

## MANAGEMENT DISCUSSION AND ANALYSIS

During the period, the Group had a turnover of RMB2,616,641,000 and a net profit of RMB65,894,000, representing a decrease of 0.3% and a decrease of 62.4% respectively to the corresponding previous period. Personal computers ('PCs') and PC peripheral products, hard disk drives ('HDDs') and HDD related products, and network transmission and add-on products accounted for 39%, 54% and 7% of the above-mentioned turnover.

## FINANCIAL REVIEW

### Liquidity and Financial Resources

As at 30 June, 2001, the Group's total amount of bank balances and cash was RMB2,516,826,000 and the Group's total borrowings was RMB 2,625,400,000. The profile of the before-mentioned borrowings is as follows:

- (1) 100% of which were in Renminbi ('RMB').
- (2) 16.5% of which were repayable between 2-5 years and,
- (3) 100% of which were based on fixed interest rate.

### Gearing Ratio

As at 30 June, 2001, the total borrowings and shareholders' equity were RMB2,625,400,000 and RMB3,070,355,000 respectively, as compared to RMB1,360,350,000 and RMB2,948,421,000 for the corresponding previous period. The gearing ratio was 85.5% (gearing ratio for the corresponding previous period was 46.14% and gearing ratio was the ratio between total bank and other borrowings and shareholders' equity).

### Current Ratio and Working Capital

As at the end of the Period, the amount of the Group's working capital was RMB1,607,153,000 compared to RMB2,199,908,000 for the corresponding previous period. The amount of the Group's current liabilities was RMB3,601,591,000. The current ratio was 1.45.

### Charge on Group Assets

As at the end of 30 June, 2001, the Group and the Company pledged savings of approximately RMB575,000,000 and RMB558,000,000 in favour of banks to secure general credit/bank facilities. As at 30 June, 2001, approximately RMB1,460,000,000 of the Group's borrowings was guaranteed by China Great Wall Computer Group Company.

**Exchange Rate Fluctuations**

The Group did not hedge against risk associated with foreign exchange fluctuations. During the Period, approximately 53% of the turnover of the Group was in US dollars. Borrowings of the Group were predominately in RMB. If US dollars rise against RMB, it will benefit the Group. If US dollars fall against RMB, it will have a negative effect on the Group. Since the exchange rate of RMB for US dollars has been relatively stable, it is expected that foreign exchange fluctuations will not pose substantial adverse influence to the business performance or financial status of the Group.

**BUSINESS REVIEW**

The Group's principle business included the development, manufacture and sale of PCs, PC peripheral products, HDDs, HDD related products, broadband network services, network transmission and add-on products.

The above-mentioned principle businesses were carried out by the Company and its four subsidiaries, i.e China Great Wall Computer Shenzhen Company Limited ('CGC'), Shenzhen Kaifa Technology Company Limited ('Kaifa'), Great Wall Broadband Network Service Company Limited ('GWBNS') and Shenzhen Kaifa Magnetics Company Limited ('Kaifa Magnetics'). The Company's main product was HDD; CGC's main businesses included PC and PC peripheral products; the main products of Kaifa were HDD magnetic heads, network transmission products and terminals; GWBNS mainly provided services relating to broadband network; and Kaifa Magnetics' main product was substrate for HDDs.

**PCs and PC Peripheral Products**

During the Period, CGC focused on product quality, market and customer needs, strengthened its internal management and adjusted its PC and PC peripheral products. The turnover for PCs and PC peripheral products increased RMB164,548,000, namely 17.7% to RMB1,096,715,000, as compared to the corresponding previous period. However, the sales volume of PCs dropped 9.8% to 111,644 units, as compared to the corresponding previous period. This was mainly due to the drastic market competition and delay caused by organization restructuring and business adjustment regarding CGC during the Period.

During the Period, CGC launched the Golden Great Wall Jiaxiang/ Jiayi PCs series that targeted broadband family users and launched the Golden Great Wall G7000/G5000 notebook computers series that targeted wireless mobile users. Furthermore, a road show in relation to 'E-Epoch' was held in the mainland. The market comments regarding such new products were good. This has provided a solid foundation for further development in the next half year.

### **PCs and PC Peripheral Products – continued**

CGC developed and launched a series of multi-patterned high-tech PDA product called “掌上王” with its own registered intellectual property rights. The aforementioned product was listed top in the “Zhongguan Village Consumerists’ Trusted Brand”. It has maintained a steady growth in sales.

