed "Unaudited Combined Financial Information under Hong Kong GAAP" in Appendix II to this circular.

5. For the purpose of the pro forma consolidated balance sheet, the balances stated in US dollar have been translated into Hong Kong dollar at an exchange rate of US$1 = HK$7.8.

6. Under Hong Kong GAAP, the Group will apply the purchase method to account for the acquisition of the Business pursuant to the APA in the consolidated accounts of the Enlarged Group. In applying the purchase method, the identifiable assets and liabilities of the Business will be recorded on the balance sheet of the Enlarged Group at their fair values at the date of the Closings, and IBM's interests in the Business upon the Closings will be eliminated as the pre-acquisition reserves of the Enlarged Group. Any goodwill or negative goodwill arising on the acquisition will be determined as the excess or deficit of the purchase consideration deemed to be incurred by the Group over the Group's interests in the net fair value of the identifiable assets and liabilities of the Business at the date of the Closings.

   For the purpose of preparing the unaudited pro forma consolidated balance sheet of the Enlarged Group after the Closings, the net fair value of the identifiable assets and liabilities of the Business as at 30 June 2004 and the fair value of the Consideration Shares based on the closing market price of the Company's Shares as at 3 December 2004 are applied in the calculation of the estimated goodwill arising from the acquisition. Since the fair values of the assets and liabilities of the Business and of the Consideration Shares at the date of the acquisition may be substantially different from their fair values used in the preparation of the unaudited pro forma consolidated balance sheet presented above, the actual goodwill arising from the acquisition of the Business may be different from the estimated goodwill shown in this Appendix.

7. The pro forma consolidation adjustments reflect the following:

   (i) issuance of the Consideration Shares, valued at HK$4,680 million on 3 December 2004, by the Company as part of the acquisition consideration;

   (ii) the elimination of IBM's interests in the Business as at the date of acquisition on consolidation;

(iii) recognition of intangible assets based on the fair value as at 30 June 2004;

(iv) fair value adjustments on tangible fixed assets of the Business as at 30 June 2004;

(v) a term loan ("Term Loan") of US$500 million (or HK$3,900 million) raised for financing the acquisition consideration, which is being negotiated by the Company with an international financial institution and bears interest at 1%–1.2% over LIBOR or swap rate per annum;

(vi) payment of cash and cash equivalents on hand of the Group as part of the acquisition consideration; and

(vii) goodwill arising from the acquisition of the Business.

(B) UNAUDITED PRO FORMA CONSOLIDATED PROFIT AND LOSS ACCOUNTS OF THE ENLARGED GROUP

Set out below are illustrative and unaudited pro forma consolidated profit and loss accounts of the Enlarged Group for the year ended 31 March 2004 and for the six months ended 30 September 2004 which have been prepared for the purpose of illustration as if the Closings had taken place on 1 April 2003.

The unaudited pro forma consolidated profit and loss accounts are based on the audited consolidated profit and loss account of the Group for the year ended 31 March 2004 and the unaudited consolidated profit and loss account of the Group for the six months ended 30 September 2004 respectively, and the audited combined statement of operations of PCD for the year ended 31 December 2003 and for the six months ended 30 June 2004 as extracted from the Appendix I to this circular, after making pro forma adjustments that are necessary.

The unaudited pro forma consolidated profit and loss accounts have been prepared to provide the unaudited pro forma financial information on the Enlarged Group as a result of the Closings. As they have been prepared for illustrative purpose only and because of their nature, they may not give a true picture of the results of the Enlarged Group for the year ended 31 March 2004 and six months ended 30 September 2004 and any future financial periods.

	The Business for the six months ended 30 June 2004 under US GAAP	Pro forma adjustments	The Business for the six months ended 30 June 2004 under US GAAP after pro forma adjustments	GAAP adjustments	The Business for the six months ended 30 June 2004 under HK GAAP after pro forma adjustments	The Business for the six months ended 30 June 2004 under HK GAAP after pro forma adjustments	Lenovo Group for the six months ended 30 September 2004	Pro forma consolidation adjustments	Note	Pro forma Enlarged Group for the six months ended 30 September 2004
	US$'m	*US$'m*	*US$'m*	*US$'m*	*US$'m*	*HK$'m*	*HK$'m*	*HK$'m*	*Note*	*HK$'m*
	(Note 1)	*(Note 2)*		*(Note 3)*		*(Note 4)*				
Turnover	5,217	—	5,217	—	5,217	40,693	11,533	—		52,226
Earnings before interest, taxation, depreciation and amortization expenses	(16)	—	(16)	3	(13)	(101)	608	—		507
Depreciation expenses	(28)	10	(18)	—	(18)	(140)	(102)	(20)	5(i)	(262)
Amortization of intangible assets	—	—	—	—	—	—	(16)	—		(16)
Amortization of intangible assets arising from the acquisition	—	—	—	—	—	—	—	(148)	5(ii)	(148)
Amortization of goodwill arising from the acquisition	—	—	—	—	—	—	—	(315)	5(iii)	(315)
Impairment of assets	—	—	—	—	—	—	(51)	—		(51)
Gain on disposal of investments	—	—	—	—	—	—	164	—		164
Finance income	—	—	—	—	—	—	42	—		42
(Loss)/Profit from operations	(44)	10	(34)	3	(31)	(241)	645	(483)		(79)
Finance costs	—	—	—	—	—	—	(4)	(93)	5(iv)	(97)
Share of losses of jointly controlled entities	—	—	—	—	—	—	(10)	—		(10)
(Loss)/Profit before taxation	(44)	10	(34)	3	(31)	(241)	631	(576)		(186)
Taxation	(74)	—	(74)	—	(74)	(577)	(25)	67		(535)
(Loss)/Profit after taxation	(118)	10	(108)	3	(105)	(818)	606	(509)		(721)
Minority interests	(21)	—	(21)	—	(21)	(164)	21	—		(143)
(Loss)/Profit attributable to shareholders	(139)	10	(129)	3	(126)	(982)	627	(509)		(864)

	The Business for the year ended 31 December 2003 under US GAAP *US$'m* *(Note 1)*	Pro forma adjustments *US$'m* *(Note 2)*	The Business for the year ended 31 December 2003 under US GAAP after pro forma adjustments *US$'m*	GAAP adjustments *US$'m* *(Note 3)*	The Business for the year ended 31 December 2003 under HK GAAP after pro forma adjustments *US$'m*	The Business for the year ended 31 December 2003 under HK GAAP after pro forma adjustments *HK$'m* *(Note 4)*	Lenovo Group for the year ended 31 March 2004 *HK$'m*	Pro forma consolidation adjustments *HK$'m*	*Note*	Pro forma Enlarged Group for the year ended 31 March 2004 *HK$'m*
Turnover	9,566	—	9,566	—	9,566	74,615	23,176	—		97,791
Earnings before interest, taxation, depreciation and amortization expenses	(56)	—	(56)	3	(53)	(413)	1,125	—		712
Depreciation expenses	(61)	22	(39)	—	(39)	(304)	(211)	(39)	5(i)	(554)
Amortization of intangible assets	—	—	—	—	—	—	(35)	—		(35)
Amortization of intangible assets arising from the acquisition	—	—	—	—	—	—	—	(296)	5(ii)	(296)
Amortization of goodwill arising from the acquisition	—	—	—	—	—	—	—	(630)	5(iii)	(630)
Gain on disposal of investments	—	—	—	—	—	—	48	—		48
Finance income	—	—	—	—	—	—	93	—		93
(Loss)/Profit from operations	(117)	22	(95)	3	(92)	(717)	1,020	(965)		(662)
Finance costs	—	—	—	—	—	—	(3)	(186)	5(iv)	(189)
Share of losses of jointly controlled entities	—	—	—	—	—	—	(39)	—		(39)
Share of profits of associated companies	—	—	—	—	—	—	17	—		17
(Loss)/Profit before taxation	(117)	22	(95)	3	(92)	(717)	995	(1,151)		(873)
Taxation	(115)	—	(115)	—	(115)	(897)	20	133		(744)
(Loss)/Profit after taxation	(232)	22	(210)	3	(207)	(1,614)	1,015	(1,018)		(1,617)
Minority interests	(26)	—	(26)	—	(26)	(203)	38	—		(165)
(Loss)/Profit attributable to shareholders	(258)	22	(236)	3	(233)	(1,817)	1,053	(1,018)		(1,782)

Notes to unaudited pro forma consolidated profit and loss accounts

1. The amounts are extracted from the Audited US Combined Financial Statements of PCD as set out in Appendix I to this circular and have been reclassified to conform with the presentation format of the Group.

2. The pro forma adjustments relate to depreciation expenses of certain property, plant and equipment included in the combined statement of financial position of the Business as per Appendix I, which are not to be acquired by the Group pursuant to the Asset Purchase Agreement ("APA"). In connection with such property, plant and equipment, the Group will enter into certain operating leasing agreements with IBM after the Closings to lease back the relevant property, plant and equipment with annual rental charges of approximately US$26 million (or HK$203 million) which is not reflected in the pro forma consolidated profit and loss accounts.

3. Adjustments are made to restate the combined financial statements of the Business under US GAAP to accounting policies adopted by the Group, which follow Hong Kong GAAP, after taking into account the effect of pro forma adjustments. Details of the relevant adjustments are set out in Note (i) of Section A headed "Unaudited Combined Financial Information under Hong Kong GAAP" in Appendix II to this circular.

4. For the purpose of the pro forma consolidated profit and loss accounts, the amounts stated in US dollar have been translated into Hong Kong dollar at an exchange rate of US$1 = HK$7.8.

5. The pro forma consolidation adjustments reflect the following:

   (i) additional depreciation arising from fair value adjustment of tangible fixed assets of the Business;

   (ii) amortization of intangible assets recognised in the acquisition of the Business;

   (iii) amortization of estimated goodwill arising from the acquisition in accordance with Hong Kong Statement of Standard Accounting Practice No. 30 "Business Combinations" ("HK SSAP 30") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). For illustrative purposes, the estimated goodwill of approximately HK$12,605 million is amortised over 20 years on a straight-line basis; and

(iv) interest expenses on the Term Loan, as detailed in Note 7(v) of Section A in this Appendix.

For the purpose of the unaudited pro forma financial information of the Enlarged Group, the accounting treatment in respect of goodwill is in accordance with HK SSAP 30. Hong Kong Financial Reporting Standard No. 3 "Business Combinations" ("HKFRS 3"), which is issued by HKICPA, will become effective for accounting period commencing 1 January 2005 and will supersede HK SSAP 30. The acquisition of the Business will be accounted for by the Group using HKFRS 3, instead of HK SSAP 30, for the year ending 31 March 2006. Under HKFRS 3, amortization of goodwill is prohibited, instead they are tested for impairment annually, or more frequently if events or changes in circumstances indicate a possible impairment. In addition, under HKFRS 3, certain new intangible assets in addition to the ones which are recognised under HK SSAP 30 will be identified and recognised.

(C) UNAUDITED PRO FORMA CONSOLIDATED CASH FLOW STATEMENTS OF THE ENLARGED GROUP

Set out below are illustrative and unaudited pro forma consolidated cash flow statements of the Enlarged Group for the year ended 31 March 2004 and for the six months ended 30 September 2004 which have been prepared for the purpose of illustration as if the Closings had taken place on 1 April 2003.

The unaudited pro forma consolidated cash flow statements are based on the audited consolidated cash flow statement of the Group for the year ended 31 March 2004 and the unaudited consolidated cash flow statement for the six months ended 30 September 2004, and the audited combined statement of cash flows of PCD for the year ended 31 December 2003 and for the six months ended 30 June 2004 as extracted from the Appendix I to this circular, after making pro forma adjustments that are necessary.

The unaudited pro forma consolidated cash flow statements have been prepared to provide the unaudited pro forma financial information on the Enlarged Group as a result of the Closings. As they have been prepared for illustrative purpose only and because of their nature, they may not give a true picture of the cash flows of the Enlarged Group for the year ended 31 March 2004 and six months ended 30 September 2004 and any future financial periods.

	The Business for the six months ended 30 June 2004 under US GAAP *US$'m* *(Note 1)*	Pro forma adjustments *US$'m* *(Note 2)*	The Business for the six months ended 30 June 2004 under US GAAP after pro forma adjustments *US$'m*	The Business for the six months ended 30 June 2004 under HK GAAP after pro forma adjustments *HK$'m* *(Note 3)*	Lenovo Group for the six months ended 30 September 2004 *HK$'m*	Pro forma consolidation adjustments *HK$'m*	*Note*	Pro forma Enlarged Group *HK$'m*
Operating activities								
Net cash inflow generated from operations	17	—	17	133	568	—		701
Finance income	—	—	—	—	42	—		42
Finance cost	—	—	—	—	(4)	—		(4)
Tax paid	(88)	—	(88)	(686)	(8)	—		(694)
Net cash inflow/(outflow) from operating activities	(71)	—	(71)	(553)	598	—		45
Investing activities								
Purchase of tangible fixed assets	(36)	—	(36)	(281)	(48)	—		(329)
Sale of tangible fixed assets	5	—	5	39	10	—		49
Payment for construction-in-progress	—	—	—	—	(62)	—		(62)
Purchase of investment securities	—	—	—	—	(81)	—		(81)
Sale of investment securities	—	—	—	—	137	—		137
Cash outflow in respect of deemed disposal of a subsidiary	—	—	—	—	(57)	—		(57)
Investment in associated companies	—	—	—	—	(6)	—		(6)
Repayment of advance from a jointly controlled entity	—	—	—	—	10	—		10
Proceeds from partial disposal of a subsidiary	—	—	—	—	10	—		10
Proceeds from disposal of an associate	—	—	—	—	64	—		64
Dividend received from an associated company	—	—	—	—	4	—		4
Net cash outflow from investing activities	(31)	—	(31)	(242)	(19)	—		(261)
Net cash inflow/(outflow) before financing	(102)	—	(102)	(795)	579	—		(216)
Financing activities								
Contribution from IBM	191	—	191	1,490	—	—		1,490
Loan from banks	—	—	—	—	125	—		125
Exercise of share options and issue of new shares	—	—	—	—	11	—		11
Repurchase of shares	—	—	—	—	(16)	—		(16)
Dividends paid	—	—	—	—	(224)	—		(224)
Dividends paid to minority shareholders	(4)	—	(4)	(31)	—	—		(31)
Interest expenses on Term Loan	—	—	—	—	—	(93)	4(iii)	(93)
Net cash inflow/(outflow) from financing	187	—	187	1,459	(104)	(93)		1,262
Increase/(decrease) in cash and cash equivalents	85	—	85	664	475	(93)		1,046
Cash and cash equivalents at the beginning of the period	211	(199)	12	93	2,650	(1,356)		1,387
Effect of foreign exchange rate changes	1	—	1	8	—	—		8
Cash and cash equivalents at the end of the period	297	(199)	98	765	3,125	(1,449)		2,441

	The Business for the year ended 31 December 2003 under US GAAP US$'m (Note 1)	Pro forma adjustments US$'m (Note 2)	The Business for the year ended 31 December 2003 under US GAAP after pro forma adjustments US$'m	The Business for the year ended 31 December 2003 under HK GAAP after pro forma adjustments HK$'m (Note 3)	Lenovo Group for the year ended 31 March 2004 HK$'m	Pro forma consolidation adjustments HK$'m	Note	Pro forma Enlarged Group HK$'m
Operating activities								
Net cash inflow generated from operations	266	—	266	2,075	749	—		2,824
Finance income	3	—	3	23	94	—		117
Finance cost	—	—	—	—	(3)	—		(3)
Tax paid	(98)	—	(98)	(764)	(22)	—		(786)
Net cash inflow from operating activities	171	—	171	1,334	818	—		2,152
Investing activities								
Purchase of tangible fixed assets	(97)	—	(97)	(757)	(96)	—		(853)
Sale of tangible fixed assets	73	—	73	569	8	—		577
Payment for construction-in-progress	—	—	—	—	(268)	—		(268)
Payment for patent acquired	—	—	—	—	(5)	—		(5)
Purchase of investment securities	—	—	—	—	(44)	—		(44)
Sale of investment securities	—	—	—	—	80	—		80
Sale of other investments	2	—	2	16	—	—		16
Net cash inflow in respect of acquisition of subsidiaries	—	—	—	—	5	—		5
Proceeds from partial disposal of a subsidiary	—	—	—	—	12	—		12
Cash consideration for acquisition of the business	—	—	—	—	—	(5,070)	4(i)	(5,070)
Proceeds from disposal of an associated company	—	—	—	—	6	—		6
Dividend received from associated companies	—	—	—	—	5	—		5
Net cash outflow from investing activities	(22)	—	(22)	(172)	(297)	(5,070)		(5,539)
Net cash inflow/(outflow) before financing	149	—	149	1,162	521	(5,070)		(3,387)
Financing activities								
Repayment to IBM	(106)	(199)	(305)	(2,379)	—	—		(2,379)
Exercise of share options and issue of new shares	—	—	—	—	29	—		29
Repurchase of shares	—	—	—	—	(29)	—		(29)
Capital injection from minority shareholders	—	—	—	—	12	—		12
Dividends paid	—	—	—	—	(762)	—		(762)
Dividends paid to minority shareholders	(31)	—	(31)	(242)	(4)	—		(246)
Loan from a shareholder of a subsidiary	—	—	—	—	75	—		75
New Term Loan	—	—	—	—	—	3,900	4(ii)	3,900
Interest expenses on Term Loan	—	—	—	—	—	(186)	4(iii)	(186)
Net cash inflow/(outflow) from financing	(137)	(199)	(336)	(2,621)	(679)	3,714		414
Increase/(decrease) in cash and cash equivalents	12	(199)	(187)	(1,459)	(158)	(1,356)		(2,973)
Cash and cash equivalents at the beginning of the year	199	—	199	1,552	2,808	—		4,360
Cash and cash equivalents at the end of the year	211	(199)	12	93	2,650	(1,356)		1,387

Notes to unaudited pro forma consolidated cash flow statements

1. The balances are extracted from the Audited US Combined Financial Statements of PCD as set out in Appendix I to this circular and have been reclassified to conform with the presentation format of the Group.

2. The pro forma adjustments represent the cash balances included in the combined statement of financial position of PCD as at 1 January 2003 as per Appendix I to this circular which will not be transferred to the Group pursuant to the APA. The final amount of these adjustments will be determined on the Closings which may be different from the amounts disclosed in this Appendix.

3. For the purpose of the pro forma consolidated cash flow statements, the amounts stated in US dollar have been translated into Hong Kong dollar at an exchange rate of US$1 = HK$7.8. In addition, there is no net impact arising from the GAAP adjustments and accordingly no adjustment in respect of GAAP adjustments has been made.

4. The pro forma consolidation adjustments reflect the following:

   (i) payment of cash consideration pursuant to the APA as if the Closings had taken place on 1 April 2003;

   (ii) raise of Term Loan on 1 April 2003 for financing the acquisition consideration as if the Closings had taken place on 1 April 2003; and

   (iii) payment of interest expenses on the Term Loan, as detailed in Note 7(v) of Section A in this Appendix.

(D) UNAUDITED PRO FORMA STATEMENT OF ADJUSTED CONSOLIDATED NET TANGIBLE ASSETS/(LIABILITIES) OF THE ENLARGED GROUP BEFORE AND AFTER CLOSINGS

Set out below is an unaudited statement of adjusted consolidated net tangible assets of the Group before Closings based on the unaudited consolidated balance sheet of the Group as at 30 September 2004 as set out in Appendix III to this circular and an unaudited pro forma statement of adjusted consolidated net tangible assets/(liabilities) of the Enlarged Group after Closings based on its unaudited pro forma consolidated balance sheet as at 30 September 2004 as set out in this Appendix:

Unaudited consolidated net assets of the Group as at 30 September 2004 *HK$'m*	**Less: Unamortised intangible assets of the Group as at 30 September 2004** *HK$'m*	**Unaudited consolidated net tangible assets of the Group as at 30 September 2004** *HK$'m*	**Unaudited adjusted consolidated net tangible assets of the Group as at 30 September 2004 attributable to each share of the Company before Closings** *HK$* *(Note 1)*
4,890	(552)	4,338	0.58

Unaudited pro forma consolidated net assets of the Enlarged Group after Closings *HK$'m* *(Note 2)*	**Less: Unamortised intangible assets of the Group** *HK$'m*	**Less: Estimated goodwill and intangible assets arising from the Acquisition** *HK$'m*	**Unaudited pro forma adjusted net tangible liabilities of the Enlarged Group after Closings** *HK$'m*	**Unaudited pro forma adjusted consolidated net tangible liabilities attributable to each share of the Company after Closings** *HK$* *(Note 3)*
9,570	(552)	(14,866)	(5,848)	(0.63)

Notes:

1. The number of shares used for the calculation of this figure is 7,473,220,108 existing shares of the Company as at 30 September 2004.

2. The balance is extracted from Section A headed "Unaudited Pro Forma Consolidated Balance Sheet of the Enlarged Group" as set out in this Appendix.

3. The number of shares used for the calculation of this figure is 9,216,091,136 shares, comprising the existing shares of the Company of 7,473,220,108 as at 30 September 2004 and the Consideration Shares of 821,234,569 new ordinary shares and 921,636,459 new non-voting shares to be allotted and issued by the Company to satisfy part of the acquisition consideration of the Business.

(E) REPORT ON UNAUDITED PRO FORMA FINANCIAL INFORMATION ON THE ENLARGED GROUP

The following is the text of a report received from the Company's auditors, PricewaterhouseCoopers Hong Kong, Certified Public Accountants, for inclusion in this circular. As there is no specific guidance on the reporting on pro forma financial information under the Auditing Guidelines issued by the Hong Kong Institute of Certified Public Accountants, this report is prepared with reference to the Statements of Investment Circular Reporting Standards and Bulletin 1998/8 "Reporting on pro forma financial information pursuant to the Listing Rules" issued by the Auditing Practices Board in the United Kingdom.

PRICEWATERHOUSECOOPERS

羅兵咸永道會計師事務所

PricewaterhouseCoopers
22/F, Prince's Building
Central, Hong Kong

31 December 2004

The Directors
Lenovo Group Limited

Dear Sirs

We report on the unaudited pro forma financial information (the "Pro Forma Financial Information"), which comprises pro forma consolidated balance sheet, pro forma consolidated profit and loss accounts and pro forma consolidated cash flow statements of Lenovo Group Limited (the "Company") and its subsidiaries (collectively the "Group") and the personal computing division of International Business Machines Corporation ("IBM") ("PCD") (hereinafter referred to as the "Enlarged Group") and the unaudited pro forma statement of adjusted net tangible liabilities of the Enlarged Group, set out on pages 201 to 210 of Appendix IV of the Company's circular dated 31 December 2004 (the "Circular") in connection with the acquisition of PCD by the Company pursuant to the Asset Purchase Agreement dated 7 December 2004 between the Company and IBM (hereinafter referred to as the "Transaction"). The unaudited Pro Forma Financial Information has been prepared by the Directors of the Company, for illustrative purposes only, to provide information about how the Transaction might have affected the relevant financial information of the Enlarged Group as at 30 September 2004 and for the year ended 31 March 2004 and six months ended 30 September 2004.

RESPONSIBILITIES

The unaudited Pro Forma Financial Information is arrived at after making adjustments on each of the financial statements of the Group under Hong Kong GAAP and audited combined financial statements of the Business under US GAAP. The financial statements of the Group and the Business are the responsibility of the Directors of the Company and the management of PCD respectively. The Directors of the Company are responsible for (i) the pro forma adjustments made to the combined financial statements of PCD in accordance with the terms of the Asset Purchase Agreement; (ii) the adjustments made in restating the combined financial statements of PCD under the US GAAP to the accounting policies of the Company which follow Hong Kong GAAP; and (iii) the preparation of the unaudited Pro Forma Financial Information in accordance with paragraph 4.29 and paragraph 13 of Appendix 1B of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules").

It is our responsibility to form an opinion, as required by paragraph 4.29 of the Listing Rules, on the unaudited Pro Forma Financial Information and to report our opinion to you. We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the unaudited Pro Forma Financial Information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.

BASIS OF OPINION

We conducted our work with reference to the Statements of Investment Circular Reporting Standards and Bulletin 1998/8 "Reporting on pro forma financial information pursuant to the Listing Rules" issued by the Auditing Practices Board in the United Kingdom, where applicable. Our work, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the unaudited Pro Forma Financial Information with the directors of the Company.

Our work does not constitute an audit or review in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants, and accordingly, we do not provide any such assurance on the unaudited Pro Forma Financial Information.

The unaudited Pro Forma Financial Information has been prepared on the bases set out on pages 201 to 210 of Appendix IV for illustrative purpose only and, because of its nature, it may not be indicative of:

— the financial position of the Enlarged Group at any future date; or

— the results and cash flows of the Enlarged Group for any future periods.

OPINION

In our opinion:

(a) the unaudited Pro Forma Financial Information has been properly compiled by the Directors of the Company on the basis stated;

(b) such basis is consistent with the accounting policies of the Company, and

(c) the adjustments are appropriate for the purposes of the unaudited Pro Forma Financial Information as disclosed pursuant to paragraph 4.29 of the Listing Rules.

Yours faithfully
PricewaterhouseCoopers
Certified Public Accountants
Hong Kong

MANAGEMENT DISCUSSION AND ANALYSIS OF RESULTS AND FINANCIAL POSITION OF THE LENOVO GROUP

Track record of the Lenovo Group

The table below sets out the condensed profit and loss accounts of the Lenovo Group for each of the three years ended 31 March 2004 and each of the six months ended 30 September 2003 and 2004.

	Six months ended 30 September		Year ended 31 March		
	2004	2003	2004	2003	2002
	(Unaudited)	*(Unaudited)*	*(Audited)*	*(Audited)*	*(Audited)*
	HK$'000	*HK$'000*	*HK$'000*	*HK$'000*	*HK$'000*
Turnover	11,532,708	11,589,140	23,175,944	20,233,290	20,853,254
Cost of sales	(9,828,870)	(9,864,801)	(19,787,944)	(17,234,746)	(18,070,819)
Gross profit	1,703,838	1,724,339	3,388,000	2,998,544	2,782,435
Finance income	41,646	40,049	93,368	77,233	67,360
Gain or (losses) on disposal of investments	164,382	6,002	47,558	(26,802)	164,240
Impairment of assets	(51,364)	—	—	—	—
	1,858,502	1,770,390	3,528,926	3,048,975	3,014,035
Distribution expenses	(818,412)	(832,162)	(1,686,932)	(1,393,990)	(1,390,571)
Administrative expenses	(170,616)	(181,192)	(343,306)	(328,736)	(363,851)
Other operating expenses	(208,584)	(206,151)	(443,794)	(261,402)	(162,123)
Amortization of intangible assets	(15,891)	(15,234)	(34,999)	(15,246)	—
Total operating expenses	(1,213,503)	(1,234,739)	(2,509,031)	(1,999,374)	(1,916,545)
Profit from operations	644,999	535,651	1,019,895	1,049,601	1,097,490
Finance cost	(3,500)	—	(2,881)	(20)	(11,785)
	641,499	535,651	1,017,014	1,049,581	1,085,705
Share of profits or (losses) of jointly controlled entities	(10,110)	(13,539)	(39,053)	(34,756)	8,468
Share of profits or (losses) of associated companies	(246)	5,379	16,891	13,826	(12,979)
Profit before taxation	631,143	527,491	994,852	1,028,651	1,081,194
Taxation	(24,905)	1,326	20,150	(26,018)	(23,092)
Profit after taxation	606,238	528,817	1,015,002	1,002,633	1,058,102
Minority interests	20,633	10,601	37,883	14,519	(13,202)
Profit attributable to shareholders	626,871	539,418	1,052,885	1,017,152	1,044,900
Total operating expenses by nature:					
Selling expenses	(285,794)	(291,952)	(558,124)	(379,842)	(382,372)
Promotional and advertising expenses	(184,141)	(189,345)	(395,905)	(425,143)	(397,352)
Staff costs	(434,349)	(458,496)	(851,476)	(688,519)	(674,920)
Other expenses	(293,328)	(279,712)	(668,527)	(490,624)	(461,901)
Amortization of intangible assets	(15,891)	(15,234)	(34,999)	(15,246)	—
Total operating expenses	(1,213,503)	(1,234,739)	(2,509,031)	(1,999,374)	(1,916,545)

OVERVIEW

The Lenovo Group is principally engaged in the provision of advanced information technology ("IT") products and services. It is the leading Personal Computer manufacturer in the PRC and the Asia Pacific region (excluding Japan). Domestic sales accounted for approximately 98.7% of the total turnover of the Lenovo Group for the year ended 31 March 2004.

It is the strategy of the Company to focus on the development of Personal Computer market. The Lenovo Group has the largest market share in the PRC Personal Computer market with about 27% market share. In terms of volume, the Lenovo Group sold more than 3.5 million units of Personal Computers (desktop and notebook combined) in 2003, more than doubled that of the second major player in the market.

