

V. Management discussion and analysis

(1) Principal operations in the reporting period

1. Principal operations of the Company

The principal activities of the Company include mobile telecommunications, satellite communication, electromechanical and information products, with mobile telecommunications being its major operations.

Since the beginning of this year, the world telecommunications market continued to deteriorate and faced lots of hurdles ahead. There were signs of slowing down in growth in the Chinese telecommunications market after years of rapid development and significant declines in investments. According to data from Information and Industrial Ministry (信息產業部), there was a decrease of 36.5% in fixed assets investment in the Chinese telecommunications industry during the first half of this year as compared with the corresponding period of last year. Under the direct impact thereto, there was a relatively large decline in sales and profits arising from mobile telecommunication products by the Company and its joint ventures in the first half of the year. Under this difficult circumstances, the Company and its joint ventures actively took steps to speed up the pace of developing new products and adjusting products mix, in an effort to expand the market share, improve management, lower the cost in order to maintain normal operations and financial position under this difficult environment and establish a consolidated foundation for subsequent development. Under the PRC accounting standards, for the period from January to June 2002, revenues from principal operations of the Company amounted to RMB 329 million, down 41.87% compared to the corresponding period of last year; net profits amounted to RMB 20.29 million, down 74.36% compared to the corresponding period of last year. Under the generally accepted accounting principles in Hong Kong, for the period from January to June 2002, revenues from principal operations

NANJING PANDA ELECTRONICS COMPANY LIMITED

of the Company amounted to RMB 328 million, down 41.97% compared to the corresponding period of last year; net profits amounted to RMB 34.18 million, down 44.12% compared to the corresponding period of last year. However, revenues from principal operations are developing in a positive direction. Gross profit margin recorded a larger increase. In accordance with the PRC accounting standards, during the period from January to June 2002, loss from principal operations amounted to RMB 34.42 million, down 39% compared to corresponding period of last year. In accordance with generally accepted accounting principles in Hong Kong, during the period from January to June 2002, profits from operations amounted to RMB 15.62 million, compared to a loss of RMB 54.66 million in the corresponding period of last year.

2. Revenues from principal operations based on classification of products are as follows (under the PRC accounting standards):

Unit: RMB'000

Classification of products	Sales revenues	Contribution to revenues from principal operations	Cost of Sales	Gross profit ratio%
Mobile telecommunications	170,523	51.86	154,279	9.53
Satellite communications	13,293	4.04	10,377	21.94
Electromechanical	67,315	20.47	56,802	15.62
Electronic information	42,576	12.95	38,833	8.79
Others	35,118	10.68	28,550	18.70
Total	328,825	100	288,841	12.16

3. Operations of the principal Sino-foreign joint ventures

- (1) Nanjing Ericsson Panda Communication Co. Ltd. (ENC)

ENC is a joint stock company owned as to 43% by the Company, 41% by Telefonaktiebolaget L.M. Ericsson, 10% by Ericsson (China), 3% by Hong Kong Yung Shing and 3% by Jiangsu Posts and Telecommunications. It is one of the four largest mobile telecommunications system supply centres of Ericsson world wide, mainly engaged in producing GSM, GPRS and CDMA mobile telecommunication products and network communication systems. It was the largest GSM and GPRS equipment supplier and one of the major CDMA equipment suppliers in the PRC. Facing declines in demand for communication equipment either in the foreign or domestic markets and intensive competition within the industry, ENC overcame all of the difficulties by speeding up the pace of localization for research and development, production, provision of auxiliaries, striving to lower costs and expand market share. In the first half of the year, it recorded sales revenues of RMB 3.189 billion, down 47.25% compared to the corresponding period of last year and recorded net profits of RMB 134 million, down 53.47% compared to the corresponding period of last year.

- (2) Nanjing Microcell Panda Mobile Terminals Co., Ltd. (MPC) (formerly named as Nanjing Ericsson Panda Mobile Terminals Co., Ltd (EPC))

Because Ericsson underwent reorganization, it transferred its 65% equity interest of EPC to a Finnish company, Microcell. On 9th May 2002, the name of EPC formally changed to "Nanjing Microcell Panda Mobile Terminals Co., Ltd." (abbreviated as "MPC"), with a business license granted. It mainly engages in manufacturing mobile phones. Faced with a competitive market, EPC/MPC actively adjusted its mix of products, speeded up the pace of launching new products, endeavored to expand the world market in the first half of the year. However, due to the adjustment of products mix and the transfer of interests held by Ericsson to Microcell, the production by EPC/MPC was inevitable lowered. In the first half of the year, EPC/MPC manufactured 752,000 mobile phones, down 42.4% compared to the corresponding period of last year, 596,000 sets of which were exported, up 2% compared to the corresponding period of last year. Sales revenues amounted to RMB 731 million, down 25.10% compared to the corresponding period of last year. Net loss amounted to RMB25.427 million.

(2) **Summary of analysis of operational performance and financial position (Prepared under the PRC accounting standards)**

1. Analysis of reasons for movements of principal financial indicators (Unit: RMB'000)

Items	Jan - June 2002	Jan - June 2001	Change%
Revenues from principal operations	328,825	565,738	-41.87
Profits from principal operations	39,122	51,204	-23.60
Net profit	20,286	79,110	-74.36
Addition of cash and cash equivalents	261,739	151,723	72.51
Items	30 June 2002	31 Dec 2001	Change%
Total assets	2,368,445	2,069,729	14.43
Shareholders' fund	959,438	939,077	2.17

Analysis of reasons for movements:

The reasons for a decrease in revenues from principal operations were adjustment of mobile phones products by the Company. There was no mass production of new products until May, resulting in a decrease in the total sales compared to the corresponding period of last year. Also market demand diminished and sales of program-controlling exchanges decreased. It is estimated that there will be a larger growth in revenues from principal operations in the second half of the year.

