

**CHENGDU TOP SCI-TECH COMPANY LTD :
WILL IT TURN A PROFIT THIS YEAR ?**

In true Communist fashion, the 7 Executive Directors of Chengdu Top Sci-Tech Company Ltd have decided that they, all, should receive exactly the same salaries for the Current Financial Year, ending December 31, 2001.

This will absorb a total of 1.40 million renminbi, which compares favourably with the aggregate salaries, paid to the 7 Executive Directors in the 2000 Financial Year, a sum of money, amounting to 348,000 renminbi.

With the exception of the 33-year-old Chairman, Mr Li Zheng Bin, who awarded himself an increase in his annual salary, amounting to about 233.33 percent, from 60,000 renminbi to 200,000 renminbi, all the other Executive Directors will be receiving an increase in their take-home pay of about 316.66 percent, from 48,000 renminbi to 200,000 renminbi.

An annual salary of 200,000 renminbi is not a lot of money for a high-ranking member of a Board of Directors, on an international scale, but it is interesting that the increase should coincide with Chengdu Top Sci-Tech, determining that it will be listed on The Growth Enterprise Market (The GEM) of The Stock Exchange of Hongkong Ltd.

Chengdu Top Sci-Tech, designated GEM Stock Code 8135, pitched its 169-million, renminbi 0.10, Share Placement at 72 cents (Hongkong) per share, last Monday, when it announced that it would be raising about \$HK121.68 million, gross.

The Company claims to be *'one of the major IT (Information Technology) solutions providers to Government-Related Entities in the PRC (People's Republic of China), and is principally engaged in ... provision of system solution services and other value added services ... and research, development, production and distribution of IT solutions for government administration systems.'* (Page One of the Prospectus)

Chengdu Top Sci-Tech was established in the PRC on January 24, 1993 and claims that it enjoys *'a significant advantage over its competitors in terms of R&D (Research and Development) capabilities in developing tailor-made IT solutions and other value added services for various Government-Related Entities ...'*

It is going to The GEM in order to raise \$HK106 million, net of expenses, for the following purposes:

1. \$HK50 million to be used for IT solution development, research and development of new technologies and products;
2. \$HK5 million to be used for IT solution reproduction activities;
3. \$HK35 million to be used to promote the Company's new products through advertising, exhibitions, etc;
4. \$HK7 million to be used in the establishment of a technology and information centres; and,
5. \$HK4 million to be used to boost the General Working Capital Account.

What may be considered interesting, in respect of the above 5 reasons for this cash-raising exercise, is that, on the one hand, Chengdu Top Sci-Tech claims to be *'one of the major IT solutions providers to Government-Related Entities in the PRC... principally engaged in ... provision of system solution services... for various Government-Related Entities* while, on the other hand, it wants to raise \$HK35 million *'to promote the*

Company's new products through advertisement, exhibitions and other marketing and promotional activities.'
(Page 91)

Since it is working, principally, for the PRC Government, and this is stated as being one of its significant advantages, it seems strange that it should be earmarking about 33 percent of the amount of money, that it is raising by going public on The GEM, for advertising and promotion and other promotional activities.

Under '*Risk Factors*', contained at Page 30 of the Prospectus, it is stated:

'Current, PRC Government-Related Entities form the Company's client base. As such, any decrease in spending on the part of such Government-Related Entities in e-Government projects could adversely affect the Company's well-being and profitability.'

One notes, also, this statement as the penultimate paragraph of Page One of the Company's Prospectus:

'In light of the Company's expertise in the e-Government projects and its R&D capabilities, the Directors believe that the Company is well positioned to capture the opportunities brought on by the PRC e-Government projects in the areas of system standardisation, system security and enhancement of electronic communication.'

The Profits

In spite of this Company, having been operating in the PRC for the past 8 years or so, it has only mentioned the past 3 Financial Years of trading results (which, of course, complies with the rules, pertaining to obtaining a listing on The GEM):

| | Financial Year ended December 31 | | |
|-------------------------------------|--|----------|----------|
| | 1998 | 1999 | 2000 |
| | All Figures are Denominated in Renminbi '000 | | |
| Turnover | 49,494 | 108,041 | 106,166 |
| Cost of Sales | (28,908) | (53,024) | (44,216) |
| Gross Profit | 20,586 | 55,017 | 61,950 |
| Selling Expenses | (1,794) | (2,924) | (4,068) |
| General and Administrative Expenses | (3,521) | (3,748) | (2,943) |
| Amortisation of Intangible Assets | (2,772) | (3,745) | (14,444) |
| Subsidy Income | 1,699 | 3,519 | 6,261 |
| Profit from Operations | 14,198 | 48,119 | 46,756 |
| Interest Expenses, Net | (1,759) | (160) | (1,896) |
| Income from Investment | 1,650 | Nil | 705 |
| Other Income, net | 675 | 1,220 | 1,412 |
| Profit before Taxation | 14,764 | 49,179 | 46,977 |
| Taxation | (2,313) | (7,798) | (8,497) |
| Profit after Taxation | 12,451 | 41,381 | 38,480 |

It is noted that the Net Profit Margin has gone from about 25 percent in 1998, rising to about 38 percent in 1999, and falling back to about 36 percent in the 2000 Financial Year.

For a company that works for a government, almost exclusively, this appears to be a very high Profit Margin.

The relatively high Profit Margins, of the past 3 Years, were assisted, in part, by official PRC Government rebates, as stated at Page 144 of the Prospectus:

'Pursuant to Jin Cai Fa [1998] No. 10 and Jin Cai Fa [1999] No. 22 issued on 8th April, 1998 and 1st June, 1999 by the finance bureau of Jin Niu District of Chengdu City, in order to support the development of the Company, the Company is entitled to a financial refund based on the conditions as stipulated in the notices. The financial refund is recorded as subsidy income and is recognised on the cash basis. According to Circular Guo Fa [2000] No. 2 issued by the State Council in January 2000, the above-mentioned financial refund would require approval from the State Council or it will cease to be available. Therefore, there is no assurance that the Company can enjoy such financial refund in the future.'

Another interesting aspect of the past 3 Years' accounts is that it appears that some PRC Government departments are reneging on contracts since Chengdu Top Sci-Tech has had to make Provisions in its Profit and Loss Statements for Doubtful Debts.

In the 1998 Year, the Provision for Doubtful Debts amounted to about 2.98 million renminbi, falling to about 1.32 million renminbi in 1999, and, then, the Company was able to write back some of prior Years' Provisions to the tune of about 154,000 renminbi.

As for debt, as at January 31, 2001, it stood at about 30 million renminbi.

This debt was unsecured and non-guaranteed bank loans ... [CLICK TO ORDER FULL ARTICLE](#)

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