Sales of the Lenovo Group's Personal Computer products are made mainly through distributors and other market channel partners in the PRC. As at the Latest Practicable Date, the nationwide third-party distribution network in the PRC comprised about 3,600 distributors and agents and a network of about 4,400 retail outlets. The highly efficient distribution system allows the Company to penetrate deeply into the PRC market including the burgeoning township market. With a view to developing close tie with customers, the Lenovo Group established a direct-to-customer sales model in 2004 in order to supplement its channel distribution system.

The Lenovo Group offers a wide spectrum of Personal Computer products at different price bands and targeting various customer segments. To adhere to the customer-oriented principle, in 2002 the Lenovo Group launched "dual mode" home Personal Computers — the "Tianjiao" and "Tianrui" series, which have adopted the self-developed operating system, LEOS, that combines the functions of computers and electrical appliances. In the same year, the Lenovo Group rolled out the "Kaitian" commercial computer series, which brought a brand-new concept to the office work, namely "Relaxed and Free Office Work Environment" and demonstrated a number of technical and design breakthroughs in the commercial Personal Computer arena, including wireless connection to the Internet, telephone synchronization, personalized interface, smart cards and VPN security. The "Kaitian" commercial computer series was accredited the "Intel Innovative PC Award" in the USA, an accolade that helped boost the Company's brand image.

Low-cost and efficient production is another major competitive advantage of the Lenovo Group. Despite the declining trend in the selling prices of Personal Computer products in the PRC as a result of keen competition among domestic players and international players, the Lenovo Group has been able to maintain a relatively stable level of profit margin due to its product differentiation, successful stringent cost control measures and efficient production, logistics and supply chain management as discussed in more details below in this sub-section.

The Lenovo Group's success has extended beyond Personal Computers. Striving to position itself as an end-to-end solution purveyor, the Lenovo Group focuses on dual business segments — information products primarily including commercial desktop, consumer desktop, notebook, Personal Computer servers, high performance servers, peripherals, certain consumer electronics; and mobile handsets. In a bid to create a seamless computing environment for both terminal and back-end equipment, the Company is taking the lead in developing Collaborating Applications and is a founding member of Intelligent Grouping and Resources Sharing (IGRS) Standardization Working Group. Notebooks and projectors with IGRS protocol have been successfully commercialized.

For the year ended 31 March 2004, sales of IT Products to the corporate sector and the consumer sector accounted for approximately 51.5% and approximately 33.5% of the total turnover of the Lenovo Group respectively. The sales of handheld devices accounted for 8.8% and the remaining 6.2% of the turnover were derived from the provision of information technology services and contract manufacturing business.

The Company has developed extensive footprints along the value chain over the years. Currently, the Company has four research and development centers, four large manufacturing facilities, and a nationwide distribution network and a nationwide after sales service network. The Lenovo Group has the largest service network and led the service experience in the market place. Lenovo is one of the strongest and most recognizable brands in China.

The successful business strategy of the Company was also reflected in its financial performance with revenue exceeding HK$23 billion in the year ended 31 March 2004; a market capitalization of over HK$18 billion (based on the closing price of the Shares as at the Latest Practicable Date); and a return of equity of above 20% for each of the three years ended 31 March 2004.

Standing behind the Company's stellar success are three core competencies that the Company has developed with painstaking efforts over the years:

- Superior branding power that the Company could leverage to obtain price premium over competitors.

- Insightful knowledge of local customers and capabilities in reflecting such insights into innovative products development.

- Effective and stringent channel management and marketing over the Company's nationwide business partners network, to achieve large coverage and low bad debt level of its kind in the PRC.

Core values that the Company has cultivated and promoted also contributed to the Company's financial success. Customer service, trustworthiness and integrity, accuracy and truth seeking, an innovative and can do spirit are the very motto instilled into the head of every employee of the Lenovo Group.

Major factors affecting the results of the Lenovo Group

Market demand and market competition

Similar to the international market that the Business is facing, the PRC IT Product market is highly competitive. Over the past few years, the IT Product market in the PRC continued to grow, but at a relatively flattened growth rate. The Lenovo Group expects the Chinese Personal Computer market to continue its steady growth under a friendlier competitive environment and the market average selling price to reduce at a slower pace.

The Lenovo Group has adopted a market strategy of providing different classes of products to various segments of the market with a view to capturing the largest market share and at the same time maximizing returns. Continuous product innovation and branding efforts allow the Lenovo Group to maintain a satisfactory margin. In order to maintain profitability, the Lenovo Group has also implemented various measures to control production and operating cost.

Technology advancement

The Lenovo Group has been increasing its spending in research and development. For each of the three years ended 31 March 2004, the Lenovo Group spent approximately HK$119 million, HK$314 million and HK$500 million respectively in product and technology research and development. The Directors believe that product and technology innovation is important to the continual success of the Lenovo Group as consumers in the market are always looking for products with new features and Personal Computer manufacturers and vendors have been competing on product and technology innovation. Product differentiation could soften price competition. Innovative product development allows the Lenovo Group to maintain higher profitability.

Business development strategy

With a view to adopting to the constantly changing market environment, the Lenovo Group significantly revised its strategy during the past three years. Emphasis is now placed on the further expansion and internationalization of the Personal Computer business of the Lenovo Group. In January 2002, the Lenovo Group disposed of 55% of its equity interest in the printed circuit board manufacturing business and the remaining 30.5% interest was subsequently disposed of in June 2004. In late 2003, the Lenovo Group disposed of 50% of its interest in its motherboard business. In 2004, the Lenovo Group further disposed of certain subsidiaries in relation to the information technology services business. The Directors believe that these disposals help the Lenovo Group streamline its structure and focus its resources on the development of the core Personal Computer business and mobile handset business.

Analysis on the results of operation of the Lenovo Group during the three years ended 31 March 2004 and the six months ended 30 September 2004

Turnover

For the year ended 31 March 2002, the turnover of the Lenovo Group amounted to approximately HK$20,853 million, which was mainly derived from sales of IT Products and other handheld devices. The Lenovo Group also provided other information technology related services and contract manufacturing business.

Turnover of the Lenovo Group for the year ended 31 March 2003 amounted to approximately HK$20,233 million, representing a decrease of approximately 3.0% as compared with prior year. Such decrease was mainly due to the separate listing and spin-off of Digital China from the Lenovo Group on the main board of the Stock Exchange on 1 June 2001. The Group recorded an increase of 5.0% in turnover if the turnover of Digital China was excluded for the year ended 31 March 2002.

Approximately 87.1% of the turnover of the Lenovo Group for the year ended 31 March 2003 was derived from the sales of IT Products, principally Personal Computers. As compared to the previous financial year, the sales of IT Products increased by approximately 0.8%; sales of handheld devices (mainly mobile handsets) grew significantly by approximately 565.5%; while the turnover of the IT service business and contract manufacturing business decreased by approximately 23.9%.

The Lenovo Group recorded an increase of approximately 7.2% in its sales to customers in the corporate segment for the year ended 31 March 2003. Despite the increase in unit shipment in the consumer market, price competition in the consumer market led to a reduction in the sales of the Lenovo Group to the consumer market by approximately 7.8% during the financial year. The increase in the turnover for the sales of handheld devices was mainly due to the launch of new mobile handsets during the financial year. The decrease in the turnover in respect of the contract manufacturing business was mainly due to the slow down of computer market in the USA and Europe and the disposal of the printed circuit board business in January 2002.

Turnover of the Lenovo Group for the year ended 31 March 2004 amounted to approximately HK$23,176 million, representing an increase of approximately 14.5% as compared with prior year. Approximately 84.9% of the turnover of the Lenovo Group for that year was derived from the sales of IT Products. As compared to prior year, the sales of IT Products increased by approximately 11.7%; sales of handheld devices grew by approximately 42.3%; and the turnover of the IT service business increased by 198.0% while the contract manufacturing business decreased by approximately 9.3%.

The increase in the turnover of the Lenovo Group for the year ended 31 March 2004 was a direct result of the strong recovery of the PRC IT market, which showed a growth in the total market value of approximately 11.1% despite the outbreak of Severe Acute Respiratory Syndrome (SARS) in early 2003, and the effective market positioning and distribution strategy of the Lenovo Group. The customer segmentation and product differentiation strategy adopted by the Lenovo Group proved to be effective. The increase in the turnover for the sales of handheld devices was mainly due to the continual efforts of the Lenovo Group in launching new and advance models of mobile handsets during the financial year. The increase in the turnover of the information technology service was mainly due to the increase in the demand for e-solution and information technology services in connection with the e-government sector and network securities products and solution for the financial service sector in the PRC. On the other hand, the contract manufacturing business remained weak. The Lenovo Group thus disposed of 50% of its interest in the motherboard business by the end of 2003.

Turnover of the Lenovo Group for the six months ended 30 September 2004 amounted to approximately HK$11,533 million, representing a decrease of approximately 0.5% as compared with the same period of the prior year. The decrease in the turnover of the Lenovo Group was mainly due to the deconsolidation of contract manufacturing business since 1 June 2004.

Approximately 87.1% of the turnover of the Lenovo Group for the six months ended 30 September 2004 was derived from the sales of IT Products, principally Personal Computers. During the period, shipment of Personal Computers and mobile handset products continued to grow. Turnover of corporate IT Product business grew by approximately 6.4% as compared with the same period of the prior year; while turnover of handheld device business grew by approximately 31.2%. As for the consumer IT Product business, turnover decreased by approximately 7.7% despite increase in unit shipment and market share due to the introduction of products tailored for low-end market (township market) at a lower average selling price.

Gross profit

Gross profit of the Lenovo Group for the year ended 31 March 2002 was approximately HK$2,782 million, representing a gross profit margin of approximately 13.3%.

Greater emphasis was put on improving profit margin during the year ended 31 March 2003 in view of the market development. The Lenovo Group adopted the strategy of product differentiation and value adding by applying new and cutting-edge technologies to its products which improved profit margin of the Lenovo Group. Gross profit margin of the Lenovo Group increased from approximately 13.3% for the year ended 31 March 2002 to approximately 14.8% for the year ended 31 March 2003.

Gross profit margin of the Lenovo Group decreased slightly from approximately 14.8% for the year ended 31 March 2003 to approximately 14.6% for the year ended 31 March 2004. This was mainly a result of the fierce competition in the PRC market which exerted downward pressure on selling prices of IT Products in the PRC. Despite the slight decrease in the overall gross profit margin of the Lenovo Group in the financial year ended 31 March 2004, the gross profit margin of the consumer IT business managed to increase from approximately 13.3% for the year ended 31 March 2003 to approximately 13.7% for the year ended 31 March 2004.

The Lenovo Group's gross profit margin for the six months ended 30 September 2004 reduced slightly to approximately 14.8% as compared with 14.9% for the same period last year. In view of the irrational price competition among second-tier Personal Computer vendors and intensified competition from foreign brands, the Lenovo Group has strategically adjusted its product line and marketing strategy to capture the low-end market and explore segments with high volume growth potential to minimize the negative impact of market competition.

Finance income

Finance income for the year ended 31 March 2002 of approximately HK$67 million was mainly derived from interest income in relation to cash deposits in banks and other financial institutions.

Finance income for the year ended 31 March 2003 was approximately HK$77 million, representing an increase of approximately 14.7% from prior year.

For the year ended 31 March 2004, finance income was approximately HK$93 million, representing an increase of approximately 20.9% from prior year.

Finance income for the six months ended 30 September 2004 was approximately HK$42 million, representing an increase of approximately 4.0% as compared to the same period of prior year.

Gain or loss on disposal of investments

The Lenovo Group disposed of 55% of its equity interest in its printed circuit board manufacturing business during the year ended 31 March 2002 and as a result recorded a gain of approximately HK$116 million. Together with the disposal of other long-term investments, the Lenovo Group recorded a gain on disposal of approximately HK$164 million for the year ended 31 March 2002.

A net loss on disposal of investments of approximately HK$27 million was recorded for the year ended 31 March 2003. The loss was mainly caused by the disposal of the Group's interest in an associated company which was principally engaged in the provision of Internet services in the PRC.

The Lenovo Group recorded a total gain on disposal of investments of approximately HK$48 million for the year ended 31 March 2004 which included a gain of approximately HK$12 million in respect of the disposal of its 50% interest in the motherboard manufacturing business and another gain of approximately HK$35 million in respect of the disposal of investment securities and other investments. The Directors consider that the disposals were in line with the development strategy of the Lenovo Group to focus on the development of its core Personal Computer business.

A net gain of approximately HK$164 million on disposal of investments was recorded during the six months ended 30 September 2004. The gain was mainly from the disposal of subsidiaries and associated companies in relation to IT services business and printed circuit board business.

Impairment of assets

During the six months ended 30 September 2004, impairment losses of approximately HK$20 million and approximately HK$31 million were recorded for investment securities and goodwill arising from business combination respectively.

Total operating expenses

Total operating expenses for the year ended 31 March 2002 amounted to approximately HK$1,917 million comprising distribution expenses of approximately HK$1,391 million, administrative expenses of approximately HK$364 million and other operating expenses of approximately HK$162 million.

Total operating expenses amounted to approximately HK$1,999 million for the year ended 31 March 2003, which comprised distribution expenses of approximately HK$1,394 million, administrative expenses of HK$329 million, other operating expenses of approximately HK$261 million and amortization of intangible assets of approximately HK$15 million. The increase in the operating expenses was mainly due to the increase in promotional and advertising expenses by approximately 7.0%, the increase in other expenses by approximately 6.2% and the record of amortization of intangible assets, for acquired goodwill and patent during the year.

Total operating expenses for the year ended 31 March 2004 amounted to approximately HK$2,509 million, comprising distribution expenses of approximately HK$1,687 million, administrative expenses of approximately HK$343 million, other operating expenses of approximately HK$444 million and amortization of intangible assets of approximately HK$35 million. The increase was mainly due to the increase in the selling efforts of the Group and the expansion in the staff force of the Lenovo Group during the year. Thus, total selling expenses and staff costs incurred by the Lenovo Group increased by approximately 46.9% and approximately 23.7% respectively.

For the six months ended 30 September 2004, total operating expenses amounted to approximately HK$1,214 million, representing a decrease of approximately 1.7% as compared with the same period of the prior year. Distribution expenses and administrative expenses decreased by approximately 1.7% and approximately 5.8% respectively. This is mainly a result of the Lenovo Group's effort in controlling the selling expenses, promotional and advertising expenses and staff cost during the period while, at the same time, allowing market share of the Lenovo Group to grow.

Profit from operations

Profit from operations for the year ended 31 March 2002 amounted to approximately HK$1,097 million which represented a margin of approximately 5.3%.

The Lenovo Group recorded a profit from operations of approximately HK$1,050 million for the year ended 31 March 2003, representing a decrease of approximately 4.4% as compared to the prior year. The operating profit margin of the Lenovo Group remained stable at approximately 5.2% for the year ended 31 March 2003 as compared to that of approximately 5.3% for the prior year despite keen market competition.

Profit from operations of the Lenovo Group was approximately HK$1,020 million for the year ended 31 March 2004, representing a slight decrease of approximately 2.8% as compared to the prior year. The operating profit margin of the Lenovo Group for the year ended 31 March 2004 was approximately 4.4%, which is approximately 0.8% lower than that of approximately 5.2% for the prior year. The decrease in the operating profit margin of the Lenovo Group was mainly due to the decrease in gross profit margin and the increase in operating expenses during the year.

The Lenovo Group recorded a profit from operations of approximately HK$645 million for the six months ended 30 September 2004, representing an increase of approximately 20.4% as compared to that of approximately HK$536 million for the six months ended 30 September 2003. Excluding the gain on disposal and the impairment of assets, operating profit margin of the Lenovo Group was approximately 4.6%, which remained stable as compared to the same period of prior year.

Finance cost

The Lenovo Group recorded a total finance cost of approximately HK$12 million for the year ended 31 March 2002 which was mainly related to interest incurred in connection with bank loans and overdraft made during the financial year.

Finance cost incurred by the Lenovo Group for the year ended 31 March 2003 decreased significantly to approximately HK$20,000. The decrease in finance cost was mainly a result of the reduction in the use of bank loans and overdraft to finance the working capital of the Lenovo Group upon the spin-off of Digital China in June 2001.

For the year ended 31 March 2004, the Lenovo Group incurred finance cost of approximately HK$3 million which mainly represented bank interest in connection with bank loans and overdraft and interest payable to minority shareholder of a non-wholly owned subsidiary.

For the six months ended 30 September 2004, finance cost incurred by the Lenovo Group was approximately HK$4 million which was mainly incurred in relation to bank loans and overdraft.

Share of profits/losses of jointly controlled entities and associated companies

The Lenovo Group shared profits of jointly controlled entities of approximately HK$8 million and losses of associated companies of approximately HK$13 million for the year ended 31 March 2002. During the year, the two jointly controlled entities were principally engaged in the provision of Internet services and contract manufacturing services and the associated companies mainly engaging in software development, printed circuit board manufacturing and provision of Internet services. Losses of the associated companies were mainly derived from Internet business.

For the year ended 31 March 2003, the Lenovo Group shared losses of jointly controlled entities of approximately HK$35 million and profits of associated companies of approximately HK$14 million. The losses of the jointly controlled entities were mainly related to the Internet service business. The profits of the associated companies were mainly derived from the printed circuit board manufacturing business.

For the year ended 31 March 2004, the Lenovo Group shared losses of jointly controlled entities of approximately HK$39 million which mainly related to Internet business and profits of associated companies of approximately HK$17 million which mainly derived from the printed circuit board manufacturing business.

For the six months ended 30 September 2004, the Lenovo Group shared losses of jointly controlled entities of approximately HK$10 million and associated companies of approximately HK$0.2 million.

Taxation

The Lenovo Group was entitled to various preferential income tax treatments in the PRC. Provision for taxation for the year ended 31 March 2002 amounted to approximately HK$23 million representing an effective tax rate of approximately 2.1%.

Provision for taxation amounted to approximately HK$26 million for the year ended 31 March 2003 representing an effective tax rate of approximately 2.5%, which is approximately 0.4% higher than that for the prior year. The increase in the effective tax rate is mainly due to the increase in the share of provision of taxation in respect of the jointly controlled entities and associated companies which amounted to a total of approximately HK$3 million. Excluding the results of the jointly controlled entities and associated companies, the effective tax rate of the Lenovo Group remained stable at approximately 2.2% as compared to the prior year.

The Lenovo Group recorded a taxation income of approximately HK$20 million for the year ended 31 March 2004. The taxation income was mainly a result of the recognition of deferred taxation relating to the origination and reversal of temporary differences of approximately HK$35 million due to the adoption of revised Statement of Standard Accounting Practice 12 "Income Taxes" during the year. In addition, taxation charges for the operations of the Lenovo Group for the year ended 31 March 2004 amounted to approximately HK$14 million.

Provision for taxation amounted to approximately HK$25 million for the six months ended 30 September 2004 representing an effective tax rate of approximately 3.9%. The increase is mainly due to certain subsidiaries in the PRC ceased to enjoy the tax free period and started 50% tax reduction period and some companies moved from income tax rate of 7.5% to 10% with effect from 1 January 2004.

Minority interests

The minority interests recorded in the profit and loss account of the Lenovo Group amounted to approximately HK$13 million for the year ended 31 March 2002 which represented the share of profit attributable to the minority shareholders of a non-wholly owned subsidiary.

The minority interests credited to the profit and loss account of the Lenovo Group for the years ended 31 March 2003 and 2004 and the six months ended 30 September 2004 amounted to approximately HK$15 million, HK$38 million and HK$21 million respectively which mainly represented the share of losses shared by minority shareholders of certain non-wholly owned subsidiaries of the Company for the relevant year/period.

Profit attributable to shareholders

Profit attributable to shareholders for the year ended 31 March 2002 amounted to approximately HK$1,045 million, representing a net profit margin of approximately 5.0%.

For the year ended 31 March 2003, the Lenovo Group recorded a profit attributable to shareholders of approximately HK$1,017 million, representing a net profit margin of approximately 5.0% which remained the same as that for the prior year.

The Lenovo Group recorded a profit attributable to shareholders of approximately HK$1,053 million for the year ended 31 March 2004, representing a net profit margin of approximately 4.5%. The decrease in net profit margin of the Lenovo Group was mainly the results of the reduction in gross profit margin and increase in operating expenses during the year.

The Lenovo Group recorded a profit attributable to shareholders of approximately HK$627 million for the six months ended 30 September 2004, representing a net profit margin of approximately 5.4% and an increase of approximately 0.7% as compared with same period of last year which was approximately 4.7%. The increase was mainly caused by the gain on disposals of investments completed during the period.

Analysis on the financial position of the Lenovo Group during the three years ended 31 March 2004 and the six months ended 30 September 2004

Cash flows

For each of the years ended 31 March 2002, 2003 and 2004, the Lenovo Group recorded net cash inflow from its operations of approximately HK$843 million, HK$1,210 million and HK$818 million respectively. For the six months ended 30 September 2004, the Lenovo Group continued to record strong net cash inflow from its operations which amounted to approximately HK$598 million. As at 30 September 2004, the cash and cash equivalents balance of the Lenovo Group amounted to approximately HK$3,126 million.

For each of the three years ended 31 March 2002, 2003 and 2004 and the six months ended 30 September 2004, the Lenovo Group recorded net cash outflow of approximately HK$733 million, HK$360 million, HK$297 million and HK$19 million respectively for various investment activities, including investment in acquisition of fixed assets, construction of new plants, strategic acquisitions and investments in jointly controlled entities and associated companies.

The Lenovo Group has been maintaining a healthy level of cash and cash equivalents balances, which represented approximately 56.1%, 53.6%, 43.4% and 43.8% of the total current assets of the Lenovo Group as at 31 March 2002, 2003 and 2004 and 30 September 2004 respectively. The Directors believe the strong cash position allows the Lenovo Group to be more flexible in its treasury management and making further development.

Financial resources

The operation of the Lenovo Group has mainly been financed by cash flows generated from operations. In order to be more flexible, the Lenovo Group has also secured certain banking facilities, including, among other things, bank loans and overdraft as a means to finance its working capital from time to time. In order to finance the Asset Acquisition, the Lenovo Group proposes to issue the Consideration Shares to IBM and to make a borrowing of up to US$500 million.

Inventory turnover days

The balance of inventory amounted to approximately HK$856 million as at 31 March 2002, approximately HK$1,269 million as at 31 March 2003, approximately 1,393 million as at 31 March 2004 and approximately HK$905 million as at 30 September 2004.

It is the general policy of the Lenovo Group to maintain a level of around 30-day inventory. The inventory turnover days, which are based on the average of the monthly closing balances of inventory as at the balance sheet dates of, and the cost of sales for, the respective periods, were approximately 25 days for the year ended 31 March 2002, 23 days for the year ended 31 March 2003, 25 days for the year ended 31 March 2004 and approximately 23 days for the six months ended 30 September 2004.

Debtors' turnover days

Sales to customers, distributors or channels are mainly made at credit terms of up to 30 days. The aggregate balance of trade and notes receivables amounted to approximately HK$678 million as at 31 March 2002, approximately HK$937 million as at 31 March 2003, approximately HK$1,751 million as at 31 March 2004 and approximately HK$2,361 million as at 30 September 2004.

The debtors' turnover days, which are calculated based on the average of the monthly closing balances of trade and notes receivables as at the balance sheet dates of, and the turnover for, the respective periods, of the Lenovo Group were approximately 24 days for the year ended 31 March 2002, approximately 22 days for the year ended 31 March 2003, approximately 28 days for the year ended 31 March 2004 and approximately 32 days for the six months ended 30 September 2004. The debtors' turnover days gradually increased during the three years ended 31 March 2004 and the six months ended 30 September 2004, which was mainly due to the increasing usage of bills of exchange, with a maturity period within six months, issued by customers of the Lenovo Group to settle the trade receivables. The amount of notes receivable outstanding as at each of the year end increased from approximately HK$18 million as at 31 March 2002 to approximately HK$520 million as at 31 March 2004.

Creditors' turnover days

The aggregate balance of trade and notes payables amounted to approximately HK$1,337 million as at 31 March 2002, approximately HK$1,868 million as at 31 March 2003, approximately HK$2,512 million as at 31 March 2004 and approximately HK$2,797 million as at 30 September 2004.

Credit terms given by the vendors to the Lenovo Group are mainly around 30 days. The creditors' turnover days, which are based on the average of the monthly closing balances of trade and notes payables as at the balance sheet dates of, and the cost of sales for, the respective periods, of the Lenovo Group were approximately 37 days, 37 days, 40 days and 44 days for the years ended 31 March 2002, 2003 and 2004 and for the six months ended 30 September 2004 respectively. The movement of the creditors' turnover days is generally in line with the movement of the debtors' turnover days as a treasury management policy.

Net current assets

As at 30 September 2004, the Lenovo Group had net current assets of approximately HK$3,294 million. The current assets comprised inventory of approximately HK$905 million, trade receivables of approximately HK$1,715 million, notes receivables of approximately HK$646 million, deposits, prepayments and other receivables of approximately HK$751 million, and cash and cash equivalents of approximately HK$3,126 million. The current liabilities comprised trade payables of approximately HK$2,479 million, notes payables of approximately HK$317 million, accruals and other payables of approximately HK$688 million, amount due to jointly controlled entity of approximately HK$107 million, tax payable of approximately HK$17 million, short-term bank loan of approximately HK$125 million and current portion of long-term liabilities of approximately HK$116 million.

The current ratios of the Lenovo Group as at 31 March 2002, 2003 and 2004 and 30 September 2004 were approximately 2.2 times, 2.1 times, 1.8 times and 1.9 times respectively.

Capital structure

The operations of the Lenovo Group have been mainly financed by its internally generated cash flow with the use of certain trade finance facilities and bank loans and overdraft to finance the group's working capital from time to time. It is the policy of the Lenovo Group to maintain a very liquid capital structure. The Lenovo Group had a borrowing of approximately HK$125 million as at 30 September 2004. When compared with shareholders' fund, the gearing ratio of the Lenovo Group as at 30 September 2004 was approximately 2.6%.

As at 30 September 2004, credit facilities available to the Lenovo Group amounted to approximately HK$4,060 million, of which HK$1,851 million was in trade line, HK$1,038 million was in short term and revolving money market facilities and HK$1,171 million was in foreign currency forward contracts. As at 30 September 2004, the facility drawn down was approximately HK$560 million and approximately HK$390 million for foreign currency contracts and options was utilized.

Capital and other commitments

As at 30 September 2004, the Lenovo Group had a capital commitment in respect of (i) purchase of certain property, plant and equipment of approximately HK$43 million; (ii) operating leases of approximately HK$157 million; (iii) potential payment of up to approximately HK$156 million in respect of the purchase of certain business and assets pursuant to an agreement entered into in December 2002 depending on the results and performance of such business and assets; and (iv) outstanding foreign currency contracts and options amounted to approximately HK$390 million.

Contingent liabilities

The Lenovo Group did not have any material contingent liabilities as at 30 September 2004.

Currency exchange risk

Sales of the Lenovo Group are mainly denominated in Renminbi while purchases of raw materials are mainly denominated in Renminbi, US dollars and Hong Kong dollars. The financial statements of the Lenovo Group are prepared in Hong Kong dollars. Any changes in the exchange rates of foreign currencies against Renminbi and/or Hong Kong dollars may have a material impact on the results of the Lenovo Group. To limit the currency exchange rate risk, it is the policy of the Lenovo Group to enter into foreign currency forward contracts and options with a view to hedging the foreign currency risk.

Staff

As at 30 September 2004, the Lenovo Group had a total of 9,206 employees, 9,148 of whom were employed in the PRC and 58 were employed in Hong Kong and other countries.

The Lenovo Group has not encountered any employment dispute with its employees which has a material adverse impact on its operations.

Remuneration policies, share option scheme, retirement benefits and training

The Lenovo Group implements remuneration policy, bonus and share option schemes subject to the performance of the Lenovo Group and individual employees. The Lenovo Group also provides training and benefits such as insurance, medical and retirement funds to its staff to sustain the competitiveness of the Lenovo Group.

MANAGEMENT DISCUSSION AND ANALYSIS OF RESULTS AND FINANCIAL POSITION OF THE BUSINESS

The following table details the results of the Business for the three years ended 31 December 2003 and the six months ended 30 June 2004 as extracted from the financial statements of the Business prepared under US GAAP set out in Appendix I to this circular.