The reasons for a decrease in profits from principal operations were decreases in revenues from principal operations. However, the Company quickened adjustment of products mix and composite gross profit margin for profits from principal operations increased from 9.14% in the first half of last year to 12.16% in the first half of the year. It is estimated that there will be a larger growth in profits from principal operations in the second half of the year.

The reasons for a decrease in net profits were a significant decrease in operational revenues and profits of the joint venture, Nanjing Ericsson Panda Communication Company Limited, as a result of deterioration in market demand, and decreases in production, sales and profits of Nanjing Microcell Panda Mobile Terminals Co., Ltd. (formerly named as Nanjing Ericsson Panda Mobile Terminals Co., Ltd), a joint venture, as a result of adjustment of products mix.

There was a significant increase in cash and cash equivalents, because finance and cash flows arising from investment activities were greatly improved in the reporting period compared to the corresponding period of last year.

2. Liquidity of funds

Gearing position: on 30th June 2002, the consolidated gearing ratio (total liabilities divided by total assets, defined the same as hereinafter) of the Company was 56.84% under the PRC accounting standards. Net current liabilities amounted to RMB222.5 million. Under the generally accepted accounting principles, the consolidated gearing ratio of the Company was 56.81%. Net current liabilities amounted to RMB231.0 million.

Bank balances and cash: on 30th June 2002, the consolidated monetary funds amounted to RMB426.8 million.

Loans: on 30th June 2002, the consolidated short-term bank loans amounted to RMB841.28 million. Monthly interest was approximately 4.3%. The Board of Directors believes that the Company will be able to maintain or expand its existing line of credit and settle every financial liability of the Company.

(3) Investments in the reporting period

1. The Company did not utilize any proceeds raised in the reporting period or proceeds raised in the previous period.
2. Principal investment financed by non-proceeds in the reporting period:

In order to speed up the development of mobile communications, the Company held an Extraordinary General Meeting on 8th February 2002. The meeting approved to establish "Nanjing Panda Mobile Communication Equipment Co., Ltd." with Mr. Ma Zhiping, with RMB60 million of registered capital. The Company invested RMB30.60 million in cash, representing 51% of equity interest. Mr. Ma Zhiping invested RMB29.40 million in cash, representing 49% of equity interest. Mr. Ma Zhiping was a renowned private entrepreneur in Jiangsu, with in-depth selling experience and outstanding operation in the mobile phone market. The said company was incorporated on 11th February 2002 and mainly engaged in sales of mobile communication products and related services. In April, it commenced its sales operation. At the end of June, it sold 136,000 mobile phones under the brand name of "Panda". Sales revenues amounted to RMB140 million. Net profits amounted to RMB5.684 million. It is estimated the sales will further increase in the second half of the year.

(4) Prospect in the second half-year

In the second half of the year, communication equipment market would still be in difficult circumstance. However, the Company is confident that operation results will grow faster compared to corresponding period of last year. Following the adjustment of products mix, gross profit margin will further improve and with the commencement of mass production of new models of mobile phones profits would be increased. After completion of the reorganization of Eicsson, joint ventures will have more lucrative development. The Company will seize every opportunity to expand its operations and fulfill the following:

1. To continue to accelerate the development of principal operations and profits from principal operations, especially increasing production of mobile phones and expanding market share in all aspects to gain economic efficiency. To fulfill production deadline for satellite phones in an effort to record a breakthrough of growth. To maintain a steady growth in the production of electromechanical and information products.
 2. To develop new products and continue to strengthen the competitiveness of its products. To accelerate the development of new mobile phone with a leading edge in the market and quickly launch them in the market. To accelerate the development of new generation of satellite communication and electromechanical products. To continue to strengthen the capacity of technological creativity and maintain the technological advantages.
 3. To continue to strengthen international cooperation. To ensure the smooth development of Sino-foreign joint ventures and to strengthen the strategic cooperation between the Company and internationally renowned enterprises to transfer foreign knowledge and technologies, enhancing its strategic position. The Company endeavors to keep the steady development of existing joint ventures and continues to expand. To strive to keep the steady production of ENC and gain a breakthrough in the development of MPC in order to ensure record profits instead of loss. To greatly improve the operations of Nanjing Sharp Electronic.
 4. To deepen internal reform, strengthen management and lower expenses as well as enhance economic efficiency.
- (5) It is estimated that operations of the Company in the second half of the year would improve compared to the reporting period. However, during the period from January to June, the Company recorded a decrease of 74.36% of consolidated net profits compared to the corresponding period of last year under the PRC accounting standards. It is estimated that during the period from January to September, the Company may record a larger decrease of consolidated net profits compared to the corresponding period of last year.

(6) Employees of the Company

As of 30 June 2002, there were 2,380 employees in the Company, 1,344 of which were engaged in production, 581 of which were engaged in technology, 124 of which were engaged in sales, 56 of which were engaged in finance, 275 of which were engaged in administration. There were 700 retirees, for whom the Company undertook to reimburse retirement pension.

(7) Purchase, sale and redemption of shares of the Company

During the reporting period, the Company and its subsidiaries did not purchase, sell and redeem any shares of the Company.

(8) Pre-emptive right

In accordance with the relevant law and articles of association of the Company, there was no provision for pre-emptive right.