	For the six months ended 30 June		For the year ended 31 December		
	2004	**2003**	**2003**	**2002**	**2001**
	(Audited)	*(Unaudited)*	*(Audited)*	*(Audited)*	*(Audited)*
	US$ million	*US$ million*	*US$ million*	*US$ million*	*US$ million*
NET REVENUE:					
External sales	5,003	4,160	9,288	8,962	9,745
Sales to IBM	214	136	278	275	333
Total net revenue	5,217	4,296	9,566	9,237	10,078
COST OF REVENUE:					
External sales	4,492	3,668	8,327	8,066	8,815
Sales to IBM	214	136	278	275	333
Total cost of revenue	4,706	3,804	8,605	8,341	9,148
Gross profit	511	492	961	896	930
EXPENSE AND OTHER INCOME:					
Selling, general and administrative	511	489	1,013	1,038	1,201
Research, development and engineering	70	72	139	138	179
Intellectual property income	(27)	(30)	(75)	(118)	(134)
Other (income) and expense	1	(4)	1	(94)	(23)
TOTAL EXPENSE AND OTHER INCOME	555	527	1,078	964	1,223
LOSS BEFORE INCOME TAXES, MINORITY INTERESTS AND CHANGE IN ACCOUNTING PRINCIPLE	(44)	(35)	(117)	(68)	(293)
Provision for income taxes	74	51	115	86	77
Minority interests	21	11	26	17	17
Net loss before change in accounting principle	(139)	(97)	(258)	(171)	(387)
Effect of change in accounting principle	—	—	—	—	10
NET LOSS	(139)	(97)	(258)	(171)	(397)

The table below details the revenue of the Business for the three years ended 31 December 2003 and the six months ended 30 June 2004 by product category.

	For the six months ended 30 June		For the year ended 31 December		
	2004	**2003**	**2003**	**2002**	**2001**
	(Audited)	*(Unaudited)*	*(Audited)*	*(Audited)*	*(Audited)*
	US$ million	*US$ million*	*US$ million*	*US$ million*	*US$ million*
Mobile (notebook)	2,922	2,166	5,029	4,601	5,167
Desktop	1,426	1,427	2,988	3,226	3,435
Monitors and displays	425	344	769	724	848
Software	383	318	704	622	558
Other	61	41	76	64	70
Total	5,217	4,296	9,566	9,237	10,078

Overview

The Business is one of the leading Personal Computer providers in the world and sells its products in over 160 countries. The Americas region, which covers the USA, Canada, South America and Latin America, accounted for approximately 41.5% and approximately 38.6% respectively of the total net revenue of the Business for the year ended 31 December 2003 and the six months ended 30 June 2004; the Asia Pacific region, which covers Japan, China, South Korea, Australia, New Zealand, Association of South East Asian Nations, Hong Kong and Taiwan, accounted for approximately 30.5% and approximately 32.9% respectively of the total net revenue of the Business for the year ended 31 December 2003 and the six months ended 30 June 2004; and the Europe Middle-East and Africa region accounted for approximately 28.0% and approximately 28.4% respectively of the total net revenue of the Business for the year ended 31 December 2003 and the six months ended 30 June 2004.

Substantially all of the Personal Computers sold by the Business are marketed under IBM's brand name. Revenue of the Business during the period covered by the financial statements set out in Appendix I to this circular was mainly derived from the sales of desktop and mobile Personal Computer products. The Business focuses on sales to corporate customers, with a goal of providing them with business solutions that improve their productivity and lower their costs.

Production of desktop Personal Computers of the Business is substantially outsourced to independent contract manufacturers while the production of mobile Personal Computers of the Business is partly outsourced to independent contract manufacturers and partly carried out by the Chinese Business Unit, which is owned as to 80% by IBM. As stated in the letter from the Board, IBM proposes to effect a restructuring of the shareholding and business of the Chinese Business Unit. It is currently contemplated that, upon completion of such restructuring, IBM will then sell its entire interest in the Chinese Business Unit to the Company.

The Business, mainly the Chinese Business Unit, sources a large variety of components, such as liquid crystal displays, hard disk drives and microprocessors, for the production of its products. Credit terms given by the contract manufacturers and other material and component suppliers range from 30 days to 45 days.

In order to facilitate and promote the purchase of the products of the Business, the Business has an arrangement with IGF i.e. the Customer Financing Services and the Distribution Channel Financing Services, under which IGF provides commercial loans and/or lease financing to the Business's business partners, which include distributors, resellers, and other remarketers of the Business's products. IGF also provides end-user financing, including leasing, installment loans, and other facilities to end-users of Personal Computer equipment, including customers of the Business's business partners. The Customer Financing Services and the Distribution Channel Financing Services on the one hand allows the promotion of the sales of the Business's products and on the other hand reduces the credit risk of the PCD Business as the credit risk is borne by IGF.

With respect to the Distribution Channel Financing Services, the Business paid market-rate based program fees amounting to approximately US$64 million, US$57 million and US$63 million to IGF for the three years ended 31 December 2003 respectively and such fees were approximately US$29 million and US$33 million for the six months ended 30 June 2003 and 2004 respectively as a return to IGF for taking up the relevant credit risk and bearing the relevant interest cost and administrative cost for providing financing to the customers and the channel partners. The Customer Financing Services and the Distribution Channel Financing Services will continue after the Initial Closing and the detailed terms of which (including the Distribution Channel Financing Services and the Customer Financing Services) are set out in the section headed "Ancillary Agreements" in the letter from the Board set out in this circular.

During the three years ended 31 December 2003 and the six months ended 30 June 2004, a majority of the sales of the Business were made through arrangements with the Customer Financing Services and the Distribution Channel Financing Services. Please refer to note D to the financial statements of the Business set out in Appendix I to this circular for the amount of loans and leases originated by IGF in respect of the marketing of the Business's products for three years ended 31 December 2003 and the six months ended 30 June 2004. The remaining sales were mainly made to sizeable corporations on term which shall be due and payable upon delivery with payment have to be made within 30 days to 45 days from delivery. From time to time, the Business sells certain accounts receivable internally to other IBM entities as part of its working capital management.

The Business sold its products to IBM at cost during the three years ended 31 December 2003 and the six months ended 30 June 2004. The amount of sales to IBM amounted to approximately US$333 million, US$275 million, US$278 million and US$214 million for each of the three years ended 31 December 2003 and the six months ended 30 June 2004 respectively. After completion of the Asset Purchase Agreement, the Business will continue to sell products to IBM at cost of the products plus an agreed profit margin determined as a result of arm's length negotiations between the Company and IBM.

Major factors affecting the results of the Business

Market competition

The global Personal Computer market has been highly competitive and has created downward pressure on Personal Computer prices. This market segment is characterized by a high degree of commoditization, short product life cycles and intense price competition. Various Personal Computer manufacturers and distributors have been reducing their product selling prices in order to capture a larger market share. The selling prices of the Personal Computer products of the Business are also exposed to such downward adjustment pressure. In order to maintain the profit margin, the Business has been focusing on the development of differentiated products that deliver higher margin while driving productivity improvements for its customers. The Business has also adopted a number of cost control measures. This combination of cost controls and product differentiation enabled the Business to maintain profit margins despite the competitive pricing environment.

In addition, continued investment has been made by IBM for promoting its brand name with a view to generating greater brand loyalty and recognition.

Warranty costs

For the three years ended 31 December 2003, the warranty costs charged to the costs of sales of the Business amounted to approximately US$452 million, US$430 million, US$586 million respectively; while the amount of warranty cost charged to the cost of sales of the Business for the six months ended 30 June 2003 and 2004 amounted to approximately US$226 million and US$365 million respectively. The relevant percentages of the warranty cost to the total cost of revenue of the Business for the three years ended 31 December 2003 were approximately 4.9%, 5.2% and 6.8% respectively and those for the six months ended 30 June 2003 and 2004 were approximately 5.9% and 7.8% respectively.

The amount of warranty expenses for the year ended 31 December 2003 and the six months ended 30 June 2004 were exceptionally high as a result of some component problems in certain Personal Computer products produced and sold in previous periods. The Business has stopped the production of systems with these previously identified problematic components. Under the Asset Purchase Agreement, IBM will bear any of the warranty expenses in the future related to such component problems that have been identified with respect to certain Personal Computer models, and the Company will not assume all the warranty, enhanced warranty and maintenance obligations relating to or arising from the Products sold and shipped by the Business prior to the Initial Closing. In addition, IBM has agreed to reimburse the Company for the costs incurred by the Enlarged Group in performing standard warranty obligations with respect to desktop and mobile computers shipped by the Enlarged Group after the Initial Closing up to a maximum of US$100 million in aggregate, to the extent the level of defects requiring warranty services exceeds specified levels.

Technology advancement

Technology advancement is one of the keys to be successful in the Personal Computer industry. The Business has been making substantial investments in product and technology development with a view to maintaining its leading position in the global market. For the three years ended 31 December 2003 and the six months ended 30 June 2004, the amount of research and development expenses incurred by the Business amounted to approximately US$161 million, US$129 million, US$131 million and US$66 million respectively.

In order to reduce the risk of inventory obsolescence as a result of rapid technology and product development, the Business has adopted a tight production and inventory policy. The Business has maintained close business relationships with production sub-contractors around the world so that products are produced shortly before order delivery and therefore the Business has been able to improve its inventory turnover performance. Please refer to the sub-paragraph headed "Inventory turnover days" below for further details of the inventory level of the Business.

Cost control ability

The Business has been implementing various measures to maintain its gross profit margin and to reduce operating costs. One of the key control measures is supply chain management which aims at reducing inventory, converting fixed cost into variable costs, simplifying and streamlining internal operations and understanding and responding to market opportunities and external risks. Actions taken by the Business include outsourcing production and other operations in order to reduce fixed costs and administrative costs, and increasing the flexibility in inventory management. In 2002, the Business transferred a substantial portion of its assets in relation to the production of desktop Personal Computer to a contract manufacturer. Currently, production of desktop Personal Computers of the Business is carried out by independent contract manufacturers. The adoption of outsourced production around the world allows the Business to enhance operational efficiency and improve profitability.

In addition, the Business has been enhancing its various internal systems, including, among other things, ordering and other logistic system and staff training system, with a view to further lowering its operating and administrative costs.

Cost allocation and other expenses charged by IBM and pass through costs and charges in respect of services provided by the Business to other divisions of IBM

As stated in note A to the financial statements of the Business set out in Appendix I to this circular, the Business has been relying on IBM for a significant amount of its operational and administrative support services, such as centralized research and development, legal, human resources, payroll, accounting, information technology services, telecommunications, treasury and other IBM's corporate and sales support/infrastructure costs. The relevant costs were then allocated by IBM to the Business using methodologies which the management of IBM and the Business considered appropriate and reasonable for reflecting the utilization of the Business in relation to the various support from IBM to the Business. Shareholders should note that such allocations materially affected the results of the Business as shown in the financial statements and may not necessarily reflect the expenses which may be incurred by the Business when it is operated on a standalone basis.

The Business also has a number of contractual arrangements with IBM for the procurement of services, such as warranty services, hardware services, information technology services, product distribution, technology support and software costs, employees' benefits and occupancy costs, the Customer Financing Services and the Distribution Channel Financing Services, marketing and sales programs. The fees of such services were charged to the Business based on pre-agreed utilization rates or otherwise negotiated amounts. On the other hand, the Business provided a number of services to the other divisions of IBM and passed through costs and charges for such services as reductions to the cost of revenue, selling, general and administrative expenses and research, development and engineering expenses.

After Initial Closing, the operations of the Business will continue to rely on the support of IBM for a period of time. Such support includes, among other things, the Customer Financing Services and the Distribution Channel Financing Services, sales and distribution support, maintenance and warranty services, and license of certain intellectual property rights. Shareholders should note that costs to be incurred in the future for using such support and services from IBM will depend on the terms of various Ancillary Agreements entered into between the Company and IBM, and may differ from the historical figures. Details of the terms of the Continuing Connected Transactions between the Business and IBM after Initial Closing are set out in the section headed "Ancillary Agreements" in the letter from the Board set out in this circular.

The table below details the net amount of expenses charged by IBM to the Business during the three years ended 31 December 2003 and the six months ended 30 June 2004.

	For the six months ended 30 June		For the year ended 31 December		
	2004	**2003**	**2003**	**2002**	**2001**
	US$ million	*US$ million*	*US$ million*	*US$ million*	*US$ million*
Cost of revenue	371	335	710	794	1,032
Selling, general and administrative expenses	296	258	539	480	455
Research, development and engineering expenses	16	16	32	27	40
Other (income) and expenses	4	(5)	—	(43)	(38)

Critical accounting policies

The financial statements of the Business are prepared in accordance with US GAAP. The significant accounting policies are set forth in note B to the financial statements of the Business set out in Appendix I to this circular. The results and financial position of the Business as presented in the financial statements are subject to certain assumptions and estimates. The following is a summary of the significant accounting policies of the Business which involve the use of assumptions and estimates. Nevertheless, Shareholders should review the full details of the significant accounting policies set out in the financial statements of the Business with a view to obtaining a better understanding on the financial statements of the Business for the three years ended 31 December 2003 and the six months ended 30 June 2004.

Product warranty

The Business generally offers three-year warranties for its Personal Computer products. The Business estimates the potential amount and cost of future warranty claims for its current period sales. These estimates are used to record accrued warranty cost for current period product shipment. The Business uses historical warranty claim information, as well as recent trends that might suggest that past cost information may differ from future claims. The warranty accrual is reviewed quarterly. However, the actual amount of warranty claims may differ from the estimated expenses.

Under the Asset Purchase Agreement, the Company will not assume the warranty, enhanced warranty and maintenance obligations relating to or arising from the Products sold and shipped by the Business prior to the Initial Closing.

Net realizable value of inventory

Inventory of the Business is recorded at the lower of average cost or net realizable value and obsolete inventory is written off. Due to the nature of the industry of relatively short product life cycles and price sensitive inventory, the Business is subject to a relatively high risk of write-downs.

Changes in product demand and selling prices will have a significant impact on the net realizable value of the inventory. In view of this, it has been the policy of the Business to maintain a low level of inventory.

Retirement related benefits

Most of the employees of the Business participated in the defined benefit pension plans of the IBM. The Business also provides post-retirement benefits to the employees through IBM. IBM charges the Business costs of these plans based on certain actuarial valuations which are done based on a number of assumptions, including the discount rates, the expected long-term return on plan assets and rate of compensation increase.

Useful life of plant and equipment

The Business determines the useful lives and related depreciation charges for its plant and equipment. Factors which may affect the useful lives of the plant and equipment include, among other things, technology advancement. Accordingly, the useful lives of the plant and equipment may change if the business environment changes.

Analysis on the results of operation of the Business during the three years ended 31 December 2003 and the six months ended 30 June 2004

Revenue

For the year ended 31 December 2001, the revenue of the Business amounted to approximately US$10,078 million, which was mainly derived from sales of personal computers (mobile and desktop computers).

Revenue for the Business for the year ended 31 December 2002 amounted to approximately US$9,237 million, representing a decrease of approximately US$841 million or approximately 8.3% as compared with prior year. Such decrease was mainly due to (i) the decline of total sales volume by 4%; and (ii) the moderate decline of average unit revenue in 2002 due primarily to commodity cost decline and fierce competition. The decrease in revenue was also partly due to the gradual phase-out of consumer Personal Computer products of the Business.

Revenue for the Business for the year ended 31 December 2003 amounted to approximately US$9,566 million, representing an increase of approximately US$329 million or approximately 3.6% as compared with prior year. Such increase was mainly a combined result of (i) the success of the business development and marketing strategy of the Business with focus on the development of mobile Personal Computers allowing the Business to capture strong sales volume growth of approximately 24% of mobile Personal Computer products which offset the declining revenue from desktop Personal Computer products; and (ii) increase in the percentage of mobile Personal Computer (which had a higher average selling price) to the total sales volume from approximately 37% in 2002 to approximately 42% in 2003. However, these factors were partially offset by a drop in the average unit revenue due primarily to the overall commodity price reductions.

Revenue for the Business for the six months ended 30 June 2004 amounted to approximately US$5,217 million, representing an increase of approximately US$921 million or approximately 21.4% as compared with that for the six months ended 30 June 2003. Such increase was mainly driven by a 36% improvement in mobile Personal Computer volume which offset moderate year-to-year average unit revenue decline due primarily to commodity price declines.

Gross profit

The basis of calculating the cost of sales of the Lenovo Group differs from that of the Business. Certain items, such as warranty costs and shipping charges, were included as part of the cost of revenue of the Business but such charges were recorded as distribution, administrative or other expenses by the Lenovo Group. Accordingly, the historical gross profit margin of the Lenovo Group and that of the Business may not be directly comparable.

Gross profit of the Business for the year ended 31 December 2001 was approximately US$930 million, representing a gross profit margin of approximately 9.2%. Cost of sales mainly consists of cost of products sourced from contract manufacturers, product production costs, such as raw material costs, staff and overhead costs, warranty costs, hardware costs, information technology service costs, technology support costs and software costs.

Gross profit margin of the Business increased from approximately 9.2% for the year ended 31 December 2001 to approximately 9.7% for the year ended 31 December 2002. The improvement in gross profit margin was attributable to management's effort to reduce costs.

Gross profit margin of the Business increased from approximately 9.7% for the year ended 31 December 2002 to approximately 10.0% for the year ended 31 December 2003. The improvement in gross profit margin was attributable to the higher percentage of sales coming from mobile Personal Computers which carry a higher gross profit margin than desktop Personal Computers. This improvement was partially offset by exceptional warranty costs arising from certain types of products with component problems.

Gross profit margin of the Business decreased from approximately 11.5% for the six months ended 30 June 2003 to approximately 9.8% for the six months ended 30 June 2004. The reduction in gross profit margin was attributable primarily to increase in the exceptional warranty costs related to certain types of products with component problems.

Intellectual property income

Intellectual property income, which is generated from intellectual property developed by the Business and licensed to others under royalty arrangements, was approximately US$134 million for the year ended 31 December 2001. Intellectual property income for the year ended 31 December 2002 was approximately US$118 million, representing a decrease of approximately 11.9% as compared to 2001. Intellectual property income for the year ended 31 December 2003 was approximately US$75 million, representing a further decrease of approximately 36.4% as compared to 2002. Intellectual property income for the six months ended 30 June 2004 was approximately US$27 million, representing a decrease of approximately 10.0% as compared with that for the six months ended 30 June 2003.

The declining trend of intellectual property income was mainly due to the expiration of certain large licensing contracts which were not fully replaced by contracts with new manufacturers as well as the gradual expiration of fundamental Personal Computer patents owned by the Business.

Other income/expenses

The Business recorded net other income of approximately US$23 million for the year ended 31 December 2001, which mainly represented gains on foreign currency hedging. Net other income of approximately US$94 million for the year ended 31 December 2002 mainly represented a gain on disposal of certain fixed assets and inventory to the contract manufacturer as a step to production outsourcing. The Business recorded net other expenses of approximately US$1 million for the year ended 31 December 2003, which mainly represented a small gain from the disposal of additional fixed assets and inventory to the Personal Computer contract manufacturer offset by various other expenses.

The Business recorded net other expenses of approximately US$1 million for the six months ended 30 June 2004. A net gain of approximately US$4 million for the six months ended 30 June 2003 was primarily a result of further disposal of certain assets in respect of the outsourcing of production facilities in Guadalajara, Mexico.

Selling, general and administrative expenses

Selling, general and administrative expenses for the years ended 31 December 2001, 2002 and 2003 amounted to approximately US$1,201 million, US$1,038 million and US$1,013 million respectively. Selling, general and administrative expenses for the years ended 31 December 2001, 2002 and 2003 included direct advertising and promotional expenses of approximately US$146 million, US$127 million and US$132 million, and program fee in respect of the Distribution Channel Financing Services of approximately US$64 million, US$57 million and US$63 million respectively.

Selling, general and administrative expenses for the year ended 31 December 2002 decreased by approximately 13.6% as compared to 2001. The percentage of selling, general and administrative expenses to the total net revenue of the Business was approximately 11.2% for the year ended 31 December 2002 which decreased from approximately 11.9% for the year ended 31 December 2001. The decrease in the selling, general and administrative expenses was mainly due to restructuring activities undertaken by the Business to improve operational efficiency and to reduce costs.

Selling, general and administrative expenses for the year ended 31 December 2003 decreased by approximately 2.4% as compared to prior year. The percentage of selling, general and administrative expenses to the total revenue of the Business further decreased to approximately 10.6% for the year ended 31 December 2003 from approximately 11.2% for the year ended 31 December 2002. The decrease in the selling, general and administrative expenses was mainly due to continued streamlining of operations.

Selling, general and administrative expenses for the six months ended 30 June 2004 amounted to approximately US$511 million (30 June 2003: US$489 million), representing an increase of approximately 4.5% as compared with those for the six months ended 30 June 2003. Selling, general and administrative expenses for the period included advertising and promotional expenses of approximately US$59 million (30 June 2003: US$69 million) and program fee in respect of the Distribution Channel Financing Services of approximately US$33 million (30 June 2003: US$29 million). The percentage of selling, general and administrative expenses to the total net revenue of the Business decreased to approximately 9.8% for the six months ended 30 June 2004 from approximately 11.4% for the six months ended 30 June 2003. The decrease in the percentage of selling, general and administrative expenses to revenue as compared with that for the six months ended 30 June 2003 was mainly due to strong revenue performance which more than offset incremental expense allocations from IBM.

Research, development and engineering expenses

Research, development and engineering expenses for the year ended 31 December 2001 amounted to approximately US$179 million. Research, development and engineering expenses mainly consisted of scientific research and the application of scientific advances to the development of new and improved products and their uses of approximately US$161 million, and product-related engineering expenses of approximately US$18 million.

Research, development and engineering expenses for the year ended 31 December 2002 amounted to approximately US$138 million, representing a decrease of approximately 22.9% as compared to that of the year ended 31 December 2001, which comprised new technology application and product research and development of approximately US$129 million and product-related engineering expenses of approximately US$9 million. The percentage of research, development and engineering expenses to the net revenue of the Business decreased from approximately 1.8% for the year ended 31 December 2001 to approximately 1.5% for the year ended 31 December 2002. The decrease in the research, development and engineering expenses was mainly due to the streamlining of operations including the outsourcing of some development activities regarding certain production steps to the independent contract manufacturers together with the production outsourcing.

Research, development and engineering expenses for the year ended 31 December 2003 amounted to approximately US$139 million, which comprised new technology application and product research and development of approximately US$131 million and product-related engineering expenses of approximately US$8 million and was roughly the same as that recorded in 2002. The percentage of research, development and engineering expenses to the total net revenue of the Business remained approximately 1.5% for the year ended 31 December 2003.

The level of research and development work of the Business remained relatively stable. Research, development and engineering expenses for the six months ended 30 June 2004 amounted to approximately US$70 million (30 June 2003: US$72 million), which comprised new technology application and product research and development of approximately US$66 million (30 June 2003: US$68 million) and product-related engineering expenses of approximately US$4 million (30 June 2003: US$4 million). The percentage of research, development and engineering expenses to the total net revenue of the Business for the six months ended 30 June 2004 was approximately 1.3% as compared to that of approximately 1.7% for the six months ended 30 June 2003 due to the significant increase in the sales of the Business.

Loss from operations

The Business recorded a loss from operations of approximately US$68 million in 2002 compared to that of approximately US$293 million in 2001. The result of the narrowing of the loss from operations was because of management's stringent cost control, including the measures taken to outsource production following the sale of certain production facilities and the gain from disposal of certain fixed assets and inventory in 2002. The Business recorded a loss from operations of approximately US$117 million in 2003 compared to that of approximately US$68 million in 2002.

The widening of the loss from operations was mainly due to the change from the net other income of approximately US$94 million in 2002 to net other expenses of approximately US$1 million in 2003. Excluding the net other income or expenses, the results of the operations of the Business actually improved from a loss of approximately US$162 million in 2002 to a loss of approximately US$116 million in 2003 despite the substantial increase in warranty cost as described in the sub-paragraph headed "Warranty costs" above.

The Business recorded a loss from operations of approximately US$44 million for the six months ended 30 June 2004 compared to that of approximately US$35 million for the six months ended 30 June 2003. The widening of the loss from operations was mainly due to the increased level of warranty costs as compared with that of the last period.

The relevant percentages of the warranty cost to the total net revenue of the Business for the three years ended 31 December 2003 and six months ended 30 June 2004 were approximately 4.5%, 4.7%, 6.1% and 7.0% respectively. The Business has stopped the production of systems with the previously identified problematic components. With respect to certain Personal Computers shipped by the Company after the Initial Closing, IBM will continue to assume certain liability with respect to warranty costs on those products subject to a cap of US$100 million pursuant to the Asset Purchase Agreement. If the percentage of the warranty cost to net revenue were to return to the 2002 level, the results of the Business could have a significant improvement. The management will continue to manage exposure to warranty costs with focused efforts in the future.

Taxation

Provision for income taxes for the years ended 31 December 2001, 2002 and 2003 amounted to approximately US$77 million, US$86 million and US$115 million respectively. The provision for taxation for the six months ended 30 June 2004 was approximately US$74 million and that for the six months ended 30 June 2003 was approximately US$51 million.

As a result of valuation allowances recorded in certain jurisdictions as described below, the provision for taxation for the business mainly arose from income taxes booked against the profitable non-USA locations, including China, Japan, Australia and India, as well as withholding taxes paid to the local country tax authorities on the inter-company royalty remittances to the USA, for which no benefit has been recorded for the corresponding foreign tax credit in the USA. Period to period movements in the provision are due to the geographic mix of earnings related to the profitable jurisdictions as well as any movements in the withholding taxes paid on the inter-company royalty remittances paid to the USA.

Operating results of the Business have historically been included in IBM's consolidated USA, federal and state income tax returns, or non-USA jurisdictions tax returns. The provision for income taxes for the Business has been determined on a separate return basis. IBM's global tax model has been developed based on its entire portfolio of businesses. Accordingly, the tax results of the Business as presented in the financial statements of the Business set out in Appendix I to this circular are not reflective of the results that the Business would have generated on a stand-alone basis.

The Business is required to assess the realization of its deferred tax assets and the need for a valuation allowance on a separate return basis, and exclude from that assessment any utilization of those losses by IBM. Due to cumulative losses incurred in the USA and certain non-USA locations, a valuation allowance has been recorded against any net deferred tax assets in these jurisdictions.

Minority interests

Minority interests represent the share of profits by the minority shareholders of two non-wholly owned joint venture companies of the Business, including a 51% owned Korean joint venture, which is principally engaged in sales and marketing activities, and a 80% owned Chinese Business Unit, which is principally engaged in the production of mobile Personal Computers.

The Korean joint venture will be dissolved effective 1 January 2005 and the assets and liabilities of the Korean joint venture will not be sold to the Company under the Asset Purchase Agreement.

The amount of minority interests for the year ended 31 December 2002 remained largely the same as that for the year ended 31 December 2001 of approximately US$17 million. The amount of minority interests for the year ended 31 December 2003 amounted to approximately US$26 million, representing an increase of approximately 52.9% over that for the year ended 31 December 2002. The increase in minority interests was mainly due to the increase in the profit of the Chinese Business Unit as a result of the increased level of mobile Personal Computer production at the Business and the consolidation of the mobile unit production at the Chinese Business Unit.

The amount of minority interests for the six months ended 30 June 2004 amounted to approximately US$21 million, representing an increase of approximately 90.9% over that for the six months ended 30 June 2003. The increase in minority interests was mainly due to the continued improvement in the profits of the Chinese Business Unit as a result of the increase in the production level of mobile Personal Computers and the consolidation of the mobile unit production at the Chinese Business Unit.

Net loss

The Business recorded a net loss of approximately US$171 million for the year ended 31 December 2002. As compared to the net loss of approximately US$387 million for the year ended 31 December 2001 (before adjustment of the US$10 million additional loss as a result of changes in certain accounting principles in 2001 related to activities prior to 2001), the decrease in the net loss was mainly due to management's cost controls. The Business recorded a net loss of approximately US$258 million for the year ended 31 December 2003. The widening of the net loss as compared to the net loss of approximately US$171 million for the year ended 31 December 2002 was mainly due to the decrease in other income and the increase in warranty costs and the provision for income taxes and minority interests.

The Business recorded a net loss of approximately US$139 million for the six months ended 30 June 2004. As compared to the net loss of approximately US$97 million in the six months ended 30 June 2003. The widening of the net loss was mainly due to the increase in warranty costs as compared with that of the last period.

Shareholders should note that the historical net loss position reflected the profitability of the Business which had been managed as a division of IBM. It may not reflect the profitability of the Business as it would have been on a standalone basis or that of the Acquired Assets and the Assumed Liabilities as it would be following the Initial Closing.

Analysis on the financial position of the Business during the three years ended 31 December 2003 and the six months ended 30 June 2004

Cash flows

For the year ended 31 December 2001, the Business recorded net cash outflow from its operations of approximately US$199 million. For the years ended 31 December 2002 and 2003, the Business recorded net cash inflow from its operations of approximately US$205 million and US$171 million respectively. For the six months ended 30 June 2004, the Business recorded net cash outflow from its operations of approximately US$71 million as compared with the net cash outflow from operating activities of approximately US$96 million for the six months ended 30 June 2003. The net cash outflow from operations for the first half of the year is in line with the seasonal fluctuations of sales of the Business. As at 30 June 2004, the cash balance of the Business amounted to approximately US$297 million.

For each of the three years ended 31 December 2001, 2002 and 2003 and the six months ended 30 June 2004, the Business used approximately US$107 million, US$86 million US$97 million and US$36 million respectively for the purchase of plant and other property for landlord activities at facilities at the Business's Research Triangle Park in North Carolina, USA, Guadalajara, Mexico and Greenock, UK and for purchase of equipment needed for continued new product development.

The cash balance of the Business as at each of the year end or period end during the three years ended 31 December 2003 and the six months ended 30 June 2004 was held by the Chinese Business Unit and the Korean joint venture. Operations and development of the Business had been funded by IBM during the three years ended 31 December 2003 and the six months ended 30 June 2004. All cash generated by the Business (other than the Chinese Business Unit and the Korean joint venture) were remitted to IBM as part of its centralized global treasury function. As shown in the cash flow statements of the Business, the Business recorded a net cash inflow from IBM of approximately US$291 million for the year ended 31 December 2001 and a net cash outflow to IBM of approximately US$155 million and US$113 million respectively for the years ended 31 December 2002 and 2003. During the six months ended 30 June 2004, IBM further provided net cash of approximately US$150 million to the Business to finance its operations. Under the Asset Purchase Agreement, the cash held by the Business will not be transferred to the Company.

As described above, the management of the Business has been implementing various cost control measures, including, among other things, disposing of its manufacturing facilities and adopting the sub-contracting manufacturing business model. For the three years ended 31 December 2003 and the six months ended 30 June 2004, the Business recorded cash inflow from disposals of plant and other property of approximately US$2 million, US$163 million, US$73 million and US$5 million respectively.

Financial resources

The Business has historically relied on cash flows generated from operations and interest free funding from IBM. As at 30 June 2004, the net investment amount of IBM in the Business amounted to approximately US$973 million. As explained in the section headed "Asset Purchase Agreement" in the letter from the Board set out in this circular, any amount due from the Business to IBM (i.e. the net investment of IBM in the Business) will not be assumed by the Company under the Asset Purchase Agreement.

After completion of the Asset Purchase Agreement, Lenovo Group plans to continue to finance the operation and development, fulfillment of commitment and repayment of liabilities of the Business by various means, including cash generated from its operations, the various financing arrangements with IGF and other available banking and other facilities.

Inventory turnover days

The balance of inventory amounted to approximately US$322 million as at 31 December 2001, approximately US$216 million as at 31 December 2002, approximately US$235 million as at 31 December 2003 and approximately US$279 million as at 30 June 2004. It is the policy of the Business to maintain a general inventory provision depending on the ageing of the finished goods, net salvage value of raw materials, work in progress and finished goods. As at 31 December 2001, 2002 and 2003 and the six months ended 30 June 2004, the provision of slow-moving and obsolete inventory of the Business amounted to approximately US$14 million, US$27 million, US$17 million and US$16 million respectively.

The inventory turnover days, which are based on the closing balances of inventory as at the balance sheet dates of, and the cost of sales for, the respective periods, of the Business throughout the three years ended 31 December 2003 and the six months ended 30 June 2004 remained relatively stable at approximately around 13 days for the year ended 31 December 2001, 9 days for the year ended 31 December 2002, 10 days for the year ended 31 December 2003 and approximately 11 days for the six months ended 30 June 2004. The relatively low number of days of inventory on hand, and corresponding high inventory turnover, reflects the Business's extensive supply chain management system that requires vendors and production sub-contractors to provide inventory just-in-time, and leverages outsourcing opportunities where appropriate.

Debtors' turnover days

The balance of trade receivables amounted to approximately US$443 million as at 31 December 2001, approximately US$425 million as at 31 December 2002, approximately US$470 million as at 31 December 2003 and approximately US$398 million as at 30 June 2004. It is the policy of the Business to provide the full amount of all trade receivable outstanding for over one year. For each of the three years ended 31 December 2003 and the six months ended 30 June 2004, the Business did not encounter any significant bad and doubtful debt in respect of the trade receivables due from its customers. As at 31 December 2001, 2002 and 2003 and the six months ended 30 June 2004, the provision of bad and doubtful debts of the Business amounted to approximately US$14 million, US$9 million, US$7 million and US$7 million respectively.

The debtors' turnover days, which are calculated based on the closing balances of trade receivables as at the balance sheet dates of, and the turnover for, the respective periods, of the Business throughout the three years ended 31 December 2003 and the six months ended 30 June 2004 were approximately 16 days for the year ended 31 December 2001, approximately 17 days for the year ended 31 December 2002, approximately 18 days for the year ended 31 December 2003 and approximately 14 days for the six months ended 30 June 2004. The relatively low number of debtors' turnover days reflects, in part, the benefits of the Customer Financing Services and the Distribution Channel Financing Services whereby IGF provides customer financing to a significant portion of the Business's overall sales. The low debtors' turnover days also reflects management's strong focus on credit and collections for those customers that do not participate in the arrangements offered by IGF.

Creditors' turnover days

The balance of trade payables amounted to approximately US$956 million as at 31 December 2001, approximately US$1,168 million as at 31 December 2002, approximately US$1,457 million as at 31 December 2003 and approximately US$1,441 million as at 30 June 2004.

The creditors' turnover days, which are based on the closing balances of trade payables as at the balance sheet dates of, and the cost of sales for, the respective periods, of the Business throughout the three years ended 31 December 2003 and the six months ended 30 June 2004 gradually increased from approximately 38 days to 56 days. In particular, for the three years ended 31 December 2003 and the six months ended 30 June 2004, the creditors' turnover days of the Business were approximately 38 days, 51 days, 62 days and 56 days respectively. The lengthening of the creditors' turnover days was mainly due to extended creditors' credit terms as management works closely with its vendors to maximize allowable credit terms and minimize the Business's required investment in working capital.

Net current liabilities

As at 30 June 2004, the Business had net current liabilities of approximately US$1,027 million. The current assets mainly comprised cash of approximately US$297 million, trade receivables of approximately US$398 million, net inventories of approximately US$279 million, and prepaid expenses and other current assets of approximately US$192 million. The current liabilities mainly comprised taxes of approximately US$21 million, trade payables of approximately US$1,441 million, compensation accruals of approximately US$30 million, deferred revenue of approximately US$21 million, warranty accruals of approximately US$289 million, rebates and returns accrual of approximately US$175 million, software royalties payable of approximately US$159 million, and other accrued expenses and liabilities of approximately US$57 million.

The Business has been operating with a net working capital deficit (i.e. net current liabilities) reflecting the effective treasury management and funding it historically received from its parent, IBM, as well as efficient management of its inventories, trade receivables and trade payables, as evidenced by the fact that the turnover of inventory and trade receivables are much higher than the turnover of trade payables.

The net working capital deficit position allows the Business to minimize its investment in working capital and this enhances its earning ability. However, the ability of the Business to be operated under a net working capital deficit relies substantially on the Customer Financing Services and the Distribution Channel Financing Services. The Customer Financing Services and the Distribution Channel Financing Services will continue for a term of 5 years after the Initial Closing. If there is any material change in the terms of the Customer Financing Services and the Distribution Channel Financing Services or, for whatever reason, the Customer Financing Services and the Distribution Channel Financing Services cease to be in place and the Business fails to secure a substitute arrangement of effectively the same terms, the Business will then have an immediate short-term funding requirements to finance the settlement of its current liabilities depending on the credit terms of the sales of the Business.

Capital structure

As described above, the operation and development of the Business has been funded by its internally generated cash flow and interest free funding from IBM. The working capital of the Business has also been supported by the Customer Financing Services and the Distribution Channel Financing Services.

During the three years ended 31 December 2003 and the six months ended 30 June 2004, the Business did not have any bank or other borrowings.

As at 31 December 2001, 2002 and 2003, the deficiency in net assets of the Business were approximately US$266 million, US$628 million and US$991 million respectively. As at 30 June 2004, the Business had deficiency in net assets of approximately US$975 million comprising non-current assets of approximately US$368 million (comprising plant and other property of approximately US$308 million, and investments and sundry assets of approximately US$60 million), net current liabilities of approximately US$1,027 million and non-current liabilities of approximately US$316 million (comprising mainly warranty accruals of approximately US$229 million and minority interests of approximately US$87 million).

Not all the assets and liabilities of the Business will be acquired or assumed by the Company under the Asset Purchase Agreement. Based on the scope of the Acquired Assets and Assumed Liabilities as defined in the Asset Purchase Agreement, as at 30 June 2004, the aggregate book value of the Acquired Assets amounted to approximately US$935 million and the aggregate book value of the Assumed Liabilities amounted to approximately US$1,615 million, resulting in net liabilities of US$680 million.

The increase in the deficiency in net assets of the Business was mainly a result of the losses recorded by the Business during the years and period.

Capital and other commitments

Commitments of the Business mainly comprise warranties offered for its products and capital commitments in relation to the purchase of goods and services.

As at 30 June 2004, the Business had on-balance sheet liabilities in relation to its warranties provision amounting to approximately US$518 million. This amount was estimated by the management of the Business based on historical warranty claim information as well as recent trends.

As at 30 June 2004, the Business also had off-balance sheet contractual purchase obligations of approximately US$1,465 million which were either (1) non-cancelable; (2) involved cancellation penalty or (3) involved minimum payments even if the Business does not take delivery of the contracted goods or services. These obligations extend through 2007 and are primarily for the purchase of hard-disk drives.

Contingent liabilities

As disclosed in note L to the financial statements of the Business set out in Appendix I to this circular, the Business is involved in a number of litigations which may result in the Business having to incur additional settlement costs and/or fine if the Business fails to defend itself and lose in the litigations. Shareholders should refer to the disclosures made in the financial statements for details of the contingent liabilities. Under the Asset Purchase Agreement, none of the above contingent liabilities will be assumed by the Company.

Currency exchange and interest rate risks

The Business's exposure to financial market risks relates primarily to fluctuations in currency exchange rates. Sales of the Business are mainly denominated in US dollars with exposures to other currencies in respect of sales and expenses of the Business, in particular, Japanese Yen and Euro. Any changes in the exchange rates of foreign currencies, in particular Japanese Yen and Euro, against US dollars may have a material impact on the results of the Business.

The Business is also exposed to interest rate risk in relation to its bank deposits, the Customer Financing Services and the Distribution Channel Financing Services and other financial transactions, such as the derivative operations as mentioned above.

Historically, the above market risks were hedged by the derivative operations provided through the centralized risk management and treasury functions of IBM. After Closings, the Enlarged Group will continue to take the necessary steps, such as hedging, with a view to minimizing the above mentioned currency exchange and interest rate risks that the Business may expose to. The relevant gains or losses in relation to any hedging exercise were then allocated to the Business. Please refer to note I of the financial statements of the Business set out in Appendix I to this circular for details of the gain or loss and expenses incurred in respect of the derivative transactions of the Business for the three years ended 31 December 2003 and the six months ended 30 June 2004.

Staff

Under the Employee Matters Agreement, a total of approximately 9,500 employees located in nearly 60 countries will be transferred to the Enlarged Group. Approximately 37% of these employees were located in the PRC and approximately 24% were located in the USA. Other major countries include Japan, the United Kingdom, Canada, Australia, France, Brazil, Germany and Ireland.

The Directors understand from IBM that the Business has not encountered any employment dispute with the employees of Business which has a material adverse impact on the operation of the Business. As disclosed in note L to the financial statements of the Business set out in Appendix I to this circular, the Business is involved in litigations with respect to, among other things, employment matters. In particular, it was held in 2003 that IBM's pension plan violated certain employment regulations in the USA. Whilst IBM continues to believe that its pension plan formulas are fair and legal and will appeal the rulings on certain claims, IBM agreed in principle with the plaintiffs on settlement terms of certain other claims in the third quarter of 2004, resulting in a significant one-time charge during that period.

Under the Asset Purchase Agreement, the Company will assume certain pension liabilities in relation to the employees of the Business in certain jurisdictions outstanding upon Closings which is estimated to be approximately US$39 million as at 30 June 2004 (please refer to note 3 to the unaudited pro forma consolidated balance sheet of the Enlarged Group set out in Appendix IV to this circular for details of basis of estimation), while IBM will inject an equivalent amount of cash to the Business.

Remuneration policies, stock option scheme, retirement benefits and training

The Directors understand from IBM that most of the employees of the Business are employed under a fixed salary basis with some of the employees entitled to discretionary bonuses and stock options of IBM. The Company is in the process of reviewing the remuneration policy of the Business. After completion of the Asset Purchase Agreement, employees of the Business will become eligible participants of the Company's share option scheme approved by its shareholders under Chapter 17 of the Listing Rules subject to the securities law of the jurisdictions in which they work.

As disclosed in the audited financial statements of the Business set out in Appendix I to this circular, employees of the Business participate in certain defined benefit pension plans, certain defined contribution plans and certain non-pension post-retirement benefit plans, all of which are sponsored by IBM.

Depending on the roles of the employees of the Business, they are given various training, such as an extensive portfolio of business, sales and technical education offerings to enable the process of skills development. The training are either organized and provided internally by the Business or provided by IBM.

INDEBTEDNESS STATEMENT OF THE ENLARGED GROUP

As at the close of business on 31 October 2004, being the latest practicable date for the purpose of this indebtedness statement prior to the printing of this circular, the Group had short term bank loans and trust receipt loans of approximately HK$225 million and HK$2.89 million respectively, which were unsecured and guaranteed by one or more of the cross guarantees provided by certain subsidiaries and guarantees provided by the Company.

Save as aforesaid, and apart from intra-group liabilities and normal trade payables in the ordinary course of business, the Group did not have any outstanding debt securities, bank overdrafts and liabilities under acceptances, acceptance credits, hire purchase commitments, mortgages and charges, material contingent liabilities or guarantees.

Also as at 31 October 2004, apart from normal trade payables in the ordinary course of business, the Business did not have any outstanding debt securities, bank overdrafts and liabilities under acceptances, acceptance credits, hire purchase commitments, mortgages and charges, material contingent liabilities or guarantees.

The Directors have confirmed that there has not been any material adverse change in the indebtedness and contingent liabilities of the Enlarged Group since 31 October 2004.

WORKING CAPITAL

The Directors are of the opinion that, after taking into account the Enlarged Group's present internal resources and available banking facilities (including the Bridge Loan), the Enlarged Group has sufficient working capital for its present requirement for at least 12 months from the date of this circular.

NO MATERIAL ADVERSE CHANGE

Up to the Latest Practicable Date, the Board is not aware of any material adverse change in the financial or trading position of the Lenovo Group since 31 March 2004, the date to which the latest audited consolidated financial statements of the Company were made up.

SHARE CAPITAL OF THE COMPANY

The authorized and issued share capital of the Company as at the Latest Practicable Date were as follows:

		HK$
Authorized:		
20,000,000,000	Shares	500,000,000
Issued and fully paid:		
7,474,152,108	Shares	186,853,803

All the existing Shares rank *pari passu* in all respects including all rights as to dividends, voting and return of capital.

On 25 March 2002, a new share option scheme (the "New Scheme") was approved by the Company to enable the Company to grant options to the eligible participants as a way of providing incentives to and attracting them for better performance of the Lenovo Group. The New Scheme replaced the share option scheme adopted by the Company on 18 January 1994 (the "Old Scheme"). Those outstanding Share Options granted under the Old Scheme are continue to be valid and exercisable in accordance with the provisions of the Old Scheme. As at the Latest Practicable Date, there were outstanding Share Options to subscribe for 516,744,000 new Shares.

Save as disclosed in the paragraph above, the Company has no options, warrants and conversion rights convertible into Shares as at the Latest Practicable Date. The number, rights and restrictions of the Consideration Shares to be issued under the Asset Purchase Agreement are set out in the section entitled "Letter from the Board".

Since 31 March 2004, being the last financial year end date of the Company, 6,058,000 Shares and 7,500,000 Shares have been issued and repurchased by the Company respectively.

The following is the text of a letter, summary of valuation and valuation certificates, prepared for the purpose of incorporation in this circular of the Group dated 31 December 2004 received from Vigers Appraisal & Consulting Limited, an independent property valuer, in connection with its valuation as at 31 October 2004.

Vigers Appraisal & Consulting Limited
International Asset Appraisal Consultants

10th Floor, The Grande Building
398 Kwun Tong Road
Kowloon
Hong Kong

31 December 2004

The Directors
Lenovo Group Limited
23rd Floor, Lincoln House
Taikoo Place,
979 King's Road,
Quarry Bay,
Hong Kong

Dear Sirs,

In accordance with your instructions for us to value of the property interests exhibited to us as held or leased or to be acquired from IBM upon the applicable Closings (by way of assignment of leases or sub-leases or entering into new leases, sub-leases or license arrangement) by Lenovo Group Limited (the "Company") and its subsidiaries (together referred to as "the Group") in the Hong Kong Special Administrative Region ("Hong Kong"), the People's Republic of China ("the PRC"), the United State of America ("USA"), Japan, Canada, Commonwealth of Australia ("Australia"), the Republic of India ("India"), the Republic of Singapore ("Singapore") and United Kingdom of Great Britain and North Ireland ("UK"), in which, the PRC and India are defined as developing countries in accordance with Practice Note 12 of the Listing Rules. We confirm that we have carried out inspections, made relevant enquiries and obtained such further information as we consider necessary for the purpose of providing you with our opinion of the open market value of such property interests as at 31 October 2004.

Our valuation is our opinion of the open market value of the property interests which we would define to mean — "the best price at which the sale of an interest in property would have been completed unconditionally for cash consideration on the date of valuation, assuming:

(a) a willing seller;

(b) that, prior to the date of valuation, there had been a reasonable period (having regard to the nature of the property and the state of the market) for the proper marketing of the interest, for the agreement of the price and terms and for the completion of the sale;

(c) that the state of the market, level of values and other circumstances were, on any earlier assumed date of exchange of contracts, the same as on the date of valuation;

(d) that no account is taken of any additional bid by a prospective purchaser with a special interest; and

(e) that both parties to the transaction had acted knowledgeably, prudently and without compulsion."

In valuing the property interests in Group I (Property interests held by the Group in the PRC), we have adopted a combination of the market approach and depreciated replacement cost approach in assessing the land portion of the properties and the buildings and structures standing on the land respectively. Hence, the sum of the two results represents the market value of the properties as a whole. In the valuation of the land portions, reference has been made to the standard land prices in relevant cities and the evidence of sales available to us in the localities. Due to the nature of the buildings and structures, they cannot be valued on the basis of open market value and they have therefore been valued on the basis of their depreciated replacement costs. The depreciated replacement cost approach considers the cost to reproduce or replace in new condition the properties appraised in accordance with current construction costs for similar properties in the localities, with allowance for accrued depreciation as evidenced by observed condition or obsolescence present, whether arising from physical, functional or economic causes. The depreciated replacement cost approach generally furnishes the most reliable indication of value for property interests in the absence of a known market based on comparable sales.

The properties in Groups II to IV (Property interests leased by the Group in Hong Kong, the PRC and USA) have no commercial value as transfer, short-term lease or subletting are prohibited or otherwise due to a lack of substantial profit rent.

The properties in Group V to XII (Property interests to be leased, to be acquired by way of lease assignment, grant of a license, lease assignment, grant of a sub-lease, new lease, grant of a license or to be sub-leased by the Group in the PRC, India, USA, Australia, UK, Canada, Japan and Singapore) have no commercial value as transfer, short-term lease or subletting are prohibited or otherwise due to a lack of substantial profit rent after the completion of the lease assignment and sub-lease assignment.

Our valuation has been made on the assumption that the owner sells the property interests on the open market in its existing state without the benefit of a deferred terms contract, leaseback, joint venture, management agreement or any similar arrangement which would serve to increase the value of the property interests.

We have been provided with extracts from title documents relating to such property interests. We have not, however, searched the original documents to verify ownership or to verify the existence of any lease amendments which do not appear on the copies handed to us. All documents and leases have been used for reference only. All dimensions, measurements and areas are approximations.

In undertaking our valuation of the property interests in Group I, III and V, we have relied on the legal opinion provided by the Group's PRC legal adviser Commerce & Finance Law Offices ("the PRC Legal Opinion") and we have relied on the legal opinion provided by the Group's Indian legal adviser AZB & Partners ("the Indian Legal Opinion") on valuing the property interest in Group VI.

We have inspected the exterior and, where possible, the interior of the properties. However, we have not carried out a structural survey nor have we inspected woodwork or other parts of the structures which are covered, unexposed or inaccessible and we are therefore unable to report that any such parts of the property interests are free from defect.

We have relied to a considerable extent on information provided by you and have accepted advice given to us by you on such matters as planning approvals or statutory notices, easements, tenure, occupation, lettings, site and floor areas and in the identification of the property interests in which the Group has a valid interest.

No allowance has been made in our valuation for any charges, mortgages or amounts owing on the property interests nor for any expenses or taxation which may be incurred in effecting a sale. Unless otherwise stated, it is assumed that the property interests are free from encumbrances, restrictions and outgoings of an onerous nature which could affect their values.

We have had no reason to doubt the truth and accuracy of the information provided to us by the Group. We were also advised by the Group that no material factors have been omitted from the information supplied. We consider that we have been provided with sufficient information to reach an informed view.

Unless otherwise stated, all money amounts stated are in Hong Kong Dollars. The exchange rate used in valuing the property interests in Groups I, III to XII are rates prevailing as at the date of valuation, the details of which are summarized as follows:

Country	**Currency**	**Exchange Rate as at 31 October 2004**
The PRC	RMB	HK$1.00 = RMB1.06
USA	US$	HK$1.00 = US$0.13
India	INR (Rs)	HK$1.00 = Rs5.80
Canada	CAD (CA$)	HK$1.00 = CA$0.15
Australia	AUD (A$)	HK$1.00 = A$0.17
Japan	JPY (Yen)	HK$1.00 = Yen13.77
Singapore	SGD (S$)	HK$1.00 = S$0.21
UK	GBP(£)	HK$1.00 = £14.37

We enclose herewith a summary of valuation and valuation certificates.

Yours faithfully,
For and on behalf of
Vigers Appraisal & Consulting Limited
Raymond, Ho Kai Kwong
Registered Professional Surveyor
MRICS, MHKIS, MSc (e-com)
Executive Director

Note: Raymond Ho Kai Kwong, Chartered Surveyor, MRICS, MHKIS, MSc (e-com) has extensive experience in undertaking valuations of properties in Hong Kong, Macau and the PRC. Moreover, Raymond K. K. Ho also has extensive experience in valuing leased properties in the USA, Canada, Japan, India, Singapore, Australia and the UK.

SUMMARY OF VALUATION

Group I — Property interests held by the Group in the PRC

	Property	Open Market Value in existing state as at 31 October 2004
1.	No. 6 Chuangye Road, Shangdi Information Industry Base, Haidian District, Beijing the PRC	RMB181,000,000 (equivalent to HK$171,000,000)
2.	No. 6 Shangdi Road West, Haidian District, Beijing, The PRC	No commercial value
3.	No. 8 Chuangye Road, Shangdi, Haidian District, Beijing, the PRC	RMB61,300,000 (equivalent to HK$58,000,000)
4.	Units 32-1, 32-2 and 32-5, Block 32, Shangdi Chuangye Middle Road, Haidian District, Beijing, the PRC	RMB19,000,000 (equivalent to HK$18,000,000)
5.	Industrial Complex on Lenovo Technology Park, Taiyang City, Tantouchenkengdu Section, Liantangmian Village, Qiuchang Town, Huiyang, Guangdong Province, the PRC	RMB160,000,000 (equivalent to HK$151,000,000)
	Sub-total:	**RMB421,300,000 (equivalent to HK$398,000,000)**

Group II — Property interests leased by the Group in Hong Kong

6.	23rd Floor, Lincoln House, Taikoo Place, No. 979 King's Road, Quarry Bay, Hong Kong	No commercial value
7.	Flat H on 6th Floor, Nam Tien Mansion, Horizon Gardens, No. 18C Taikoo Shing Road and Flat H on 9th and 19th Floors, Juniper Mansion, Harbour View Gardens, No. 16 Taikoo Wan Road, Taikoo Shing, Hong Kong	No commercial value
	Sub-total	**Nil**

Group III — Property interests leased by the Group in the PRC

	Property	Open Market Value in existing state as at 31 October 2004
8.	Southern Portion of Level 7, Chengda Technology Building, No. 63 Sanhao Street, Heping District, Shenyang, Liaoning Province, the PRC	No commercial value
9.	Units 308, 309, 310 and a carparking spaces on basement, Poly Technologies Plaza, No. 93 Zhongshan Road, Harbin City, Heilongjiang Province, the PRC	No commercial value
10.	Unit 532, Chuangchun Lefu Hotel, No. 46 Renminda Street, Chuangchun City, Jilin Province, the PRC	No commercial value
11.	Units 8810 and 8812 on Level 8 Huaneng Building, No. 17 Quancheng Road, Jinan City, Shandong Province, the PRC	No commercial value
12.	Unit H-1 on Level 10, Qingdaoguangda International Financial Centre, No. 67 Hong Kong Road West, Qingdao, Shandong Province, the PRC	No commercial value
13.	Units 5, 7, 9 & 11 on Level 17, Simeicaizhi Centre, No. 6 Jianchenanda Street, Shijiazhuang, Hebei Province, the PRC	No commercial value
14.	Units 307–310 on Level 3, Rujie Technology Centre, No. 9 Gaoxin Street, Gaoxin Technology Development District, Taiyuan, Shanxi Province, the PRC	No commercial value
15.	The whole block of Liangxian Building, No. 696 Songtao Road, Zhangjiang Hi Technology Park, Shanghai, the PRC	No commercial value
16.	Units 1 and 8 on Level 12, Suninghuanqiu Building, No. 188 Guangzhou Road, Nanjing, Jiangsu Province, the PRC	No commercial value

	Property	Open Market Value in existing state as at 31 October 2004
17.	Unit 506 on Level 4, Jiahua International Business Centre, No. 15 Hangda Road, Xihu District, Hangzhou, Zhejiang Province, the PRC	No commercial value
18.	Unit 2501 on Level 25, Huanqiu Building, No. 158 Wusi Road, Fuzhou, Fujian Province, the PRC	No commercial value
19.	Unit D on Level 9, Youdian Building, No. 303 Huaihe Road, Hefei, Anhui Province, the PRC	No commercial value
20.	Various units on Lenovo Research Centre, Nanyi Road, Gaoxin Technology Park, Nanshan District, Shenzhen, Guangdong Province, the PRC	No commercial value
21.	Units 817 and 819, The Plaza East Building, No. 28 Tianhe Road North, Tianhe District, Guangzhou, Guangdong Province, the PRC	No commercial value
22.	The whole on Level 25, Guangxi Waijingmao Building, No. 137 Qixing Road, Nanning, Guangxi Province, the PRC	No commercial value
23.	Units 2102 and 2103 on Level 21, Shuntianguojicaifu Centre, No. 80 Furong Middle Road (Section 2), Changsha, Hunan Province, the PRC	No commercial value
24.	The eastern portion on Level 12, Huazhong Electricity and Finance Building, Xudong Road, Wuchang District, Wuhan, Hubei Province, the PRC	No commercial value
25.	Units 8–11 on Level 15, Pingan Insurance Building, No. 68 Jingsan Road, Zhengzhou, Henan Province, the PRC	No commercial value
26.	Units 907, 908 and 910 on Level 9, No. 88 Beijing Road West, Nanchang, Jiangxi Province, the PRC	No commercial value
27.	The maintenance Centre, guestroom and warehouse on Level 1, Level 2 and Level 4, Lenovo Building, No. 1 Taiyi Road South Section, Beilin District, Xi'an City, Shanxi Province, the PRC	No commercial value

	Property	Open Market Value in existing state as at 31 October 2004
28.	Units 1–5 and 10 on Level 15, Hong Xin Hotel, No. 61 Jiefang Road North, Tianshan District, Uramqi City, Xinjiang Uygur Autonomous Region, the PRC	No commercial value
29.	Units B2, B3 and B4 on Level 26, Dongfangshuma Building, No. 3 Qingyang Road, Chengquan District, Lanzhou, Gansu Province, the PRC	No commercial value
30.	The North Tower, Block 4 Gaoxinfufa Park, Tianfuda Road (Southern extension), Chengdu, Sichuan Province, the PRC	No commercial value
31.	Units C, D & G on Level 8, Xinhua Building, No. 6 Renmin Road East, Kunming City, Yunnan Province, the PRC	No commercial value
32.	Unit 13-8, Block D, Technology Development Building, Keyuanyi Road, Jiulongpo District, Chongqing, the PRC	No commercial value
33.	Unit 6 on Level 8, Huakun Development Building, No. 45 Zhonghua Road South, Nanming District, Guiyang, Guizhou Province, the PRC	No commercial value
34.	Factories No. 40–45, No. 55 Jinwan Road, Jingqiao Export District, Shanghai, the PRC	No commercial value
35.	No. 62 Huancheng Road North, Kunming, Yunnan Province, the PRC	No commercial value
36.	Level 1, Xiya Plaza, No. 33 Yuzhou Road, Jiulongpo District, Chongqing, the PRC	No commercial value
37.	Shop No. 1–2 on basement, No. 41 Nanxian Court, Xuanwu District, Beijing, the PRC	No commercial value
38.	No. 11 Yancao Street, Nangang District, Harbin City, Heilongjiang Province, the PRC	No commercial value

	Property	Open Market Value in existing state as at 31 October 2004
39.	No. 401 Hengye Road, Shanghai, the PRC	No commercial value
40.	Various units on level 1 of Guangqinghua Building, No. 18 Siyouxin Road South the 2nd Street, Wuyangxincheng, Guangzhou, Guangdong Province, the PRC	No commercial value
41.	No. 358 Fahuazhen Road, Chuangning District, Shanghai, the PRC	No commercial value
42.	No. 268–272 Yanggaozhong Road, Pudong New District, Shanghai, the PRC	No commercial value
43.	A building on the West portion, No. 84-1 Jiefang Road, Jinan City, Shandong Province, the PRC	No commercial value
44.	Level 2, The middle Wangdian, Block 3, No. 262 Weihai Road, Qingdao, Shandong Province, the PRC	No commercial value
45.	No. 8 Wangdian on Level 1–2, Unit A, Block 1, No. 341 Wuyishan Road, Qingdao Development District, Shandong Province, the PRC	No commercial value
46.	No. 66 (Fu No. 2) Longye Road, Zhengzhou City, Henan Province, the PRC	No commercial value
47.	Level 1, No. 45 Gaoloumen, Xuanwu District, Nanjing City, Jiangsu Province, the PRC	No commercial value
48.	No. 50 Wangyunsi Road, Shenhe District, Shenyang City, Liaoning Province, the PRC	No commercial value
49.	No. 61. 61-1 Guojicheng Shangyongmenlian, Dangu Main Street, Shijiazhuang, Hebei Province, the PRC	No commercial value
50.	Level 1, Zhejiang Broadcast Television Press Building, No. 241–245 Hushu Road South, Gongshu District, Hangzhou City, Zhejiang Province, the PRC	No commercial value

	Property	Open Market Value in existing state as at 31 October 2004
51.	Commercial unit No. 25, Yuxiu Garden, Yucai Road, Chengxiang Town, Xiaoshan District, Hangzhou City, Zhejiang Province, the PRC	No commercial value
52.	No. 85 Xinhua Road, Zhucui Garden, Huzhou City, Zhejiang Province, the PRC	No commercial value
53.	Shop 3/4 on basement, No. 15, Zone G, Qiaodong District, Qiaodong Street, Taiyuan City, Shanxi Province, the PRC	No commercial value
54.	Unit 103–104, 106–107 on Level 1, Block B, Xintiandi Building, No. A1 Xibeihe Road South, Chaoyang District, Beijing, the PRC	No commercial value
55.	No. 190 Luoyu Road (also known as No. 182 Luoyu Road), Wuchang District, Wuhan City, Hunan Province, the PRC	No commercial value
56.	Front Room on Level 1, Level 2 and a unit on basement level, No. 155 Jianxiang Road, Chuangsha City, Hunan Province, the PRC	No commercial value
57.	Unit 10A, Block A, Xiandaizhichuang Building, Huaqiang Road North, Futian District, Shenzhen, Guangdong Province, the PRC	No commercial value
58.	Units Fu 10–13 on level 1, Tianzhuliyuan, No. 8 Xiaotian Street North, Chengdu City, Sichuan Province, the PRC	No commercial value
59.	Unit 6F of Block A, unit 6F of Block C, and unit 3F on Block C and various units on level 1, Xiahua Electrical Industrial City, Huoju District, Xiamen, Fujian Province, the PRC	No commercial value
	Sub-total	**Nil**

Group IV — Property interest leased by the Group in USA

60.	No. 48401 Landing Parkway, Fremont, Alameda, California, USA	No commercial value
	Sub-total	**Nil**

Group V — Property interests to be leased by the Group in the PRC upon the applicable Closing

	Property	Open Market Value in existing state as at 31 October 2004
61.	Temporary Godown, Industrial Zone of Science & Industry Park, Nanshan District, Shenzhen, Guangdong Province, the PRC	No commercial value
62.	Levels 1–2 and cockloft, Nanshan Technology Park, Shenzhen, Guangdong Province, the PRC	No commercial value
63.	Levels 7–12, Great Wall Computer Group Building, No. 2 Keji Road, Science & Industry Park, Nanshan District, Shenzhen, Guangdong Province, the PRC	No commercial value
64.	Various units of Futian Baoshui District, Futian, Shenzhen, Guangdong Province, the PRC	No commercial value
65.	Unit 06A on Level 11, Shui On Plaza, No. 333 Huaihai Middle Road, Shanghai, the PRC	No commercial value
66.	Unit 64632 of Beijing Friendship Hotel, No. 3 Baishiqiao Road, Beijing, the PRC	No commercial value
	Sub-total	**Nil**

Group VI — Property interest to be leased by the Group in India upon the applicable Closing

67.	R.S. No. 19/1A and 19/2A Thavalakuppam Revenue Village, Edayarpalayam, Ariankuppam Commune Panchayat, Pondicherry, India	No commercial value
	Sub-total	**Nil**

Group VII — Property interest to be acquired by the Group by way of lease assignment or grant of a license in USA upon the applicable Closing

	Property	Open Market Value in existing state as at 31 October 2004
68.	4401 Silicon Drive, Bldg 675, Durham, North Carolina, 27709, USA	No commercial value
69.	4407 Silicon Drive, Bldg 676, Durham, North Carolina, 28217, USA	No commercial value
70.	500 Park Offices, Bldg 660, Research Triangle Park, Raleigh, North Carolina, 27709, USA	No commercial value
71.	600 Park Offices, Bldg 660, Research Triangle Park, Raleigh, North Carolina, 27709, USA	No commercial value
72.	700 Park Offices, Bldg 662, Research Triangle Park, Raleigh, North Carolina, 27709, USA	No commercial value
	Sub-total	**Nil**

Group VIII — Property interests to be acquired by the Group by way of lease assignment or grant of a sub-lease in Australia upon the applicable Closing

73.	The whole on Levels 10–12 and 26, 288 Edwards Street, Brisbane, Queensland, Australia	No commercial value
74.	Level 24, 288 Edwards Street, Brisbane, Queensland, Australia	No commercial value
75.	Level 27, 288 Edwards Street, Brisbane, Queensland, Australia	No commercial value
76.	Levels 5, 7, 8 and 9, No. 601 Pacific Highway, St. Leonards, Sydney, New South Wales, Australia	No commercial value
77.	55 Coonara Avenue, Sydney, New South Wales, Australia	No commercial value
	Sub-total	**Nil**

Group IX — Property interest to be acquired by the Group by way of a new lease or grant of a license in UK upon the applicable Closing

78.	Various buildings on Inverkip Road, Spango Valley, Greenock, Scotland, UK	No commercial value
	Sub-total	**Nil**

Group X — Property interests to be sub-leased by the Group in Canada upon the applicable Closing

	Property	Open Market Value in existing state as at 31 October 2004
79.	Suite 400 on Level 4, Suite 500 on Level 5 and Suite 602 on Level 6 of 10 York Mills Road, Suite 600 on Level 6 of 20 York Mills Road and Suite 502 on Level 5 of 4101 Yonge Street Toronto, Ontario, Canada	No commercial value
80.	1250 Boulevard René–Lévesque, Montreal, Quebec, Canada	No commercial value
	Sub-total	**Nil**

Group XI — Property interests to be leased, to be sub-leased or to be licensed by the Group in Japan upon the applicable Closing

81.	1 Kirihara-cho, Fujisawa-shi, Kanagawa-ken, 252-8588, Japan	No commercial value
82.	1623-14, Aza-kou, Shimotsuruma, Yamato-shi, Kanagawa-ken, Japan	No commercial value
83.	3-2-12 Ropponngi, Minato-ku, Tokyo, Japan	No commercial value
	Sub-total	**Nil**

Group XII — Property interest to be sub-leased by the Group in Singapore upon the applicable Closing

84.	7 & 9 Changi Business Park, Central 1, Singapore	No commercial value
	Sub-total	**Nil**
	Grant-total	**RMB421,300,000 (equivalent to HK$398,000,000)**

VALUATION CERTIFICATE

Group I — Property interests held by the Group in the PRC

	Property	Description and Tenure	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
1.	No. 6 Chuangye Road, Shangdi Information Industry Base, Haidian District, Beijing, the PRC	The property comprises the whole block of a 6-storey industrial building and 2 levels basement underneath and a single storey building attached all completed in 2000. The property has a site area of approximately 32,703.5 sq.m. and the total gross floor area of approximately 70,963.04 sq.m. According to a State-owned Land Use Right Certificate, the land use right of the property are vested in the Group for a term of 50 years commencing from 15 December 2003 to 30 July 2051 for industrial uses.	The property at present is occupied by the Group as office.	RMB181,000,000 (equivalent to HK$171,000,000)

Notes:

1. Pursuant to a State-owned Land Use Right Grant Contract (Document No. Jing Di Chu He Zi (2001) No. 355) 31 July 2001 entered into between Beijing Land Resources and Building Management Bureau (Party A) and the Group (Party B), the land use right of the property with a site area of approximately 33,175.3 sq.m. has been granted from Party A to Party B for a term of 50 years commencing from 31 July 2001 for industrial uses at a consideration of RMB19,905,180.

2. According to a State-owned Land Use Right Certificate (Document No. Jing Shi Hai Gang Ao Tai Guo Yong (2003 Chu) Zi No. 10213 dated 15 December 2003, the land use right of the property with a site area of approximately 32,703.5 sq.m. is vested in the Group for a term of 50 years commencing from 15 December 2003 to 30 July 2051 for industrial uses.

3. According to a Building Ownership Certificate (Document No. Jing Fang Quan Zheng Shi Hai Gang Ao Tai Zi No. 10217), the building portion of the property with a total gross floor area of approximately 70,963.04 sq.m. is vested in the Group.

4. Pursuant to the PRC legal opinion, we understand that the current status of titles, grant of major approvals, licences and documents of the property are as follows:

Document	Status
State-owned Land Use Right Certificate	Yes
Building Ownership Certificate	Yes

5. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

   The Group is entitled to freely transfer, lease and mortgage the whole or portion of the property on the open market without any premium and cost payable.

	Property	Description and Tenure	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
2.	No. 6 Shangdi Road West, Haidian District, Beijing, The PRC	The property comprises 4 blocks of 4 to 8-storey office buildings completed in or about 2002. The property has a site area of approximately 54,608.5 sq.m. and has a total gross floor area of approximately 96,156.2 sq.m. Detail information of the building portion of the property are summarized in Note 2. According to a State-owned Land Use Right Grant Contract, the property has been granted with a land use right for a term of 50 years commencing from 18 October 2004 for industrial uses.	The property at present is occupied by the Group as office.	No commercial value

Notes:

1. According to a State-owned Land Use Right Transfer Agreement (Document Nos.: Jing Di Chu He Zi (2004) No. 1293) dated 18 October 2004 entered into between the Beijing Land Resources Bureau (Party A) and the Group (Party B), the land use right of the property with a site area of approximately 54,608.5 sq.m. has been transferred from Party A to Party B for a term of 50 years commencing from 18 October 2004 for industrial uses at a consideration of RMB9,915,303.

   Pursuant to a supplementary agreement entered into between Party A and Party B, land premium was exempted on account of the Beijing government's policy, thus, the property is not entitled to lease, mortgage and transfer on the open market unless land premium are fully settled.

2. According to the Construction Work Permit (Document No. 06 (Jian) 2002-1793) and Construction Planning Permit (Document No. 2002 Gui Jian Zi 0577), the detail information of the building portion of the property are summarized as follow:

Building	Gross Floor Area *(sq.m.)*	No. of storey
South Tower	47,944.93	8-storey with 1-storey basement
North Tower	39,327.19	6-storey with 1-storey basement
West Tower	8,063.63	4-storey with 1-storey basement
East Tower	820.40	3-storey
Total	**96,156.15**	

3. Due to the absence of the State-owned Land Use Right Certificate and Building Ownership Certificates and the property is not entitled to freely transfer, lease and mortgage on the open market unless land premium was fully settled, we have assigned no commercial value to the property.

   However, for indicative purpose, the capital value of the property as at the date of valuation was RMB358,000,000 (equivalent to HK$338,000,000) on the basis of the assumption that the property can be freely transferred, mortgaged and leased on the open market.

4. Pursuant to the PRC legal opinion, we understand that the current status of titles, grant of major approvals, licences and documents of the property are as follows:

Document	**Status**
State-owned Land Use Right Transfer Agreement and Supplementary Agreement	Yes
Construction Work Permit	Yes
Construction Planning Permit	Yes

5. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

   The land premium was exempted due to the policy carried out by the Beijing government, thus, the property is not entitled to freely transfer, lease and mortgage on the open market unless land premium was fully settled.

	Property	Description and Tenure	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
3.	No. 8 Chuangye Road, Shangdi, Haidian District, Beijing, the PRC	The property comprises six units on two blocks of 4 to 6-storey buildings completed in or about 2000. The property has a total site area of approximately 8,311.34 sq.m. and has a total gross floor area of approximately 18,889.46 sq.m. Detail information are summarized in Notes 3 and 4. The property has been granted with a land use right for a term of 50 years and with an expiry date on 2 June 2043 for industrial uses.	The property at present is occupied by the Group as factory and ancillary office.	RMB61,300,000 (equivalent to HK$58,000,000)

Notes:

1. According to three State-owned Land Use Right Certificates (Document Nos.: Jing Shi Hai Gang Ao Tai Guo Yong (2004 Chu) Zi No. 3170010, 3170011 and 3170012), the land use right of the property with a total site area of approximately 8,311.34 sq.m. has been vested in the Group for a term of 50 years with an expiry date on 2 June 2043 for industrial uses.

2. According to three Building Ownership Certificates (Document Nos.: Jing Fang Quan Zheng Shi Hai Gang Ao Tai Zi No. 3170010, 3170011 and 3170012), the building portion of the property with a total gross floor area of approximately 18,889.46 sq.m. has been vested in the Group.

3. According to three State-owned Land Use Right Certificates mentioned in Note 1, the detail information of the site portion of the property are summarized as follow:

Site	Site Area *(sq.m.)*	Document No
1	4,853.40	Jing Shi Hai Gang Ao Tai Guo Yong (2004 Chu) Zi No. 3170010
2	3,286.37	Jing Shi Hai Gang Ao Tai Guo Yong (2004 Chu) Zi No. 3170011
3	171.57	Jing Shi Hai Gang Ao Tai Guo Yong (2004 Chu) Zi No. 3170012
Total	**8,311.34**	

4. According to Building Ownership Certificates mentioned in Note 2, the detail information of the building portion of the property are summarized as follow:

Unit	Gross Floor Area *(sq.m.)*	Document No
1-1	8,507.12	
1-2	1,362.61	Jing Fang Quan Zheng Shi Hai Gang Ao Tai Zi No. 3170010
1-3	979.35	
2-1	2,317.13	
2-2	5,324.31	Jing Fang Quan Zheng Shi Hai Gang Ao Tai Zi No. 3170011
2-3	398.94	Jing Fang Quan Zheng Shi Hai Gang Ao Tai Zi No. 3170012
Total	**18,889.46**	

5. Pursuant to the PRC legal opinion, we understand that the current status of titles, grant of major approvals, licences and documents of the property are as follows:

Document	Status
State-owned Land Use Right Certificates	Yes
Building Ownership Certificates	Yes

6. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

The property is entitled to transfer, mortgage and lease on the open market without any land premium or acquisition cost payable.

	Property	Description and Tenure	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
4.	Units 32-1, 32-2 and 32-5, Block 32, Shangdi Chuangye Middle Road, Haidian District, Beijing, the PRC	The property comprises a parcel of land and three five-storey buildings completed in or about 1998 erected thereon. The property has a total site area of approximately 3,457.5 sq.m. and total gross floor area of approximately 10,631.8 sq.m. According to two State-owned Land Use Right Certificates, the land use rights of the property are vested in the Group for a term with an expiry date on 2 June 2043.	The property at present is occupied by the Group as factory.	RMB19,000,000 (equivalent to HK$18,000,000)

Notes:

1. According to a State-owned Land Use Right Certificate (Document No. Shi Hai Quan Guo You (98) Zi No. 0590001), the land use right of a land with a site area of approximately 3,033.4 sq.m. has been vested in the Group for a term with an expiry date on 2 June 2043 for residential uses.

2. Pursuant to a State-owned Land Use Right Certificate (Document No. Jing Shi Hai Gang Ao Tai Guo Yong (2001 Chu) Zi No. 0590006), the land use of a land with a site area of approximately 424.1 sq.m. has been vested in the Group for a term with an expiry date on 2 June 2043 for industrial uses.

3. According to two Building Ownership Certificates (Document Nos.: Jing Fang Quan Zheng Hai Gang Ao Tai Zi No. 0590006 and Shi Hai Quan Zi No. 0590001), the building portion of the property with a total gross floor area of approximately 10,631.8 sq.m. are vested in the Group.

4. Pursuant to the PRC legal opinion, we understand that the current status of titles, grant of major approvals, licences and documents of the property are as follows:

Document	Status
State-owned Land Use Right Certificates	Yes
Building Ownership Certificates	Yes

5. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

   The property is entitled to be freely transferred, leased and mortgaged on the open market without any land premium and acquisition cost payable.

	Property	Description and Tenure	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
5.	Industrial Complex on Lenovo Technology Park, Taiyang City, Tantouchenkengdu Section, Liantangmian Village, Qiuchang Town, Huiyang, Guangdong Province, the PRC	The property comprises a parcel of land and 32 buildings completed from 1996 to 2000 erected thereon. The property has a total site area of approximately 277,984 sq.m. and has a total gross floor area of approximately 153,748.59 sq.m. According to twenty-one Real Estate Ownership Certificates and a State-owned Land Use Right Certificate, the land use right of the property has been vested in the Group for a term of 50 years with the last expiry date on 31 May 2048 for industrial uses.	The property at present is occupied by the Group as factory, warehouse and ancillary uses and portion of the property are leased subject to various tenancies, detail information of the tenancies are summarized in Note 7.	RMB160,000,000 (equivalent to HK$151,000,000)

Notes:

1. According to six Real Estate Ownership Certificates (Document Nos. Yue Fang Di Zheng Zi No. 0435507, 0435509, 0435510, 0435511 and 0435512 and Fangbian 29237), a land use right of the property with a site area of approximately 90,757.5 sq.m. has been vested in the Group for a term of 50 years with an expiry date on 31 May 2048 for industrial uses.

2. Pursuant to four Real Estate Ownership Certificates (Document Nos. Yue Fang Di Zheng Zi No. 0435513, 0435514, 0435515 and 0435516), a land use right of the property with a site area of approximately 115,396.5 sq.m. has been vested in the Group for a term of 50 years with an expiry date on 31 May 2048 for industrial uses.

3. Pursuant to eleven Real Estate Ownership Certificates (Document Nos. Yue Fang Di Zheng Zi No. 0764458, 0764459, 0764460, 0764461, 0764462, 0764463, 0764464, 0764465, 0764466, 0764467 and 0764468), a land use right of the property with a site area of approximately 71,830 sq.m. has been vested in the Group for a term of 50 years with an expiry date on 31 May 2044 for industrial uses.

4. According to a State-owned Land Use Right Certificate (Document No. Hui Yang Fu Guo Yong (Te 95) Zi No. 13210500019, a land use right of the property with a site area of approximately 71,830 sq.m. has been vested in the Group for a term of 50 years commencing from 1 June 1994 to 31 May 2044 for industrial uses.

5. Pursuant to 9 Building Ownership Certificates (Document No.: Yue Fang Zi No. 3466196, Registration No. Fangbian 22980, 22983, 22977, 22981, 22982, 22978, 22984 and 22979, 9 buildings with a total gross floor area of approximately 46,249.21 sq.m. have been vested in the Group.

6. Pursuant to the Real Estate Ownership Certificates and Building Ownership Certificate stated on Notes 1–5, the building portion of the property are summarized as follow:

Building	Gross Floor Area *(sq.m.)*	No. of storey	Year of completion	Document No
Micro-computer Workshop (also known as Factory E)	24,839.51	3	2000	Yue Fang Di Zheng Zi No. 0435507
Staff Quarter A (also known as Quarter 5)	5,277.06	4	2000	Yue Fang Di Zheng Zi No. 0435509
Staff Quarter B (also known as Quarter 6)	5,277.06	4	2000	Yue Fang Di Zheng No. 0435510
Staff Quarter C (also known as Quarter 7)	5,277.06	4	2000	Yue Fang Di Zheng No. 0435511
Canteen	3,423.81	2	2000	Yue Fang Di Zheng No. 0435512
Apartment B	727.04	4	2000	Yue Fang Di Zheng No. 0435513
Apartment C2	1,198.97	4	2000	Yue Fang Di Zheng No. 0435514
Apartment D1	1,095.66	5	2000	Yue Fang Di Zheng No. 0435515
Apartment D2	1,095.66	5	2000	Yue Fang Di Zheng No. 0435516
QDI Factory (also known as Factory F)	29,406.18	2	2000	Fangbian 29237
Air Compressor Room	208.29	1	1996	Yue Fang Di Zheng Zi No. 0764462
Factory A (also known as Workshop D)	9,984	2	1996	Yue Fang Di Zheng No. 0764458
Sewage Pool	116.88	1	1996	Yue Fang Di Zheng No. 0764459
Quarter B (also known as Quarter 4)	4,833.44	8	1996	Yue Fang Di Zheng No. 0764460
Repair Room	544.11	2	1996	Yue Fang Di Zheng No. 0764461
Sewage Treatment Room	862.1	2	1996	Yue Fang Di Zheng No. 0764463
Bucket Storage Station	347.55	1	1996	Yue Fang Di Zheng No. 0764464
Factory B (also known as Workshop D)	5,499.52	1	1996	Yu Fang Di Zheng No. 0764465
Quarter A (also known as Quarter 1)	6,817.76	8	1996	Yue Fang Di Zheng No. 0764466
Acid-Alkaline Store	402	1	1996	Yue Fang Di Zheng No. 0764467
Power Station	204	1	1996	Yue Fang Di Zheng No. 0764468
Workshop A	5,575.05	6	1996	Fangbian 22980
Workshop B	5,575.05	6	1996	Fangbian 22978
Workshop C	20,848.84	6	1996	Yue Fang Zi No. 3466196
Staff Quarter 3#	6,689.83	7	1996	Fangbian 22983
Staff Quarter 2#	6,657.99	8	1996	Fangbian 22984
Electrical transforming station	718.23	1	1996	Fangbian 22977
Pump Station	40.32	1	1996	Fangbian 22981
Dangerous Goods Godown	51.93	1	1996	Fangbian 22982
Liquidated Materials Store (Oil Godown)	91.97	1	1996	Fangbian 22979
Security Guard Room 1	34.39	1	1996	Nil
Security Guard Room 2	27.33	1	1996	Nil
Total	**153,748.59**			

7. Pursuant to 36 tenancy agreements, portion of the property is subject to tenancies, the detail information of the tenancies are summarized below:

No.	Property	Gross Floor Area *(sq.m.)*	Monthly Rental *(RMB)*	Lease Term
1.	Unit 6126 on Staff Quarter B	41.44	517.1	1 November 2004 – 31 October 2005
2.	Units 5108, 5109 and 5106 on Staff Quarter A	124.32	1,330.2	1 July 2004 – 30 June 2005
3.	Unit 5107 on Staff Quarter A	41.44	443.4	1 July 2004 – 30 June 2005
4.	Portion on level 2 of QDI Factory	3,350	32,160	1 October 2004 – 30 September 2005
5.	Unit 6105 on Staff Quarter B	41.44	397.8	10 January 2004 – 9 January 2005
6.	Various units on Qi Bu Zone (comprises units on Micro-computer Workshop, QDI Factory and Staff Quarters A, B & C and Canteen)	22,917.99	251,720.14	1 April 2004 – 31 March 2005
7.	Various units on Qi Bu Zone (comprises units on Micro-computer Workshop, QDI Factory and Staff Quarters A, B & C and Canteen)	41,251.9	440,276.89	1 January 2003 – 31 December 2005
8.	North-east portion of Multi-purpose Room (Portion of area on the Canteen)	312.76	6,056	1 January 2004 – 31 December 2004
9.	Units 3507–3511 on Staff Quarter 3#	204.25	1,950.6	23 April 2004 – 22 April 2005
10.	Units 3517–3524 on Staff Quarter 3#	276.64	2,641.9	1 June 2004 – 31 December 2004
11.	Units 3502–3506, 3512–3516 on Staff Quarter 3#	377.15	3,601.8	10 May 2004 – 9 May 2005
12.	Various units on Laoyuan Zone	7,857.23	73,396.34	1 June 2004 – 31 December 2004
13.	Units 3419–3424 on Staff Quarter 3#	207.48	1,981.4	1 June 2004 – 31 December 2004
14.	Level 6 on Workshop B	938.75	9,387.5	1 August 2004 – 31 July 2005
15.	The west portion on level 1 of Staff Quarter 3#	27.2	315.5	1 September 2004 – 31 August 2005
16.	Various units on level 2 of Quarter B	262	2,476	1 October 2004 – 30 September 2005
17.	A unit on west portion on level 1 of Staff Quarter 2#	28	1,344	1 October 2004 – 30 September 2005
18.	A unit on east portion on level 1 of Quarter B	50.92	2,444.2	1 October 2004 – 30 September 2005
19.	A unit under the staircase on Quarter B	9.75	253.5	1 July 2002 – 30 June 2005
20.	North portion of Quarter A	117	2,630.72	1 July 2002 – 30 June 2005
21.	Various units on level 1 of Quarter B	120.24	2,164.32	1 January 2004 – 31 December 2006
22.	Units 3620–3624 on Staff Quarter 3#	172.9	1,651.2	8 October 2003 – 31 December 2004
23.	Various units on level 1 of Staff Quarter 3#	69.16	660.5	17 November 2003 – 31 December 2004
24.	Units 3601–3604 and 3611 on Staff Quarter 3#	202.9	1,937.7	19 September 2003 – 31 December 2004
25.	Waste Product Store and units 3605–3610 on Staff Quarter 3#	291.21	2,944.7	9 September 2003 – 31 December 2004
26.	Portion on level 4 of Workshop A	145.6	1,246.3	16 August 2003 – 31 December 2004
27.	Level 3 on Workshop B	938.75	8,063.9	10 May 2004 – 9 May 2005

No.	Property	Gross Floor Area *(sq.m.)*	Monthly Rental *(RMB)*	Lease Term
28.	Level 6 on Workshop B	973.33	8,419.05	1 December 2003 – 30 November 2004
29.	A units next to the escalator on Workshop C	27	433.35	19 January 2003 – 18 January 2006
30.	Unit 1441 on Gao Gong Building and units 3721 and 3722 on Staff Quarter 3#	93.22	1,028.1	15 August 2003 – 31 December 2004
31.	An ancillary unit of Micro-computer Workshop	120	1,440	1 January 2003 – 31 December 2005
32.	Units 3723 and 3724 on Staff Quarter 3#	69.16	660.5	1 September 2003 – 31 December 2004
33.	A unit on east portion on level 1 of Staff Quarter 3#	29.08	310.2	1 June 2004 – 31 May 2005
34.	A unit on Quarter B	25	500	15 April 2004 – 14 April 2014
35.	A unit on level 1 of Staff Quarter 3#	27.2	490	1 July 2004 – 30 June 2005
36.	Various units on level 4 of Workshop B and Unit 3501 on Staff Quarter 3#	503.94	5,392.16	1 April 2004 – 31 March 2005
	Total	**82,246.35**	**872,666.97**	

8. The tenants of tenancies nos. 1–5 and 7–36 are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates, whilst the tenant of tenancy no.: 6 is a connected party, which is a subsidiary of the Group.

9. Pursuant to the PRC legal opinion, we understand that the current status of titles, grant of major approvals, licences and documents of the property are as follows:

Document	Status
State-owned Land Use Right Certificate	Yes
Real Estate Certificates (Excluding buildings Security Guard Rooms 1 and 2)	Yes
Building Ownership Certificate (Excluding buildings Security Guard Rooms 1 and 2)	Yes

10. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

    (a) The property (excluding buildings of Security Guard Rooms 1 and 2) is entitled to be freely transferred, leased and mortgaged on the open market without any land premium and acquisition cost payable.

    (b) The content of the tenancy agreements stated on Note 7 are effective and legally binding to both parties, according to the information provided by the Group, the registration of the tenancy agreements stated on Note 7 are in progress.

    (c) Due to the absence of the relevant State-owned Land Use Right Certificate of land under the buildings of Workshops A, B & C, Staff Quarters 3# & 2#, Electrical transforming station, Pump Station, Dangerous Goods Godown and Liquidated Materials Store, it is uncertain whether the Company has the right to occupy the land under these buildings and the situation of acquisition cost payable. Hence, the nature of the land cannot be clarified and thus, this land and buildings erected thereon are not entitled to transfer, lease and mortgage on the open market.

11. Due to the absence of the Real Estate Ownership Certificates or Building Ownership Certificates and Note 10(c), Workshops A, B & C, the Staff Quarters 3# & 2#, Electrical Transforming Station, Pump Station, Liquidated Material Store, Dangerous Goods godown, Security Guard Room 1 and Security Guard Room 2 of the property are not entitled to freely transfer, lease and mortgage on the open market, we have assigned no commercial value to these buildings of the property.

    However, for indicative purpose, the capital value of these buildings of the property as at the date of valuation was RMB38,400,000 (equivalent to HK$36,000,000) on the basis of the assumption that these buildings of the property can be freely transferred, mortgaged and leased on the open market.

Group II — Property interests leased by the Group in Hong Kong

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
6.	23rd Floor, Lincoln House, Taikoo Place, No. 979 King's Road, Quarry Bay, Hong Kong	The property comprises the whole on the 23rd Floor of a 23-storey office building completed in 1998. The property has a saleable floor area of approximately 13,962 sq.ft.	The property is leased to the Group by an independent third party for a term of three years commencing from 2 September 2002 to 1 September 2005 at a monthly rent of HK$230,910 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value

Notes:

1. According to the record in the relevant Land Registry, the current registered landlord of the property is the lessor as stated on the tenancy agreement.

2. The landlord is an independent third party, which is not connected with and is independent of, any of the directors of the Group, or any of their respective associates.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
7.	Flat H on 6th Floor, Nam Tien Mansion, Horizon Gardens, No. 18C Taikoo Shing Road and Flat H on 9th and 19th Floors, Juniper Mansion, Harbour View Gardens, No. 16 Taikoo Wan Road, Taikoo Shing, Hong Kong	The property comprises 3 residential units on two residential buildings completed from 1984 to 1989. The property has a total gross floor area of approximately 3,182 sq.ft. Detail information of the property are summarized in Note 3.	The property is leased to the Group by a connected party for a term of two years commencing from 1 June 2003 to 31 May 2005 at a total monthly rent of HK$80,000 inclusive of management fee, rates and utility charges. The property at present is occupied by the Group as senior staff's quarter.	No commercial value

Notes:

1. According to the records in the relevant Land Registry, the current registered owner of the property is the lessor.

2. The landlord is a connected party, which is a subsidiary of the Group.

3. The detail information of the property are summarized as follow:

Address	Gross Floor Area *(sq.ft.)*	Total no. of storey of the building	Completion year of the building
Flat H on 6th Floor, Nam Tien Mansion, Horizon Gardens, No. 18C Taikoo Shing Road	708	26	1989
Flat H on 9th Floor, Juniper Mansion, Harbour View Gardens, No. 16 Taikoo Wan Road	1,237	27	1984
Flat H on 19th Floor, Juniper Mansion, Harbour View Gardens, No. 16 Taikoo Wan Road	1,237	27	1984
Total	**3,182**		

Group III — Property interests leased by the Group in the PRC

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
8.	Southern Portion of Level 7, Chengda Technology Building, No. 63 Sanhao Street, Heping District, Shenyang, Liaoning Province, the PRC	The property comprises portion on Level 7 of a 7-storey building completed in 1999. The property has a gross floor area of approximately 780 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 July 2004 to 1 July 2007 at an annual rent of RMB479,700 inclusive of management fee and utility charges. 3 carparking spaces on basement and 2 carparking spaces behind the property are freely provided by the landlord to the Group. The property at present is occupied by the Group as office.	No commercial value
9.	Units 308, 309, 310 and a carparking spaces on basement, Poly Technologies Plaza, No. 93 Zhongshan Road, Harbin City, Heilongjiang Province, the PRC	The property comprises three units on level 3 and a carparking space on basement level of a 16-storey building completed in 1995. The property has a total gross floor area of approximately 416 sq.m.	The property is leased to the Group by an independent third party, in which units 308 and 309 are leased for a term of sixteen months commencing from 5 March 2004 to 4 July 2005 at a total rent of RMB477,420, unit 310 is leased for a term of one year and five months commencing from 1 March 2004 to 4 July 2005 at a monthly rent of RMB1,000, the carparking space is leased for a term of half a year commencing from 28 May 2004 to 27 November 2004 at a semi-annual rent of RMB2,400 all exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
10.	Unit 532, Chuangchun Lefu Hotel, No. 46 Renminda Street, Chuangchun City, Jilin Province, the PRC	The property comprises a unit on Level 5 of a 10-storey hotel building completed in 1994. The property has a gross floor area of approximately 120 sq.m.	The property is leased to the Group by an independent third party for a term of two years commencing from 1 July 2003 to 30 June 2005 at an annual rent of RMB170,000 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
11.	Units 8810 and 8812 on Level 8 Huaneng Building, No. 17 Quancheng Road, Jinan City, Shandong Province, the PRC	The property comprises two units on Level 8 of a 22-storey building completed in 1997. The property has a total gross floor area of approximately 421 sq.m.	The property is leased to the Group by an independent third party, in which unit 8810 is leased for a term of three years commencing from 1 June 2003 to 31 May 2006 at an annual rent of RMB340,545 whilst unit 8812 is leased for a term of two years and a half months commencing from 15 May 2004 to 31 May 2006 at an annual rent of RMB120,450 both inclusive of management fee and utility charges. The landlord also provided a warehouse and a corridor on the south of the property with a gross floor area of approximately 30 sq.m. to the Group freely subject to the lease term. The property at present is occupied by the Group as office.	No commercial value
12.	Unit H-1 on Level 10, Qingdaoguangda International Financial Centre, No. 67 Hong Kong Road West, Qingdao, Shandong Province, the PRC	The property comprises a unit on Level 10 of a 27-storey building completed in 2001. The property has a gross floor area of approximately 162.372 sq.m.	The property is leased to the Group by an independent third party for a term of two years commencing from 1 August 2003 to 31 July 2005 at an annual rent of RMB148,164.45 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
13.	Units 5, 7, 9 & 11 on Level 17, Simeicaizhi Centre, No. 6 Jianchenanda Street, Shijiazhuang, Hebei Province, the PRC	The property comprises 4 units on Level 17 of a 21-storey building completed in 2002. The property has a gross floor area of approximately 256 sq.m.	The property is leased to the Group by an independent third party for a term of two years commencing from 1 November 2003 to 31 October 2005 at a total rent of RMB355,072 inclusive of management fee but utility charges is exclusive. The property at present is occupied by the Group as office.	No commercial value
14.	Units 307–310 on Level 3, Rujie Technology Centre, No. 9 Gaoxin Street, Gaoxin Technology Development District, Taiyuan, Shanxi Province, the PRC	The property comprises 4 units on Level 3 of a 8-storey building completed in 2003. The property has a gross floor area of approximately 392 sq.m.	The property is leased to the Group by an independent third party for a term of one year commencing from 9 August 2004 to 8 August 2005 at an annual rent of RMB143,080 inclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
15.	The whole block of Liangxian Building, No. 696 Songtao Road, Zhangjiang Hi Technology Park, Shanghai, the PRC	The property comprises the whole of a 10-storey building completed in 2002. The property has a total gross floor area of approximately 23,820.11 sq.m.	The property is leased to the Group by an independent third party for a term of ten years commencing from 6 March 2003 to 5 March 2013 at an annual rent of RMB10,259,321.37 exclusive of management fee and utility charges and the rental will be increased by 10% per 3 years. The property at present is occupied by the Group as office.	No commercial value
16.	Units 1 and 8 on Level 12, Suninghuanqiu Building, No. 188 Guangzhou Road, Nanjing, Jiangsu Province, the PRC	The property comprises 2 units on Level 12 of a 28-storey building completed in 2001 The property has a total gross floor area of approximately 611.64 sq.m.	The property is leased to the Group by an independent third party for a term of two years commencing from 1 May 2004 to 31 April 2006 at an annual rent of RMB580,446.36 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
17.	Unit 506 on Level 4, Jiahua International Business Centre, No. 15 Hangda Road, Xihu District, Hangzhou, Zhejiang Province, the PRC	The property comprises a unit on Level 4 of a 18-storey building completed in 2003. The property has a gross floor area of approximately 575.86 sq.m.	The property is leased to the Group by an independent third party for a term of two years commencing from 29 April 2004 to 28 April 2006 at an annual rent of RMB756,680 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
18.	Unit 2501 on Level 25, Huanqiu Building, No. 158 Wusi Road, Fuzhou, Fujian Province, the PRC	The property comprises a unit on Level 25 of a 25-storey building completed in 1999. The property has a gross floor area of approximately 262.36 sq.m.	The property is leased to the Group by an independent third party for a term of one year and one month commencing from 1 April 2004 to 30 April 2005 at a total rent of RMB180,947.95 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
19.	Unit D on Level 9, Youdian Building, No. 303 Huaihe Road, Hefei, Anhui Province, the PRC	The property comprises a unit on Level 9 of a 34-storey building completed in 1998. The property has a gross floor area of approximately 190 sq.m.	The property is leased to the Group by an independent third party for a term of 17 months commencing from 1 April 2004 to 31 August 2005 at a monthly rent of RMB12,540 inclusive of management fee but exclusive of utility charges. The property at present is occupied by the Group as office.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
20.	Various units on Lenovo Research Centre, Nanyi Road, Gaoxin Technology Park, Nanshan District, Shenzhen, Guangdong Province, the PRC	The property comprises various units on Level 5 and the west portion of level 7 and a laboratory on the basement of a 9-storey building completed in 2000. The property has a total gross floor area of approximately 5,261.6 sq.m.	The property is leased to the Group by a connected party for a term of three years commencing from 1 August 2004 to 31 July 2007 at a monthly rent of RMB365,072 exclusive of management fee and utility charges. The landlord has also provided 2 open carparking spaces on ground floor and 15 carparking spaces on basement freely to the Group subject to the lease term on tenancy agreement. The property at present is occupied by the Group as office.	No commercial value
21.	Units 817 and 819, The Plaza East Building, No. 28 Tianhe Road North, Tianhe District, Guangzhou, Guangdong Province, the PRC	The property comprises 2 units on Level 8 of a 12-storey building completed in 2000. The property has a total gross floor area of approximately 419.26 sq.m.	The property is leased to the Group by an independent third party for a term of one year commencing from 1 July 2004 to 30 June 2005 at a monthly rent of RMB33,540 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
22.	The whole on Level 25, Guangxi Waijingmao Building, No. 137 Qixing Road, Nanning, Guangxi Province, the PRC	The property comprises the whole on Level 25 of a 32-storey building completed in 1999. The property has a total gross floor area of approximately 225 sq.m.	The property is leased to the Group by an independent third party for a term of one year commencing from 20 February 2003 to 19 February 2004 at a monthly rent of RMB6,750 inclusive of management fee but exclusive of utility charges. The tenancies has been further extended to 19 February 2005 at a semi-annual rent of RMB40,500. The property at present is occupied by the Group as office.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
23.	Units 2102 and 2103 on Level 21, Shuntianguojicaifu Centre, No. 80 Furong Middle Road (Section 2), Changsha, Hunan Province, the PRC	The property comprises 2 units on Level 21 of a 36-storey building completed in 2002. The property has a total gross floor area of approximately 599.62 sq.m.	The property is leased to the Group by an independent third party for a term of one year commencing from 20 August 2004 to 21 August 2005 at an annual rent of RMB328,291.95 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
24.	The eastern portion on Level 12, Huazhong Electricity and Finance Building, Xudong Road, Wuchang District, Wuhan, Hubei Province, the PRC	The property comprises portion on Level 12 of a 21-storey building completed in 1998. The property has a total gross floor area of approximately 628.47 sq.m.	The property is leased to the Group by an independent third party for a term of two years commencing from 1 July 2004 to 30 June 2006 at a monthly rent of RMB30,166.56 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
25.	Units 8–11 on Level 15, Pingan Insurance Building, No. 68 Jingsan Road, Zhengzhou, Henan Province, the PRC	The property comprises 4 units on Level 15 of a 22-storey building completed in 2003. The property has a total gross floor area of approximately 589.53 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 June 2004 to 31 May 2007 at a total rent of RMB774,642 exclusive of management fee and utility charges. The landlord also provided unit 12 on level 15 with a gross floor area of approximately 99.74 sq.m. to the Group freely subject to the lease term stated on tenancy agreement. The property at present is occupied by the Group as office.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
26.	Units 907, 908 and 910 on Level 9, No. 88 Beijing Road West, Nanchang, Jiangxi Province, the PRC	The property comprises 3 units on Level 9 of a 20-storey building completed in 1999. The property has a total gross floor area of approximately 355 sq.m.	The property is leased to the Group by an independent third party for a term of one year commencing from 25 August 2004 to 24 August 2005 at an annual rent of RMB176,868 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
27.	The maintenance Centre, guestroom and warehouse on Level 1, Level 2 and Level 4, Lenovo Building, No. 1 Taiyi Road South Section, Beilin District, Xi'an City, Shanxi Province, the PRC	The property comprises various units on Levels 1, 2 and 4 of a 4-storey building completed in 1998. The property has a total gross floor area of approximately 4,065.43 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 October 2004 to 30 September 2007 at an annual rent of RMB1,357,400.04 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
28.	Units 1–5 and 10 on Level 15, Hong Xin Hotel, No. 61 Jiefang Road North, Tianshan District, Uramqi City, Xinjiang Uygur Autonomous Region, the PRC	The property comprises 6 units on Level 15 of a 28-storey building completed in 2000. The property has a total gross floor area of approximately 256.735 sq.m.	The property is leased to the Group by an independent third party for a term of one year commencing from 4 July 2004 to 4 July 2005 at an annual rent of RMB196,788 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
29.	Units B2, B3 and B4 on Level 26, Dongfangshuma Building, No. 3 Qingyang Road, Chengquan District, Lanzhou, Gansu Province, the PRC	The property comprises 3 units on Level 26 of a 30-storey building completed in 2001. The property has a total gross floor area of approximately 166 sq.m.	The property is leased to the Group by an independent third party, in which unit B4 is leased for a term of two years commencing from 15 July 2003 to 14 July 2005 at an annual rent of RMB36,288 whilst units B2 and B3 are leased for a term of three years commencing from 15 July 2002 to 14 July 2005 at an annual rent of RMB89,208 both inclusive of management fee and utility charges (except electricity, telephone and network charges). The property at present is occupied by the Group as office.	No commercial value
30.	The North Tower, Block 4 Gaoxinfufa Park, Tianfuda Road (Southern extension), Chengdu, Sichuan Province, the PRC	The property comprises the whole of a 4-storey building completed in 2003. The property has a total gross floor area of approximately 9,053.96 sq.m.	The property is leased to the Group by an independent third party for a term of five years and five months commencing from 4 August 2004 to 3 November 2009 at an annual rent of RMB1,955,655.36 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
31.	Units C, D & G on Level 8, Xinhua Building, No. 6 Renmin Road East, Kunming City, Yunnan Province, the PRC	The property comprises 3 units on Level 8 of a 18-storey building completed in 2000. The property has a total gross floor area of approximately 267 sq.m.	The property is leased to the Group by an independent third party for a term of two years commencing from 1 September 2003 to 31 August 2005 at a monthly rent of RMB10,680 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
32.	Unit 13-8, Block D, Technology Development Building, Keyuanyi Road, Jiulongpo District, Chongqing, the PRC	The property comprises a unit of a 18-storey building completed in 1999. The property has a gross floor area of approximately 255.79 sq.m.	The property is leased to the Group by an independent third party for a term of 23 months commencing from 1 August 2003 to 30 June 2005 at a total rent of RMB226,502.045 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
33.	Unit 6 on Level 8, Huakun Development Building, No. 45 Zhonghua Road South, Nanming District, Guiyang, Guizhou Province, the PRC	The property comprises a unit on Level 8 of a 18-storey building completed in 1999. The property has a gross floor area of approximately 254.63 sq.m.	The property is leased to the Group by an independent third party for a term of one years commencing from 1 August 2004 to 31 July 2005 at a monthly rent of RMB12,094.9 exclusive of management fee and utility charges. The property at present is occupied by the Group as office.	No commercial value
34.	Factories No. 40–45, No. 55 Jinwan Road, Jingqiao Export District, Shanghai, the PRC	The property comprises 6 blocks of single-storey factories completed in 2000. The property has a total gross floor area of approximately 16,380 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 February 2001 to 31 January 2004 at an annual rent of RMB5,081,895 exclusive of management fee and utility charges. The tenancy has been further extended to 31 January 2007. The property at present is occupied by the Group as factory, office and quarter and ancillary uses.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
35.	No. 62 Huancheng Road North, Kunming, Yunnan Province, the PRC	The property comprises a unit on level 1 of a 9-storey building completed in or about 1996. The property has a gross floor area of approximately 300 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 26 November 2004 to 25 November 2007 at an annual rent of RMB120,000. The property at present is occupied by the Group for office purposes.	No commercial value
36.	Level 1, Xiya Plaza, No. 33 Yuzhou Road, Jiulongpo District, Chongqing, the PRC	The property comprises two units on level 1 of a single-storey building completed in or about 2000s. The property has a gross floor area of approximately 300.34 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 March 2003 to 1 March 2006 at an annual rent of RMB216,000. The property at present is occupied by the Group for office uses.	No commercial value
37.	Shop No. 1–2 on basement, No. 41 Nanxian Court, Xuanwu District, Beijing, the PRC	The property comprises two units on level 1 of a single-storey building completed in or about 2000. The property has a total gross floor area of approximately 387 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 10 October 2003 to 10 October 2006 at an annual rent of RMB390,000. The property at present is occupied by the Group for retail purpose.	No commercial value
38.	No. 11 Yancao Street, Nangang District, Harbin City, Heilongjiang Province, the PRC	The property comprises the whole on levels 1–3 of a 3-storey building completed in or about 2002. The property has a total gross floor area of approximately 729.57 sq.m.	The property is leased to the Group by an independent third party for a term of five years commencing from 1 April 2003 to 1 April 2008 at an annual rent of RMB220,000. The property at present is occupied by the Group for office uses.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
39.	No. 401 Hengye Road, Shanghai, the PRC	The property comprises the whole of a 6-storey building completed in or about 2000. The property has a total gross floor area of approximately 286.47 sq.m.	The property is leased to the Group by an independent third party for a term of five years commencing from 24 March 2003 to 24 March 2008 at an annual rent of RMB180,000. The property at present is occupied by the Group for retail purpose.	No commercial value
40.	Various units on level 1 of Guangqinghua Building, No. 18 Siyouxin Road South the 2nd Street, Wuyangxincheng, Guangzhou, Guangdong Province, the PRC	The property comprises various units on level 1 of a single-storey building completed in or about 1994. The property has a total gross floor area of approximately 551 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 March 2003 to 31 March 2006 at a monthly rent of RMB37,468. The property at present is occupied by the Group for office use.	No commercial value
41.	No. 358 Fahuazhen Road, Chuangning District, Shanghai, the PRC	The property comprises the portion of level 1 and level 2 of a 6-storey building completed in or about 1999. The property has a total gross floor area of approximately 396 sq.m.	The property is leased to the Group by an independent third party for a term of 26 months commencing from 1 April 2003 to 31 May 2005 at a daily rent of RMB2.28 per sq.m.. The property at present is occupied by the Group for office use.	No commercial value
42.	No. 268–272 Yanggaozhong Road, Pudong New District, Shanghai, the PRC	The property comprises a unit of a 6-storey building completed in or about 2002. The property has a total gross floor area of approximately 365 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 July 2003 to 30 June 2006 at a monthly rent of RMB20,000. The property at present is occupied by the Group for office uses.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
43.	A building on the West portion, No. 84-1 Jiefang Road, Jinan City, Shandong Province, the PRC	The property comprises the whole of a 2-storey building completed in or about 1997. The property has a total gross floor area of approximately 204 sq.m.	The property is leased to the Group by an independent third party for a term of one year commencing from 20 May 2004 to 19 May 2005 at a total rent of RMB139,000. The property at present is occupied by the Group as office.	No commercial value
44.	Level 2, The middle Wangdian, Block 3, No. 262 Weihai Road, Qingdao, Shandong Province, the PRC	The property comprises the whole on level 2 of a 8-storey building completed in or about 1996. The property has a total gross floor area of approximately 180 sq.m.	The property is leased to the Group by an independent third party for a term of two years and one month commencing from 1 December 2002 to 31 December 2004 at an annual rent of RMB60,000. The property at present is occupied by the Group as office.	No commercial value
45.	No. 8 Wangdian on Level 1–2, Unit A, Block 1, No. 341 Wuyishan Road, Qingdao Development District, Shandong Province, the PRC	The property comprises the whole of a 2-storey building completed in or about 2001. The property has a total gross floor area of approximately 103.64 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 April 2004 to 31 March 2007 at a monthly rent of RMB2,350. The property at present is occupied by the Group as office.	No commercial value
46.	No. 66 (Fu No. 2) Longye Road, Zhengzhou City, Henan Province, the PRC	The property comprises a unit of a 3-storey building completed in or about 1999. The property has a total gross floor area of approximately 371.64 sq.m.	The property is leased to the Group by an independent third party for a term of two years commencing from 5 March 2003 to 4 March 2005 at an annual rent of RMB194,700. The property at present is occupied by the Group for office uses.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
47.	Level 1, No. 45 Gaoloumen, Xuanwu District, Nanjing City, Jiangsu Province, the PRC	The property comprises the whole on level 1 of an 8-storey building completed in or about 1997. The property has a total gross floor area of approximately 350 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 January 2003 to 31 December 2005 at an annual rent of RMB222,000. The property at present is occupied by the Group for office use.	No commercial value
48.	No. 50 Wangyunsi Road, Shenhe District, Shenyang City, Liaoning Province, the PRC	The property comprises the whole of a 2-storey building completed in or about 2001. The property has a total gross floor area of approximately 343 sq.m.	The property is leased to the Group by an independent third party for a term of two years commencing from 1 June 2004 to 1 June 2006 at an annual rent of RMB180,000. The property at present is occupied by the Group for office and repair uses.	No commercial value
49.	No. 61. 61-1 Guojicheng Shangyongmenlian, Dangu Main Street, Shijiazhuang, Hebei Province, the PRC	The property comprises a unit of a 2-storey building completed in or about 2003. The property has a gross floor area of approximately 420 sq.m.	The property is leased to the Group by an independent third party for a term of five years commencing from 15 September 2004 to 15 September 2009 at an annual rent of RMB156,000. The property at present is occupied by the Group for office and retail uses.	No commercial value
50.	Level 1, Zhejiang Broadcast Television Press Building, No. 241–245 Hushu Road South, Gongshu District, Hangzhou City, Zhejiang Province, the PRC	The property comprises the whole on level 1 of a 7-storey building completed in or about 1998. The property has a total gross floor area of approximately 313 sq.m.	The property is leased to the Group by an independent third party for a term of two years commencing from 1 April 2004 to 31 March 2006 at an annual rent of RMB345,000. The property at present is occupied by the Group for office use.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
51.	Commercial unit, No. 25 Yuxiu Garden, Yucai Road, Chengxiang Town, Xiaoshan District, Hangzhou City, Zhejiang Province, the PRC	The property comprises a unit of a 2-storey building completed in or about 2002. The property has a gross floor area of approximately 122.17 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 July 2003 to 30 June 2006 at an annual rent of RMB43,000. The property at present is occupied by the Group for office uses.	No commercial value
52.	No. 85 Xinhua Road, Zhucui Garden, Huzhou City, Zhejiang Province, the PRC	The property comprises a unit of a 5-storey building completed in or about 2002. The property has a gross floor area of approximately 41.23 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 18 February 2004 to 18 February 2007 at an annual rent of RMB32,000. The property at present is occupied by the Group for office uses.	No commercial value
53.	Shop 3/4 on basement, No. 15, Zone G, Qiaodong District, Qiaodong Street, Taiyuan City, Shanxi Province, the PRC	The property comprises a unit of an 8-storey building completed in or about 1999. The property has a gross floor area of approximately 530.69 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 January 2003 to 31 March 2006 at an annual rent of RMB200,000. The property at present is occupied by the Group for office and retail uses.	No commercial value
54.	Units 103–104, 106–107 on Level 1, Block B, Xintiandi Building, No. A1 Xibeihe Road South, Chaoyang District, Beijing, the PRC	The property comprises 4 units on level 1of a single-storey building completed in or about 2002. The property has a total gross floor area of approximately 314 sq.m.	The property is leased to the Group by an independent third party, in which units 103–104 are leased for a term of three years commencing from 1 August 2003 to 31 July 2006 at an annual rent of RMB290,000 whilst units 106–107 are leased for a term of two years and eight months commencing from 1 December 2003 to 31 July 2006 at an annual rent of RMB110,000. The property at present is occupied by the Group for retail uses.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
55.	No. 190 Luoyu Road (also known as No. 182 Luoyu Road), Wuchang District, Wuhan City, Hunan Province, the PRC	The property comprises a unit of a 3-storey building completed in or about 1990. The property has a gross floor area of approximately 497.83 sq.m.	The property is leased to the Group by an independent third party for a term of four years and four months commencing from 1 January 2003 to 30 April 2007 at an annual rent of RMB155,000. The property at present is occupied by the Group for office and retail uses.	No commercial value
56.	Front Room on Level 1, Level 2 and a unit on basement level, No. 155 Jianxiang Road, Chuangsha City, Hunan Province, the PRC	The property comprises various units on basement level, levels 1 and 2 of a 2-storey building completed in or about 1994. The property has a total gross floor area of approximately 410.39 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 11 March 2003 to 10 March 2006 at a monthly rent of RMB17,000. The property at present is occupied by the Group for office uses.	No commercial value
57.	Unit 10A, Block A, Xiandaizhichuang Building, Huaqiang Road North, Futian District, Shenzhen, Guangdong Province, the PRC	The property comprises a unit on level 10 of a 25-storey building completed in or about 1999. The property has a gross floor area of approximately 364.28 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 10 August 2003 to 10 August 2006 at a monthly rent of RMB17,485.44. The property at present is occupied by the Group for office uses.	No commercial value
58.	Units Fu 10–13 on level 1, Tianzhuliyuan, No. 8 Xiaotian Street North, Chengdu City, Sichuan Province, the PRC	The property comprises various units on level 1 of an 11-storey building completed in or about 2003. The property has a total gross floor area of approximately 421.6 sq.m.	The property is leased to the Group by an independent third party for a term of three years commencing from 1 May 2004 to 30 April 2007 at an annual rent of RMB240,000. The property at present is occupied by the Group for office uses.	No commercial value

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
59.	Unit 6F of Block A, units 3F and 6F of Block C and various units on level 1, Xiahua Electrical Industrial City, Huoju District, Xiamen, Fujian Province, the PRC	The property comprises various units on level 1 of a 6-storey building completed in or about 1999. The property has a total gross floor area of approximately 23,062.53 sq.m.	The property is leased to the Group by a connected party, in which unit 6F of Block A, unit 6F of Block C are leased for a term of eleven months commencing from 1 April 2004 to 28 February 2005 at a monthly rent of RMB63,058.2, unit 3F of Block C is leased for a term of ten months commencing from 1 May 2004 to 28 February 2005 at a monthly rent of RMB8,638.65 and the remaining units are leased for a term of one year commencing from 1 March 2004 to 28 February 2005 at a monthly rent of RMB221,437.32. The property at present is occupied by the Group for commercial, factory and repair uses.	No commercial value

Notes:

1. According to the information provided by the Group, the lessors of properties nos. 8–19 and 21–58 are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates. Whilst the landlords of properties nos.: 20 and 59 are connected to the Group, and they are the subsidiaries of the Group.

2. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

   (a) Property 16 is subject to a mortgage in favour of Shanghai Pudong Development Bank.

   (b) The landlords of properties nos. 8–14, 16–21, 23–26, 28, 31–32, 34, 39, 44–45, 47–49, 53, 55, 57 and 59 have obtained relevant certificates and registration, which are entitled to lease the property to the Group.

   (c) The tenancies of properties nos. 14, 16, 31, 44, 48, 53 and 57 has been duly registered in relevant government organizations.

   (d) The content of all the tenancy agreements are effective, valid and legally binding to both parties under the law of the PRC.

Group IV — Property interest leased by the Group in USA

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
60.	No. 48401 Landing Parkway, Fremont, Alameda, California, USA	The property comprises the whole of a single-storey building completed in 2000. The property has a total gross floor area of approximately 9,740 sq.ft.	The property is leased to the Group by an independent third party for a term of five years commencing from 15 July 2001 to 14 July 2006 at a monthly rent of US$21,915. The monthly rental will be reviewed to US$24,350 from 13th to 24th month, US$26,785 from the 25th to 36th month, US$29,220 from the 37th month to 48th month and US$31,655 from the 49th month to 60th month. The property at present is occupied by the Group as office.	No commercial value

Notes:

1. According to the record in the California Land Title Association, the current registered owner of the property is the lessor.

2. The landlord is an independent third party, which is not connected with and is independent of, any of the directors of the Group, or any of their respective associates.

Group V — Property interests to be leased by the Group in the PRC upon the applicable Closing

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
61.	Temporary Godown, Industrial Zone of Science & Industry Park, Nanshan District, Shenzhen, Guangdong Province, the PRC	The property comprises a godown of a single-storey building completed in or about 1998. The property has a gross floor area of approximately 1,740 sq.m.	The property at present is leased by the landlord to the original lessee for a term of one year commencing from 21 April 2004 to 20 April 2005 at a monthly rent RMB40,020 inclusive of management fee but other operating expense are exclusive. The property at present is occupied by the original lessee as godown, according to the information provided by the Group, the property will be also occupied by the Group as godown after Closing.	No commercial value

Notes:

1. According to the information provided by the Group, the landlord and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

2. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

   (a) The content of the existing tenancy agreement entered into between the landlord and the original lessee is valid, effective and legally binding to both landlord and original lessee.

   (b) According to the law of the PRC, original lessee is entitled to assign the lease or sub-lease the property to third parties under the permission from the landlord.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
62.	Levels 1–2 and cockloft, Nanshan Technology Park, Shenzhen, Guangdong Province, the PRC	The property comprises the whole of levels 1–2 and cockloft of a 4-storey building completed in or about 2002. The property has a total gross floor area of approximately 22,000 sq.m.	The property at present is leased by the landlord to the original lessee for a term of one year commencing from 1 February 2004 to 31 January 2005 at a monthly rent of RMB799,922.78 exclusive of management fee and other operating costs. The property at present is occupied by the original lessee as warehouse, according to the information provided by the Group, the property will be also occupied by the Group as warehouse after Closing.	No commercial value

Notes:

1. According to the information provided by the Group, the landlord and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

2. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

   (a) The content of the existing tenancy agreement entered into between the landlord and the original lessee is valid, effective and legally binding to both landlord and original lessee.

   (b) According to the law of the PRC, original lessee is entitled to assign the lease or sub-lease the property to third parties under the permission from the landlord.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
63.	Levels 7–12, Great Wall Computer Group Building, No. 2 Keji Road, Science & Industry Park, Nanshan District, Shenzhen, Guangdong Province, The PRC	The property comprises the whole on levels 7–12 of a 16-storey building completed in 2002. The property has a total gross floor area of approximately 8,115.58 sq.m.	The property at present is leased by the landlord to the original lessee for a term of three years commencing from 16 January 2003 to 15 January 2005 at a monthly rent of RMB486,934.8 exclusive of management fee and other operating costs. The property at present is occupied by the original lessee as warehouse, according to the information provided by the Group, the property will be also occupied by the Group as warehouse after Closing.	No commercial value

Notes:

1. According to the information provided by the Group, the landlord and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

2. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

   (a) The content of the existing tenancy agreement entered into between the landlord and the original lessee is valid, effective and legally binding to both landlord and original lessee.

   (b) According to the law of the PRC, original lessee is entitled to assign the lease or sub-lease the property to third parties under the permission from the landlord.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
64.	Various units of Futian Baoshui District, Futian, Shenzhen, Guangdong Province, The PRC	The property comprises various units of 4-6-storey buildings completed from 1996 to 2003. The property has a total gross floor area of approximately 103,285 sq.m.	Portion of the property at present is leased by the lessor to the original lessee and portion is occupied by the original lessee by construction contracts and Statement of work. Detail information of these tenancies, construction contracts and Statement of work of the property are summarized in Notes 2 & 3. The property at present is occupied by the original lessee as factory, warehouse, office and ancillary uses, according to the information provided by the Group, the property will be also occupied by the Group as factory, warehouse, office and ancillary uses after the Closing.	No commercial value

Notes:

1. According to the information provided by the Group, the landlord and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

2. The property at present is subject to various tenancies, detail information are summarized as follow:

Item	Building	Gross Floor Area *(sq.m.)*	Lease Term	Monthly Rental *(RMB/sq.m.)*
1.	No. 1 Hai Hong Road	18,740	16 January 2002 – 15 January 2005	50
2.	The 2nd Stage on Level 1, an office on Level 2, an office on the cockloft of level 1, ELP laboratory and Phase 4 on Level 2, No. 1 Hai Hong Road	4,100	31 August 2003 – 15 January 2005	50
3.	No. 3 Guang Lan Road	33,540	10 September 2003 – 9 September 2006	46
4.	Zones B & C on Level 3	2,030	1 April 2004 – 9 September 2006	46
Total		**58,410**		

Note 1: The tenancy of a unit located next to the lift no. 9 on Level 3 of Block 2 with a gross floor area of approximately 20 sq.m. was terminated by the original lessee.

Note 2: A rent free period from 1 January 2004 to 31 December 2004 was provided by the lessor to the original lessee on Block No. 1 with a gross floor area of approximately 620 sq.m.

3. The property at present is subject to various construction contracts and Statement of work, detail information are summarized as follow:

Item	Building	Gross Floor Area *(sq.m.)*	Term of license
1.	Rest Area on Level 7 of Block 2	660	1 January 2004 – 31 December 2007
2.	Training Room	1,415	1 January 2004 – 31 December 2007
3.	Warehouse on Wangcheng Building, Guang Lan Road, ISH Building, No. 1 Hai Hong Road and ISH Building, No. 2 Rong Hua Road	42,800	Annually base term commencing from 1 April 2004
Total		**44,875**	

Note 1: Items 1 & 2 are occupied by the original lessee by construction contracts. The lessor erected these buildings for the occupation by the original lessee, the original lessee would return the construction fee to the lessor monthly. The original lessor would return RMB41,350 to the lessor monthly for item 1 from January 2005 to December 2006 whilst RMB64,420 monthly for item 2 from 1 January 2005 to 31 December 2007. The original lessee is licensed to occupy items 1 & 2 during the period from 1 January 2004 to 31 December 2007.

Note 2: Item 3 was occupied by the original lessee by a statement of work, the lessor provided various units with a fixed gross floor area of approximately 42,800 sq.m. for the original lessee as warehouse (in which 39,800 sq.m. is fixed space and 3,000 sq.m. is variable space) commencing from 1 April 2004 at a monthly storage service charges RMB42 per square meter for fixed space and RMB42 per square meter for variable space.

Note 3: Various warehouses on Level 3 of Block A, Shenfubao Technical Industrial Park with a total gross floor area of approximately 2,130.22 sq.m. were occupied by the original lessee subject to a service agreement commencing from 1 June 2003 at a monthly service fee RMB37.5 per sq.m. inclusive of management fee. According to the information provided, the service agreement has been terminated.

4. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

(a) The content of the existing tenancy agreement entered into between the landlord and the original lessee is valid, effective and legally binding to both landlord and original lessee.

(b) According to the law of the PRC, original lessee is entitled to assign the lease or sub-lease the property to third parties under the permission from the landlord.

(c) The contents of construction contracts and the Statement of work stated in Note 3 are valid, effective and legally binding to both landlord and original lessee. Original lessee is entitled to assign the construction contracts and the Statement of work to third parties under the permission from the landlord.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
65.	Unit 06A on Level 11, Shui On Plaza, No. 333 Huaihai Middle Road, Shanghai, The PRC	The property comprises a unit on level 11 of a 26-storey building completed in 1997. The property has a gross floor area of approximately 73.76 sq.m.	The property at present is leased by the landlord to the original lessee for a term of two years commencing from 16 May 2003 to 15 May 2005 at a monthly rent of RMB12,770.81 exclusive of air-conditioner and management fee. The property at present is occupied by the original lessee as office, according to the information provided by the Group, the property will be also occupied by the Group as office after Closing.	No commercial value

Notes:

1. According to the information provided by the Group, the landlord and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

2. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

   (a) The content of the existing tenancy agreement entered into between the landlord and the original lessee is valid, effective and legally binding to both landlord and original lessee.

   (b) According to the law of the PRC, original lessee is entitled to assign the lease or sub-lease the property to third parties under the permission from the landlord.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
66.	Unit 64632 of Beijing Friendship Hotel, No. 3 Baishiqiao Road, Beijing, The PRC	The property comprises a unit of a 6-storey building completed in or about 1954. The property has a gross floor area of approximately 115 sq.m.	The property at present is leased by the landlord to the original lessee for a term of one year commencing from 16 December 2003 to 15 December 2004 at a daily rent of RMB632.5 exclusive of utility charges. The property at present is occupied by the original lessee as office, according to the information provided by the Group, the property will be also occupied by the Group as office after Closing.	No commercial value

Notes:

1. According to the information provided by the Group, the landlord and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

2. We have been provided with a legal opinion on the property prepared by the Group's PRC legal advisers, which contains, inter alia, the following information:

   (a) The content of the existing tenancy agreement entered into between the landlord and the original lessee is valid, effective and legally binding to both landlord and original lessee.

   (b) According to the law of the PRC, original lessee is entitled to assign the lease or sub-lease the property to third parties under the permission from the landlord.

Group VI — Property interest to be leased by the Group in India upon the applicable Closing

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
67.	R.S. No. 19/1A and 19/2A Thavalakuppam Revenue Village, Edayarpalayam, Ariankuppam Commune Panchayat, Pondicherry, India	The property comprises the whole of a 2-storey buildings and various ancillary buildings completed in or about 2003. The property has a super built area of approximately 89,556 sq.ft.	The property is leased by the landlord to the sub-lessor for a term of three years commencing from 1 June 2003 to 31 May 2006 at a monthly rent of Rs.810,000. The property is at present sub-leased by the sub-lessor to the original sub-lessee for a term of three years commencing from 1 August 2003 to 31 July 2006 at a monthly rent Rs.2,573,072 and such sub-lease has obtained the consent from the landlord. The property at present is occupied by the original sub-lessee as factory, warehouse and ancillary uses, according to the information provided by the Group, the property will be also occupied by the Group as factory, warehouse and ancillary uses after Closing.	No commercial value

Notes:

1. According to the information provided by the Group, the landlord, sub-lessor and the original sub-lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

2. The leases described above are the current leases entered into between the landlord and the sub-lessor and between the sub-lessor to the original sub-lessee. According to the information provided by the Group, as part of the acquisition, the original sub-lessee will assign the above referenced sub-lease to the Group. However, the exact terms of the proposed sub-lease assignment are under negotiation between the original sub-lessee and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

   (a) The lease will be assigned to the Group from the original sub-lessee on the same terms and conditions stated on the current lease entered into between the sub-lessor and the original sub-lessee in a material respect.

   (b) Assuming that the assumption in (a) applies, the lease to be assigned to the Group from the original sub-lessee will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the assigned leased to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) There is no foreseeable obstacle for the Group to obtain consent to the proposed sub-lease assignment issued by relevant parties within a reasonable period of time.

3. We have been provided with a legal opinion on the property prepared by the Group's Indian legal advisers, which contains, inter alia, the following information:

   (a) The landlord is the owner of the property and the landlord has vested legal title to the property and has full right and power to grant the lease to the sub-lessor.

   (b) The tenancy agreement entered into between the landlord and the sub-lessor is legal, valid and binding and is enforceable as a whole.

   (c) Although the sub-lease agreement entered into between the sub-lessor and the original sub-lessee is not appropriately stamped and registered, the sub-lease is valid and binding to both parties.

Group VII — Property interest to be acquired by the Group by way of lease assignment or grant of a license in USA upon the applicable Closing

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
68.	4401 Silicon Drive, Bldg 675, Durham, North Carolina, 27709, USA	The property comprises the whole of a 4-storey building completed in or about 1987. The property has a rentable area of approximately 80,000 sq.ft.	The property is leased by the prime lessor to the sub-lessor for a term of eight years commencing from 1 January 1997 to 31 December 2004. Detail information of this prime tenancy is summarized in Note 4. The property is at present sub-leased by the sub-lessor to the original sub-lessee for a term of five years commencing from 1 March 2001 to 31 May 2005. Detail information of this sub-tenancy is summarized in Note 5. The property at present is occupied by the original sub-lessee as office, laboratory and ancillary uses, according to the information provided by the Group, the property will be also occupied by the Group as office, laboratory and ancillary uses after Closing.	No commercial value

Notes:

1. According to the record of North Carolina Land Title Association, the current registered owner of the property is the prime lessor.

2. According to the information provided by the Group, the prime lessor, sub-lessor and the original sub-lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. According to the information provided by the Group, upon its acceptance if sub-lease assignment, the Group will have reserved the rights to renew the sub-lease in accordance with the terms stated in the proposed sub-lease agreement entered into between the original sub-lessee and the Group.

4. The detail information of the prime tenancy is summarized as follow:

Lease Term	Monthly Rent (US$) (Exclusive of management fee and operating costs)
1 January 1997 – 31 December 1997	63,333.33
1 January 1998 – 31 December 1998	64,933.33
1 January 1999 – 31 December 1999	66,533.33
1 January 2000 – 31 December 2000	68,200
1 January 2001 – 31 December 2001	69,933.33
1 January 2002 – 31 December 2002	71,666.67
1 January 2003 – 31 December 2003	73,466.67
1 January 2004 – 31 December 2004	75,333.33

5. The detail information of the sub-tenancy is summarized as follow:

Lease Term	Monthly Rent (US$) (Exclusive of management fee and operating costs)
1 March 2001 – 31 May 2001	99,666.67
1 June 2001 – 31 May 2002	101,400
1 June 2002 – 31 May 2003	103,133.33
1 June 2003 – 31 May 2004	104,933.33
1 June 2004 – 31 May 2005	106,800

6. The leases described above are the current leases entered into between the lessor and the sub-lessor and between the sub-lessor and the original sub-lessee. According to the information provided by the Group, as part of the acquisition, the original sub-lessee has granted the Group an option to accept an assignment and assume to sub-lease or to license the above property. However, the exact terms of the proposed sub-lease assignment are under negotiation between the original sub-lessee and the Group. In view of the above circumstances and assuming that the Group will agree to accept an assignment of the sub-lease, we have adopted the following assumptions in our valuation of the property:

   (a) The material terms of the proposed terms of the proposed sub-lease agreement between the original sub-lessee and the Group will not depart from the terms of the existing lease in a material respect.

   (b) Assuming that the assumption in (a) applies, the sub-lease to be assigned to the Group from the original sub-lessee will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the assigned leased to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) No substantial profit rent will be generated if the Group exercises any option to renew the assigned sub-lease agreement.

   (d) There is no foreseeable obstacle for the Group to obtain consent to the proposed sub-lease assignment issued by relevant parties within a reasonable period of time.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
69.	4407 Silicon Drive, Bldg 676, Durham, North Carolina, 28217, USA	The property comprises the whole of a 4-storey building completed in or about 1987. The property has a rentable area of approximately 80,000 sq.ft.	The property is leased by the lessor to the original lessee for a term of three years commencing from 1 February 2002 to 31 January 2005 at a monthly rent of US$117,156.67 for the period from 1 February 2002 to 31 January 2003, monthly rent of US$120,656.67 for the period from 1 February 2003 to 31 January 2004 and monthly rent of US$124,261.67 for the period from 1 February 2004 to 31 January 2005. The lease term of the tenancy has been further extended for two years and will be expired on 31January 2007 at a monthly rent of US$106,666.67 for the period from 1 February 2005 to 31 January 2006 and of US$109,866.67 for the period from 1 February 2006 to 31 January 2007. The property at present is occupied by the original lessee as office, laboratory and ancillary uses, according to the information provided by the Group, the property will be also occupied by the Group as office, laboratory and ancillary uses after Closing.	No commercial value

Notes:

1. According to the record of North Carolina Land Title Association, the current registered owner of the property is the lessor.

2. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. According to the information provided by the Group, upon its acceptance of the lease assignment, the Group will have right to exercise any renewal option contained in the renew the terms stated on the proposed lease assignment entered into between the original lessee and the Group subject to the provisions of the Renewal Option contained in the lease.

4. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee has granted the Group an option to accept an assignment of and assume the lease or to license the above property. However, the exact

terms of the proposed lease assignment are under negotiation between the original lessee and the Group. In view of the above circumstances and assuming that the Group will enter into a lease under the option to lease, we have adopted the following assumptions in our valuation of the property

(a) The material terms of the proposed terms of the proposed lease assignment between the original lessee and the Group will not depart from the terms of the existing lease in a material respect.

(b) Assuming that the assumption in (a) applies, the lease to be assigned to the Group from the original lessee will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the assigned leased to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

(c) No substantial profit rent will be generated if the Group exercise the option to renew the assigned lease agreement.

(d) There is no foreseeable obstacle for the Group to obtain consent to the proposed lease assignment issued by relevant parties within a reasonable period of time.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
70.	500 Park Offices, Bldg 660, Research Triangle Park, Raleigh, North Carolina, 27709, USA	The property comprises the whole of a 3-storey building completed in or about 1985. The property has a rentable area of approximately 125,743 sq.ft.	The property is leased by the lessor to the original lessee for a term of eight years commencing from 1 January 2001 to 31 December 2008 at an annual rent of US$1,915,065.9 exclusive of management fee and utility charges. The property at present is occupied by the original lessee as office, laboratory and ancillary uses, according to the information provided by the Group, the property will be also occupied by the Group as office, laboratory and ancillary uses after Closing.	No commercial value

Notes:

1. According to the record of North Carolina Land Title Association, the current registered owner of the property is the lessor.

2. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. According to the information provided by the Group, upon its acceptance of the lease assignment, the Group will have the right to exercise any renewal option contained in the lease agreement entered into between the original lessee and the Group subject to the Renewal Option contained in the lease.

4. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee has granted the Group an option to accept an assignment of and assume the lease or to license the above property. However, the exact terms of the proposed lease assignment are under negotiation between the original lessee and the Group. In view of the above circumstances and assuming that the Group will enter into a lease under the option to lease, we have adopted the following assumptions in our valuation of the property:

   (a) The material terms of the proposed lease assignment between the original lessee and the Group will not depart from the terms of the existing lease in a material respect.

   (b) Assuming that the assumption in (a) applies, the lease to be assigned to the Group from the original lessee will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the assigned leased to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) No substantial profit rent will be generated if the Group exercise the option to renew the assigned lease agreement.

   (d) There is no foreseeable obstacle for the Group to obtain consent to the proposed lease assignment issued by relevant parties within a reasonable period of time.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
71.	600 Park Offices, Bldg 660, Research Triangle Park, Raleigh, North Carolina, 27709, USA	The property comprises the whole of a 4-storey building completed in or about 1986. The property has a rentable area of approximately 129,047 sq.ft.	The property is leased by the lessor to the original lessee for a term of six years commencing from 1 January 2001 to 31 December 2006 at an annual rent of US$1,965,385.8 exclusive of management fee and utility charges. The property at present is occupied by the original lessee as office, laboratory and ancillary uses, according to the information provided by the Group, the property will be also occupied by the Group as office, laboratory and ancillary uses after Closing.	No commercial value

Notes:

1. According to the record of North Carolina Land Title Association, the current registered owner of the property is the lessor.

2. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. According to the information provided by the Group, upon its acceptance of the lease assignment, the Group will have the right to exercise any renewal option contained in the lease agreement entered into between the original lessee and the Group subject to the provision of the Renewal Option contained in the lease.

4. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee has granted the Group an option to accept an assignment of and assume to lease or to license the above property. However, the exact terms of the proposed lease assignment are under negotiation between the original lessee and the Group. In view of the above circumstances and assuming that the Group will enter into a lease under the option to lease, we have adopted the following assumptions in our valuation of the property:

   (a) The material terms of the proposed lease assignment between the original lessee and the Group will not depart from the terms of the existing lease in a material respect.

   (b) Assuming that the assumption in (a) applies, the lease to be assigned to the Group from the original lessee will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the assigned leased to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) No substantial profit rent will be generated if the Group exercise the option to renew the proposed lease assignment.

   (d) There is no foreseeable obstacle for the Group to obtain consent to the proposed lease assignment issued by relevant parties within a reasonable period of time.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
72.	700 Park Offices, Bldg 662, Research Triangle Park, Raleigh, North Carolina, 27709, USA	The property comprises the whole of a 4-storey building completed in or about 1987. The property has a rentable area of approximately 120,473 sq.ft.	The property is leased by the lessor to the original lessee for a term of five years commencing from 1 January 2001 to 31 December 2005 at an annual rent of US$1,834,803.8 exclusive of management fee and utility charges. The property at present is occupied by the original lessee as office, laboratory and ancillary uses, according to the information provided by the Group, the property will be also occupied by the Group as office, laboratory and ancillary uses after Closing.	No commercial value

Notes:

1. According to the record of North Carolina Land Association, the current registered owner of the property is the lessor.

2. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. According to the information provided by the Group, upon its acceptance of the lease assignment, the Group will have the right to exercise any renewal option contained in the proposed lease assignment entered into between the original lessee and the Group subject to the provisions of the Renewal Option contained in the proposed lease.

4. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee has granted the Group an option to accept an assignment of and to assume lease or to license the above property. However, the exact terms of the proposed lease assignment are under negotiation between the original lessee and the Group. In view of the above circumstances and assuming that the Group will enter into a lease under the option to lease, we have adopted the following assumptions in our valuation of the property:

   (a) The material terms of the proposed lease assignment between the original lessee and the Group will not depart from the terms of the existing lease in a material respect.

   (b) Assuming that the assumption in (a) applies, the lease to be assigned to the Group from the original lessee will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the assigned leased to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) No substantial profit rent will be generated if the Group exercise the option to renew the assigned lease assignment.

   (d) There is no foreseeable obstacle for the Group to obtain consent to the proposed lease assignment issued by relevant parties within a reasonable period of time.

Group VIII — Property interests to be acquired by the Group by way of lease assignment of a lease or grant of a sub-lease in Australia upon the applicable Closing

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
73.	The whole on Levels 10–12 and 26, 288 Edwards Street, Brisbane, Queensland, Australia	The property comprises the whole on Levels 10 to 12 and Level 26 of a 29-storey building completed in 1980s. The property has a rentable area of approximately 2,751 sq.m.	The property is leased by the lessor to the original lessee for a term of three years commencing from 1 August 2003 to 31 July 2006 at an annual rent of A$756,525 exclusive of operating expenses. The property at present is occupied by the original lessee as office and call centre uses, according to the information provided by the Group, the property will be also occupied by the Group as office and call centre uses after Closing.	No commercial value

Notes:

1. According to the record in the Department of Natural Resources and Mines in Queensland, the current registered owner of the property is the lessor.

2. The property is subject to a mortgage in favour of Australian Mutual Provident Society, Jadamal Pty Ltd vide a memorial no. 601546304 (L 753169B) dated 6 December 1993 and the mortgage was transferred to Westpac Banking Coporation vide a memorial no. 701813159 dated 17 February 1997.

3. The property is subject to a mortgage in favour of Westpac Banking Corporation vide a memorial no. 701813185 dated 17 February 1997.

4. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

5. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee will assign the above lease to the Group. However, the exact terms of the proposed lease assignment are under negotiation between the original lessee and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

   (a) The lease will be assigned to the Group from the original lessee on the same terms and conditions stated in the current lease entered into between the lessor and the original lessee in a material respect.

   (b) Assuming that the assumption in (a) applies, the lease to be assigned to the Group from the original lessee will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the assigned leased to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) There is no foreseeable obstacle for the Group to obtain consent to the proposed lease assignment issued by relevant parties within a reasonable period of time.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
74.	Level 24, 288 Edwards Street, Brisbane, Queensland, Australia	The property comprises the whole of Level 24 of a 29-storey building completed in 1980s. The property has a rentable area of approximately 688 sq.m.	The property is leased by the lessor to the original lessee for a term of three years commencing from 1 November 2004 to 31 October 2007 at an annual rent of A$196,080 exclusive of operating expenses and goods & services taxes (GST). The property at present is occupied by the original lessee as office uses, according to the information provided by the Group, the property will be also occupied by the Group as office uses after Closing.	No commercial value

Notes:

1. According to the record of the Department of Natural Resources and Mines in Queensland, the current registered owner of the property is the lessor.

2. The property is subject to a mortgage in favour of Australian Mutual Provident Society, Jadamal Pty Ltd vide a memorial no. 601546304 (L 753169B) dated 6 December 1993 and the mortgage was transferred to Westpac Banking Coporation vide a memorial no. 701813159 dated 17 February 1997.

3. The property is subject to a mortgage in favour of Westpac Banking Corporation vide a memorial no. 701813185 dated 17 February 1997.

4. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

5. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee will assign the above lease to the Group. However, the exact terms of the proposed lease assignment are under negotiation between the original lessee and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

   (a) The lease will be assigned to the Group from the original lessee on the same terms and conditions stated in the current lease entered into between the lessor and the original lessee in a material respect.

   (b) Assuming that the assumption in (a) applies, the lease to be assigned to the Group from the original lessee will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the assigned leased to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) There is no foreseeable obstacle for the Group to obtain consent to the proposed lease assignment issued by relevant parties within a reasonable period of time.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
75.	Level 27, 288 Edwards Street, Brisbane, Queensland, Australia	The property comprises the whole of Level 27 of a 29-storey building completed in 1980s. The property has a rentable area of approximately 257 sq.m.	The property is leased by the lessor to the original lessee for a term of one year commencing from 1 February 2004 to 31 January 2005 at an annual rent of A$275 per square meter exclusive of goods & services taxes (GST), operating expenses and management fee. The property at present is occupied by the original lessee as office uses, according to the information provided by the Group, the property will be also occupied by the Group as office uses after Closing.	No commercial value

Notes:

1. According to the record of the Department of Natural Resources and Mines in Queensland, the current registered owner of the property is the lessor.

2. The property is subject to a mortgage in favour of Australian Mutual Provident Society, Jadamal Pty Ltd vide a memorial no. 601546304 (L 753169B) dated 6 December 1993 and the mortgage was transferred to Westpac Banking Coporation vide a memorial no. 701813159 dated 17 February 1997.

3. The property is subject to a mortgage in favour of Westpac Banking Corporation vide a memorial no. 701813185 dated 17 February 1997.

4. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

5. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee will assign the above lease to the Group. However, the exact terms of the proposed lease assignment are under negotiation between the original lessee and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

   (a) The lease will be assigned to the Group from the original lessee on the same terms and conditions stated in the current lease entered into between the lessor and the original lessee in a material respect.

   (b) Assuming that the assumption in (a) applies, the lease to be assigned to the Group from the original lessee will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the assigned leased to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) There is no foreseeable obstacle for the Group to obtain consent to the proposed lease assignment issued by relevant parties within a reasonable period of time.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
76.	Levels 5, 7, 8 and 9, No. 601 Pacific Highway, St. Leonards, Sydney, New South Wales, Australia	The property comprises the whole of Levels 5, 7, 8 and 9 of a 14-storey building completed in 1988. The property has a net lettable area of approximately 3,642 sq.m.	The property is leased by the lessor to the original lessee for a term of seven years and nine months commencing from 1 February 2002 to 31 October 2009 at an annual rent of A$1,209,144 exclusive of goods & services taxes (GST) but exclusive of operating expenses. The property at present is occupied by the original lessee as office uses, according to the information provided by the Group, the property will be also occupied by the Group as office uses after Closing.	No commercial value

Notes:

1. According to the record of the Department of Lands in New South Wales, the current registered owner of the property is the lessor.

2. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee will sublet portion of the above property to the Group. However, the exact terms of the proposed sub-lease agreement are under negotiation between the original lessee and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

   (a) The material terms of the proposed sub-lease agreement between the original lessee and the Group will not depart from the terms of the existing lease in any material respect.

   (b) Assuming that the assumption in (a) applies, the proposed sub-lease to be entered into by the Group will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the proposed sub-lease to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) There is no foreseeable obstacle for the Group to obtain consent to the proposed sub-lease assignment issued by relevant parties within a reasonable period of time.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
77.	55 Coonara Avenue, Sydney, New South Wales, Australia	The property comprises the whole of a 2-storey building with one-storey basement completed in 1984. The property has a gross floor area of approximately 8,375 sq.m.	The property is leased by the lessor to the original lessee for a term of fifteen years commencing from 1 September 1993 to 31 August 2008 at an annual rent of A$7,990,000 exclusive of management fee, operating cost, public risk insurance and building insurance and the rent is increased by 4% annually. The property at present is occupied by the original lessee as office uses, according to the information provided by the Group, the property will be also occupied by the Group as office uses after Closing.	No commercial value

Notes:

1. According to the record of the Department of Lands in New South Wales, the current registered owner of the property is the lessor.

2. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. The property is subject to a mortgage in favour of Westpac Banking Corporation vide memorial no. 5957230.

4. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee will sublet portion of the above property to the Group. However, the exact terms of the proposed sub-lease agreement are under negotiation between the original lessee and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

   (a) The material terms of the proposed sub-lease agreement between the original lessee and the Group will not depart from the terms of the existing lease in any material respect.

   (b) Assuming that the assumption in (a) applies, the proposed sub-lease to be entered by the Group will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the proposed sub-lease to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) There is no foreseeable obstacle for the Group to obtain consent to the proposed sub-lease assignment issued by relevant parties within a reasonable period of time.

Group IX — Property interest to be acquired by the Group by way of a new lease or grant of a license in UK at the time upon the applicable Closing

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
78.	Various buildings on Inverkip Road, Spango Valley, Greenock, Scotland, UK	The property comprises 7 blocks of 1- to 3-storey buildings completed from 1954 to 1978. According to the information provided by the landlord, the property has a total gross floor area of approximately 652,868 sq.ft.	The property at present is occupied by the landlord as factory, warehouse, office, laboratory and ancillary uses. According to the information provided by the Group, the property will be occupied by the Group as factory, warehouse, office, laboratory and ancillary uses after Closing.	No commercial value

Notes:

1. According to the record of relevant property search certificate, the current registered owner of the property is the landlord.

2. According to the information provided by the Group, the landlord is an independent third party, which is not connected with and is independent of, any of the directors of the Group, or any of their respective associates.

3. According to the information provided by the Group, as part of the acquisition, the landlord has granted the Group an option to lease or license the above property. However, the exact terms of the proposed lease assignment are still under negotiation between the landlord and the Group. In view of the above circumstances and assuming that the Group will enter into a lease under the option to lease, we have adopted the following assumptions in our valuation of the property:

   (a) The proposed lease assignment between the landlord and the Group will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the assigned lease to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

Group X — Property interest to be sub-leased by the Group in Canada upon the applicable Closing

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
79.	Suite 400 on Level 4, Suite 500 on Level 5 and Suite 602 on Level 6 of 10 York Mills Road, Suite 600 on Level 6 of 20 York Mills Road and Suite 502 on Level 5 of 4101 Yonge Street, Toronto, Ontario, Canada	The property comprises three whole levels and two units of three 7-storey buildings completed in 1989. The property has a rentable floor area of approximately 101,958 sq.ft.	The property is leased by the lessor to the original lessee for a term of twelve years and six months commencing from 1 March 1999 to 31 August 2011 at an annual rent of CA$14 per sq.ft. for the period from 1 March 1999 to 28 February 2001, CA$15 per sq.ft. for the period from 1 March 2001 to 28 February 2003, CA$16 per sq.ft. for the period from 1 March 2003 to 28 February 2005, CA$17 per sq.ft. for the period from 1 March 2005 to 28 February 2008 and CA$18 per sq.ft. from the period from 1 March 2008 to 31 August 2011. The property is at present occupied by the original lessee for office uses, according to the information provided by the Group, the property will be occupied by the Group for office uses after Closing.	No commercial value

Notes:

1. According to the record in the record of First Canadian Title, the current registered owner of the property is the lessor.

2. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee will sub-let portion of the above property to the Group. However, the exact terms of the proposed sub-lease agreement are under negotiation between the original lessee and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

   (a) The material terms of the proposed sub-lease agreement between the original lessee and the Group will not depart from the terms of the existing lease in any material respect.

   (b) Assuming that the assumption in (a) applies, the proposed sub-lease to be entered by the Group will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the proposed sub-lease to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

(c) There is no foreseeable obstacle for the Group to obtain consent to the proposed sub-lease issued by relevant parties within a reasonable period of time.

4. The property is subject to a court order in favour of the Confederation Life Insurance Company dated 21 December 1993 vide a memorial no. TB935239.

5. The property is subject to a court order in favour of the Confederation Life Insurance Company and Canada Trustco Mortgage Company dated 4 January 1994 vide a memorial no. TB936449.

6. The property is subject to a court order in favour of the Confederation Life Insurance Company dated 18 February 1994 vide a memorial no. TB942431.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
80.	1250 Boulevard René—Lévesque, Montreal, Quebec, Canada	The property comprises the whole of various unit of a 47-storey building completed in or about 1992. The property has a rentable floor area of approximately 295,759 sq.ft.	The property is leased by the lessor to the original lessee for a term of fifteen years commencing from 1 May 1991 to 30 April 2006 at an annual rent of CA$7,689,734.04 for the period from 1 May 1991 to 30 April 1996, CA$9,168,528.96 for the period from 1 May 1996 to 30 April 2001 and CA$11,830,359.96 for the period from 1 May 2001 to 30 April 2006. The property is at present occupied by the original lessee for office uses, according to the information provided by the Group, the property will be occupied by the Group for office uses after Closing.	No commercial value

Notes:

1. According to the record in Registry Office for the Registration Division of Montreal, the current registered owner of the property is the lessor.

2. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee will sublet portion of the above property to the Group. However, the exact terms of the proposed sub-lease agreement are under negotiation between the original lessee and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

   (a) The material terms of the proposed sub-lease agreement between the original lessee and the Group will not depart from the terms of the existing lease in a material respect.

   (b) Assuming that the assumption in (a) applies, the sub-lease to be entered into by the Group will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the proposed sub-lease to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) There is no foreseeable obstacle for the Group to obtain consent to the proposed sub-lease assignment issued by relevant parties within a reasonable period of time.

Group XI — Property interests to be leased, to be sub-leased or to be licensed by the Group in Japan upon the applicable Closing

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
81.	1 Kirihara-cho, Fujisawa-shi, Kanagawa-ken, 252-8588, Japan	The property comprises the whole of a 2-storey building completed in 1967. The property has a net rentable floor area of approximately 288,560 sq.ft.	The property is leased by the lessor to the original lessee for a term of seven years commencing from 1 January 2003 to 31 December 2009, detail information of the tenancy are summarized in Note 3. The property is at present occupied by the original lessee for office and laboratory uses, according to the information provided by the Group, the property will be occupied by the Group for office and laboratory uses after Closing.	No commercial value

Notes:

1. According to the record in relevant Land Management Organization in Japan, the current registered owner of the property is the lessor.

2. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. Detail information of the tenancy are summarized as follow:

Period	**Monthly Rental** *(Yen)*
1 January 2003 – 30 September 2003	55,551,296
1 October 2003 – 31 December 2003	43,012,779
1 January 2004 – 31 November 2004	52,250,000
1 December 2004 – 31 December 2004	40,250,000
1 January 2005 – 31 December 2005	51,416,667

Note: The monthly rental for the period from 1 January 2006 to 31 December 2009 will be reviewed.

4. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee will sublet portion of the above property to the Group. However, the exact terms of the propose sub-lease agreement are under negotiation between the original lessee and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

   (a) The material terms of the proposed sub-lease agreement between the original lessee and the Group will not depart from the terms of the existing lease in a material respect.

   (b) Assuming that the assumption in (a) applies, the sub-lease to be entered into by the Group will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the proposed sub-lease to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) There is no foreseeable obstacle for the Group to obtain consent to the proposed sub-lease assignment issued by relevant parties within a reasonable period of time.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
82.	1623-14, Aza-kou, Shimotsuruma, Yamato-shi, Kanagawa-ken, Japan	The property comprises various units of a 6-storey building and 1 level basement built underneath completed from 1985 to 1989. The property has a gross floor area of approximately 97,468.91 sq.m.	The property is leased by the lessor to the original lessee for a term of two years commencing from 1 April 2004 to 31 March 2006 at an annual rent of Yen3,067,000,000 exclusive of fixed property tax, city planning tax and fire insurance premium. The property is at present occupied by the original lessee for office and laboratory uses, according to the information provided by the Group, the property will be occupied by the Group for office and laboratory uses after Closing.	No commercial value

Notes:

1. According to the record in relevant Land Management Organization in Japan, the current registered owner of the property is the lessor.

2. According to the information provided by the Group, the lessor and the original lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. The lease described above is the current lease entered into between the lessor and the original lessee. According to the information provided by the Group, as part of the acquisition, the original lessee will sublet portion of the above property to the Group. However, the exact terms of the propose sub-lease agreement are under negotiation between the original lessee and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

   (a) The material terms of the proposed terms of the proposed sub-lease agreement between the original lessee and the Group will not depart from the terms of the existing lease in a material respect.

   (b) Assuming that the assumption in (a) applies, the sub-lease to be entered into by the Group will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the proposed sub-lease to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

   (c) There is no foreseeable obstacle for the Group to obtain consent to the proposed sub-lease assignment issued by relevant parties within a reasonable period of time.

	Property	Description	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
83.	3-2-12 Ropponngi, Minato-ku, Tokyo, Japan	The property comprises various units of a 22-storey building completed from 1971. According to the information provided by the landlord, the property has a net usable area of approximately 240,000 sq.ft.	The property is at present occupied by the landlord for office uses, according to the information provided by the Group, the property will be occupied by the Group for office uses after Closing.	No commercial value

Notes:

1. According to the record in the relevant Land Management Organization in Japan, the current registered owner of the property is the landlord.

2. According to the information provided by the Group, the landlord is an independent third party, which is not connected with and is independent of, any of the directors of the Group, or any of their respective associates.

3. According to the information provided by the Group, as part of the acquisition, the landlord has granted the Group an option to lease or license the above property. However, the exact terms of the proposed lease assignment are still under negotiation between the landlord and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

   (a) The lease between the landlord and the Group will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the lease to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

Group XII — Property interest to be sub-leased by the Group in Singapore upon the applicable Closing

	Property	Description and Tenure	Particular of occupancy	Open Market Value in existing state as at 31 October 2004
84.	7 and 9 Changi Business Park, Central 1, Singapore	The property comprises various units of a 7-storey building and a 5-storey building completed in 2001 and 2003. The property has a total gross floor area of approximately 22,510.9 sq.m.	The property is leased by the lessor to the original lessee with the last expiry date on 31 March 2014. Detail information of the tenancies are summarized in Note 3. The property is at present occupied by the original sub-lessee for factory, warehouse, office, laboratory and ancillary uses, according to the information provided by the Group, the property will be occupied by the Group for factory, warehouse, office, laboratory and ancillary uses after Closing.	No commercial value

Notes:

1. According to the record in the record in Singapore Land Authority, the current registered owner of the property is the lessor.

2. According to the information provided by the Group, the lessor, sub-lessor and the original sub-lessee are independent third parties, which are not connected with and are independent of, any of the directors of the Group, or any of their respective associates.

3. The detail information of the tenancies are summarized as follow:

Portion of property	Gross Floor Area *(sq.m.)*	Lease Term	Monthly Rental *(S$ per sq.m.)*
A18667(a)	6,689	1 April 2004 – 31 March 2005	25.85
A18667(b)	1,499.62	1 April 2005 – 31 March 2007	28
A18667(c)	1,502.28	1 April 2007 – 31 March 2012	33.5
		1 April 2012 – 31 March 2014	38.53
A18667	12,820	1 February 2002 – 31 January 2005	25.85
		1 February 2005 – 31 January 2007	28
		1 February 2007 – 31 January 2012	33.5
Total	**22,510.9**		

4. The leases described above are the current leases entered into between the lessor and the sub-lessor and between the sub-lessor and the original sub-lessee. According to the information provided by the Group, as part of the acquisition, the original sub-lessee will sublet portion of the above property to the Group. However, the exact terms of the proposed sub-lease agreement are under negotiation between the original sub-lessee and the Group. In view of the above circumstances, we have adopted the following assumptions in our valuation of the property:

    (a) The material terms of the proposed terms of the proposed sub-lease agreement between the original sub-lessee and the Group will not depart from the terms of the existing lease in any material respect.

(b) Assuming that the assumption in (a) applies, the proposed sub-lease to be entered by the Group will not generate any substantial profit rent and is subject to the following prohibitions: (i) transfer the proposed sub-lease to other third parties, (ii) transfer interest to third parties by way of short term lease and (iii) sub-letting.

(c) There is no foreseeable obstacle for the Group to obtain consent to the proposed sub-lease assignment issued by relevant parties within a reasonable period of time.

RESPONSIBILITY STATEMENT

This circular includes particulars given in compliance with the Listing Rules for the purpose of providing information with regard to the Lenovo Group. The Directors collectively and individually accept full responsibility for the accuracy of the information contained in this circular and confirm, having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission of which would make any statement herein misleading.

DISCLOSURE OF INTERESTS

Interests of Directors

As at the Latest Practicable Date, the interests and short positions of the Directors and the chief executive of the Company in the Shares, underlying shares and debentures of the Company and its associated corporations (within the meaning of Part XV of the SFO, which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions in which they were taken or deemed to have under such provisions of the SFO) or which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers in the Listing Rules were as follows:

Interests in the Shares and underlying shares of the Company

Name of Director	Long/Short position	Interests in Shares/ underlying shares	Capacity and number of Shares/ underlying shares held Personal interests	Family interests	Trust	Aggregate interests
Mr Liu Chuanzhi	Long position	Shares	16,010,000	976,000	—	16,986,000
	Long position	Share options	5,250,000	—	—	5,250,000
						22,236,000
Mr Zeng Maochao	Long position	Shares	8,080,000	600,000	—	8,680,000
	Long position	Share options	1,600,000	—	—	1,600,000
						10,280,000
Mr Yang Yuanqing	Long position	Shares	10,200,000	—	—	10,200,000
	Long position	Share options	11,250,000	—	—	11,250,000
						21,450,000
Ms Ma Xuezheng	Long position	Shares	15,834,000	—	7,240,000	23,074,000
	Long position	Share options	6,120,000	—		6,120,000
						29,194,000

Note: The above-mentioned share options are options granted by the Company pursuant to its share option schemes.

Save as disclosed above, as at the Latest Practicable Date, none of the Directors or the chief executive of the Company or their associates had any interests or short positions in the Shares, underlying shares or debentures of the Company or its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions in which they were taken or deemed to have under such provisions of the SFO) or which were required, pursuant to section 352 of the SFO, to be entered in the register referred to therein or which were required to be notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers in the Listing Rules.

Interests of Shareholders

As at the Latest Practicable Date, so far as was known to the Directors or the chief executive of the Company, the following persons (not being a Director or the chief executive of the Company) had an interest or short position in the Shares or underlying shares of the Company which would fall to be disclosed to the Company under provisions of Divisions 2 and 3 of Part XV of the SFO or were directly or indirectly interested in 10% or more of the nominal value of the issued share capital carrying rights to vote in all circumstances at general meetings of the Company's subsidiaries:

(i) *Interests in the Shares of the Company*

		Capacity and number of Shares held			
Name	**Long/short position**	**Beneficial owner**	**Corporate interests**	**Aggregate long/short position**	**Percentage** *(note 4)*
Legend Holdings Limited *(note 1)*	Long position	2,763,570,724	1,469,311,247 *(note 2)*	4,232,881,971	56.6%
	Short position	95,934,000	—	95,934,000	1.3%
Employees' Shareholding Society of Legend Holdings Limited *(note 3)*	Long position	—	4,232,881,971	4,232,881,971	56.6%
	Short position	—	95,934,000	95,934,000	1.3%
International Business Machines Corporation *(note 5)*	Long position	1,742,871,028	—	1,742,871,028	23.3%

Notes:

1. The English company name "Legend Holdings Limited" is a direct translation of its Chinese company name.

2. The Shares were beneficially held by Right Lane Limited, a direct wholly-owned subsidiary of Legend Holdings Limited.

3. Employees' Shareholding Society of Legend Holdings Limited is an equity holder of Legend Holdings Limited which in turn wholly owns Right Lane Limited. Therefore, Employees' Shareholding Society of Legend Holdings Limited is taken to be interested, or has short positions, in any Shares in which Legend Holdings Limited and Right Lane Limited are interested or have short positions.

4. The calculation of the percentage figure is based on the aggregate long/short position as a percentage of the number of Shares of the Company in issue as at the Latest Practicable Date.

5. Allotment of 821,234,569 Shares and 921,636,459 Non-voting Shares are subject to terms and conditions of the Asset Purchase Agreement, inter alia, approval by Shareholders at the Extraordinary General Meeting. The percentage of interests immediately after Initial Closing is set out in the section entitled "Corporate structure before and after Initial Closing" in this circular.

(ii) *Interests in shares of subsidiaries of the Company*

Name of subsidiary	Name of shareholder	Percentage of holding
Shenzhen Legend Computer Co., Ltd.	Legend Holdings Limited	20%
	Shenzhen Science and Industry Park Corporation	10%
Legend Creat Holdings Limited	Nanchang Creat Group Co., Ltd.	45%
Lenovo Mobile Communication Co., Ltd.	Xiamen Overseas Chinese Electronic Co., Ltd.	19.2%
Lenovo AI Computer Technology Co., Ltd.	A.I. Software Co., Ltd.	30%

Save as disclosed above, the Directors and the chief executive of the Company are not aware of any person (other than a Director or the chief executive of the Company) who, as at the Latest Practicable Date, had an interest or short position in the Shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO or, who was, directly or indirectly, interested in 10% or more of the nominal value of the issued share capital carrying rights to vote in all circumstances at general meeting of subsidiaries of the Company or any options in respect of such capital.

INTEREST IN CONTRACTS OR ARRANGEMENT AND COMPETING BUSINESS

(a) As at the Latest Practicable Date, none of the Directors or their associates had any direct or indirect interest in any assets which have been, since 31 March 2004 (being the date to which the latest published audited consolidated financial statements of the Lenovo Group were made up), acquired or disposed of by or leased to or are proposed to be acquired or disposed of by or leased to any member of the Lenovo Group.

(b) As at the Latest Practicable Date, none of the Directors or their associates was materially interested in any contract or arrangement entered into by any member of the Lenovo Group and subsisting at the date of this circular which was significant in relation to the business of the Lenovo Group.

(c) As at the Latest Practicable Date, none of the Directors or their associates had any interests in a business, apart from the business of the Lenovo Group, which competes or is likely to compete, either directly or indirectly, with the business of the Lenovo Group.

DIRECTORS' SERVICE CONTRACTS

As at the Latest Practicable Date, none of the Directors or proposed Directors had any existing or proposed service agreement with any member of the Lenovo Group which will not expire or is not determinable within one year without payment of compensation (other than statutory compensation).

EXPERTS

The following are the qualifications of the experts who have given opinions or advice, which are contained or referred to in this circular:

Name	Qualification	Date of opinion	Nature of opinion or advice
AZB & Partners	Qualified lawyer in India	10 December 2004	Legal opinion on the titles of the property interests of the Enlarged Group in India for the purpose of property valuation
Cazenove Asia Limited	Licensed under the SFO to carry out types 1, 4, 6 and 9 regulated activities	31 December 2004	Letter of advice to the Independent Board Committee and the Independent Shareholders
Commerce & Finance Law Offices	Qualified lawyer in the PRC	28 December 2004	Legal opinion on the titles of the property interests of the Enlarged Group in the PRC for the purpose of property valuation
PricewaterhouseCoopers LLP, New York, as appears in Appendix I to this circular	Independent Registered Public Accounting Firm	16 December 2004	Audited US combined financial statements of Personal Computing Division of IBM under US GAAP
PricewaterhouseCoopers, Hong Kong	Certified Public Accountants	31 December 2004	Unaudited combined financial information of the Business reconciled between the accounting policies of the Business to those of the Company which follow Hong Kong GAAP, and unaudited pro forma financial information on the Enlarged Group
Vigers Appraisal & Consulting Ltd.	Qualified Property Valuer	31 December 2004	Valuation on the property interests of the Enlarged Group

Each of the above experts has given and has not withdrawn their respective written consent to the issue of this circular with the inclusion of their respective opinion or advice above-mentioned and reference to its name, in the form and context in which they appear.

None of the above experts has any shareholding in any member of the Lenovo Group or the right (whether legally enforceable or not) to subscribe for or to nominate persons to subscribe for securities in any member of the Lenovo Group.

None of the above experts has any direct or indirect interest in any assets which have been acquired or disposed of by or leased to any member of the Lenovo Group or are proposed to be acquired or disposed of by or leased to any member of the Lenovo Group since 31 March 2004 (being the date to which the latest published audited consolidated financial statements of the Lenovo Group were made up).

MATERIAL CONTRACTS

The following contracts (not being contracts entered into in the ordinary course of business) have been entered into by members of the Lenovo Group within two years immediately preceding the date of this circular and are or may be material:

(a) The Asset Purchase Agreement entered into between the Company as purchaser and IBM as seller dated 7 December 2004;

(b) The Company Agreement entered into between the Company and IBM dated 7 December 2004;

(c) The Transition Services Agreement entered into between the Company and IBM dated 7 December 2004;

(d) The Strategic Financing and Asset Disposition Services Agreement entered into between the Company and IBM dated 7 December 2004;

(e) The IGS Services Agreement entered into between the Company and IBM dated 7 December 2004;

(f) The Marketing Support Agreement entered into between the Company and IBM dated 7 December 2004;

(g) The Internal Use Purchase Agreement entered into between the Company and IBM dated 7 December 2004;

(h) The Master Distribution Agreement entered into between the Company and IBM dated 7 December 2004;

(i) The Trademark Assignment Agreement entered into between IBM as the assignor and a subsidiary of IBM as the assignee dated 7 December 2004;

(j) The Trademark License Agreement entered into between IBM as the licensor, a subsidiary of IBM as licensee and the Company as guarantor of the obligations and responsibilities of the licensee dated 7 December 2004;

(k) The Patent Assignment Agreement entered into between IBM as the assignor and a subsidiary of IBM as the assignee dated 7 December 2004;

(l) The Patent Cross License Agreement entered into between IBM and a subsidiary of IBM and the Company dated 7 December 2004; and

(m) The Intellectual Property Assignment and License Agreement between IBM and the Company dated 7 December 2004.

LITIGATION

The Directors are not aware of any litigation or claims of material importance pending or threatened against the Company or any of its subsidiaries or the Business.

MISCELLANEOUS

(a) The registered office of the Company is at 23rd Floor, Lincoln House, Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong.

(b) The secretary of the Company is Ms Look Pui Fan who is an associate member of both The Institute of Chartered Secretaries and Administrators and The Hong Kong Institute of Company Secretaries.

(c) The qualified accountant of the Company is Mr Wong Wai Kwong who is a fellow member of both The Association of Chartered Certified Accountants and The Hong Kong Institute of Certified Public Accountants.

(d) The share registrar of the Company is Abacus Share Registrars Limited, situated at Ground Floor, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong.

(e) This circular has been prepared in both English and Chinese. In the case of any discrepancies, the English text shall prevail over the Chinese text.

DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection during normal business hours at the registered office of the Company from the date of this circular up to and including 16 January 2005:

(a) the memorandum and articles of association of the Company;

(b) the material contracts referred to in the sub-section headed "Material Contracts" above (The Company has applied to the Stock Exchange for a waiver from strict compliance with paragraph 43(2)(b) of Part B of Appendix I to the Listing Rules that certain confidential and commercially sensitive information in such material contracts (including, without limitation, information relating to pricing, benchmarking mechanism, intellectual property rights, commission rates and personal data) be obliterated for the purpose of public inspection);

(c) the audited US combined financial statements of the personal computing division of IBM and report of independent registered accounting firm thereon as set out in Appendix I to this circular;

(d) the unaudited combined financial information of the personal computing division of IBM for each of the six months ended 30 June 2004 and 2003 and each of the years ended 31 December 2003, 2002 and 2001 under Hong Kong GAAP, and the report of the Company's auditors thereon as set out in Appendix II to this circular;

(e) the unaudited pro forma financial information of the Enlarged Group and the report of the Company's auditors thereon as set out in Appendix IV to this circular;

(f) the property valuation of the Enlarged Group as set out in Appendix VI to this circular;

(g) the letter from Cazenove Asia, the text of which is set out in the section of letter from Cazenove Asia in this circular;

(h) the letters of consent referred to in the sub-section headed "Experts" above;

(i) the annual reports of the Company for the financial years ended 31 March 2003 and 31 March 2004; and

(j) the interim report of the Company for the six months ended 30 September 2004.

Lenovo Group Limited 聯想集團有限公司

(Incorporated in Hong Kong with limited liability)

(Stock Code : 992)

NOTICE IS HEREBY GIVEN that an extraordinary general meeting (the "EGM") of Lenovo Group Limited (the "Company") will be held on Thursday, 27 January 2005 at 9:30 a.m. at Ballroom B, Level 5, Island Shangri-La Hong Kong, Pacific Place, Supreme Court Road, Central, Hong Kong for the purposes of considering and, if thought fit, passing, with or without modification, the following resolutions as ordinary resolutions:

ORDINARY RESOLUTIONS

1. **THAT:**

   (a) the entering into by the Company of the Asset Purchase Agreement, pursuant to which the Company agreed to acquire from IBM certain assets and assume certain liabilities in connection with the Business in consideration of US$1.25 billion, subject to certain adjustments (details of which are set out in the sub-section entitled "Consideration" under the section entitled "Asset Purchase Agreement" on page 17 of the circular issued by the Company dated 31 December 2004 (the "Circular")) to be satisfied by the issue of up to 821,234,569 new Shares and up to 921,636,459 new Non-voting Shares (subject to adjustments) credited as fully paid, in each case, by the Company to IBM at the issue price of HK$2.675 each and payment by the Company of US$650 million in cash to IBM (subject to adjustments), and

   (b) in connection with the Asset Purchase Agreement, the entering into of the Continuing Connected Transactions by the Company and IBM pursuant to which IBM will, among other things, provide a broad range of transition services to the Enlarged Group in conducting the Business following the Initial Closing and the annual caps thereunder (note: the transactions underlying the Master Distribution Agreement are not subject to any annual cap) set out in the section entitled "Ancillary Agreements" under the letter from the Board set out in the Circular,

   be and are hereby approved; and

2. **THAT** pursuant to the Asset Purchase Agreement, the allotment and issue of up to 821,234,569 new Shares and up to 921,636,459 new Non-voting Shares, the rights and privileges attached to such Non-voting Shares being summarised as follows:

   i. *Ranking*

   The Non-voting Shares shall rank *pari passu* in all respects with the Shares, except for voting rights.

   ii. *Voting Rights*

   The Non-voting Shares will not have any voting rights at all general meetings of the Company until they are converted into Shares.

iii. *Transferability*

The Non-voting Shares are subject to the lock-up provisions set out in the Company Agreement and upon the expiry of such lock-ups, the Non-voting Shares are transferable.

Subject to the relevant lock-up restrictions, if IBM proposes to transfer its Non-voting Shares other than to its affiliates, it shall be a condition for such transfer that the transferee will request the Company to convert the Non-voting Shares into Shares immediately following the transfer.

iv. *Conversion*

The Non-voting Shares are convertible, by the holder thereof giving written notice to the Company, into Shares on a one for one basis, subject to any adjustments as a result of any consolidation or sub-division of the Shares. A conversion notice, once duly served, is irrevocable.

No conversion of the Non-voting Shares shall be permitted if following such conversion the holder of the Non-voting Shares would become a substantial shareholder (as defined in the Listing Rules) of the Company immediately following such conversion, assuming the holder is not already a or deemed to be a, substantial shareholder.

IBM may not convert any Non-voting Shares if such conversion would reduce the holdings of Shares of persons who count as members of the public for the purposes of the Listing Rules falling below 25% of the total outstanding Shares (or such other percentage as is required of the Company under the Listing Rules to maintain the minimum public float).

v. *Listing*

The Non-voting Shares will not be listed.

vi. *Others*

With respect to any bonus, capitalisation, rights or similar issues of additional securities of the Company which all the shareholders, including holders of Shares and Non-voting Shares, are entitled to participate in or benefit from (by virtue of their being shareholders in the Company) in proportion to their shareholding, whether for any consideration or for no consideration payable by such shareholders, any additional securities to be issued to the holder of Non-voting Shares under such issues shall be Non-voting Shares.

The share certificates of the Non-voting Shares shall bear the legend that such shares are "non-voting".

be and is hereby approved.

By order of the Board
Liu Chuanzhi
Chairman

Hong Kong, 31 December 2004

Registered office:
23rd Floor,
Lincoln House,
Taikoo Place,
979 King's Road,
Quarry Bay,
Hong Kong

Executive Directors:
Mr Liu Chuanzhi
Mr Yang Yuanqing
Ms Ma Xuezheng

Non-executive Director:
Mr Zeng Maochao

Independent Non-executive Directors:
Mr Wong Wai Ming
Professor Woo Chia-Wei
Mr Ting Lee Sen

Notes:

1. A member entitled to attend and vote at the EGM convened by this notice is entitled to appoint one or more proxies to attend and vote in his stead. A proxy need not be a member of the Company.

2. To be effective, the instrument appointing a proxy together with the power of attorney or other authority, if any, under which it is signed or a notarially certified copy of that power or authority, must be completed and lodged at the share registrar of the Company, Abacus Share Registrars Limited at Ground Floor, Bank of East Asia Harbour View Centre, 56 Gloucester Road, Wanchai, Hong Kong, not less than 48 hours before the time for holding the EGM or any adjournment thereof.

3. A form of proxy for use at the meeting is enclosed. Completion and return of the form of proxy will not preclude you from attending and voting in person at the EGM or any adjournment thereof and, in such event, the relevant form of proxy shall be deemed to be revoked.

4. Where there are joint registered holders of any Share, any one of such persons may vote at the EGM, either personally or by proxy, in respect of such Share as if he were solely entitled thereto; but if more than one of such joint registered holders be present at the EGM personally or by proxy, then the registered holder so present whose name stands first on the register of members of the Company in respect of such Share will alone be entitled to vote in respect thereof.

5. Capitalised terms used in this notice have the same meaning as is set out in the section entitled "Definitions" at pages 1 to 10 of the Circular.