Growth trend in respect of monitors and power supply packs by CGC has been good with sales increased by 19.82% and 19.78% respectively over the corresponding previous period and CGC has continued to maintain its leading position in the mainland market. During the Period, CGC launched its newly-developed 17” dynaflat and LCD monitor systems, 19” big screen colorful monitors, dynaflat monitors, network power supply, P4 power supply series and related products, and has strengthened its leading position in monitors market in the mainland. In addition, CGC formed a strategic alliance with Korean Hansol Electronic Inc. to target the middle-to-top end market. The aforesaid two companies had jointly manufactured the “Golden Great Wall-Hansol” branded monitors and started exporting such products on wholesale basis.

### **HDD and HDD Related Products**

The main product of Kaifa during the Period was HDD magnetic heads. Sale price for such product has dropped considerably as a result of fierce competition in the international market. Meanwhile, as technology related to magnetic heads continued to improve and with the capacity per HDD magnetic head and substrates expanded rapidly, the demand for the number of magnetic heads for HDDs dropped. To meet this challenge, Kaifa has on the one hand strengthened its internal management to lower expense. On the other hand, it has been following the standards for HDD magnetic heads in the international market so as to improve production automation standards for its self-designed magnetic heads. Nevertheless, our Group remained as one of the few outstanding performers among the manufacturers in this business in the world.

During the Period, the Company has (with regard to international and mainland market developments), owing to the problems relating to model alterations and quality control, failed to fulfill its targets for its HDDs products for the time being. This notwithstanding, the substrates produced by Kaifa Magnetics, as core component of HDDs, has recorded an increase in sales of 43.2% over the corresponding previous period and that Kaifa Magnetics has changed from loss to profit in respect of such product. This was mainly attributed to: solving core technical problem regarding substrates; continual improvement on production process; reduction in unit material’s depletion; rising success rate in product quality; and a pick up in market demands.

## **Broadband Network Services**

As at 30 June, 2001, GWBNS established ties with 140 agents and signed up over 15,400,000 contractual users. The operation of GWBNS covered over 60 medium to large cities in the mainland, including 3,000,000 projects in progress, 910,000 completed, 490,000 connected for use as well as 15,000 online users. GWBNS had cooperation with over 1,200 property companies and had stipulated a set broadband community network construction standard. Services in respect of VOD, network education, securities, imitation touring were launched. In addition, in order to encourage online users to go online, GWBNS is currently working closely with telecommunication operators and VoIP, companies with a view to accessing the low-end IP service market and to increasing online users' usage rate.

## **Network Transmission and Add-on Products**

Kaifa has increased investment in research, development and sales of fiber optical communication products during the Period. This resulted in an increase in production capacity. Kaifa signed a contract worth of US\$153,000,000 with an Italian Company ('Italian Company') for the sale of remote-controlled meters ('Meter Contract'). Pre-production preparation in respect thereof is currently under way. Kaifa has made progress for its cash terminal and Echelon terminal products in the mainland market, and has continued to maintain its leading position in relation to product technology for such products among its mainland competitors.

## **INVESTMENTS**

During the period, Tom.com (China) Investment Limited, Great Wall Computer Software and Systems Incorporation Limited (a non-wholly owned subsidiary of the Company) and the Company jointly invested in and formed Beijing ChangTong United Broadband Technology Company Limited ('CTUBT') with a registered capital of RMB25,000,000. The aforementioned companies invested RMB17,500,000, RMB5,000,000, RMB2,500,000 and held 70%, 20%, 10% in CTUBT respectively. CTUBT was formed to develop and integrate the advantages on resources, operations and market of the parties concerned and to develop application software for broadband network services with a view to providing customers with quality software and information services. With the rapid development of broadband network in the mainland, it is anticipated that customer demands for the aforesaid items would increase and market potential thereof would be good.

## **INVESTMENTS – continued**

Kaifa and Mandarin IT Fund I jointly founded O-NET Communications Company Limited ('O-NET') with a registered capital of HK\$150,000,000 and the parties respectively held HK\$110,000,000 and HK\$40,000,000 thereof. O-NET mainly engaged in research and development, production, operation and related technology consultation for optical crystal, optic integration and fiber optics communication products. As global broadband and fiber optics communication businesses develop, it is anticipated that O-NET will have a promising future market.

## **PROSPECTS**

As for PCs and PC peripheral products, CGC intends to practise 'customer-oriented' management philosophy comprehensively, to adjust product structure and to increase efforts in market development with a view to achieving better product effectiveness for the next half year.

The Company shall increase new OEM customers in respect of HDD products. This would provide an opportunity for the expansion of production scale and market share for such products. The Company will reinforce quality control relating to HDDs, lower costs and work to improve their competitiveness. Kaifa shall take further steps to improve production automation standards for its magnetic heads. As for magnetic heads, Kaifa aims to enhance the technical capabilities of its magnetic heads, to increase the production of magnetic heads and to achieve economy through production scale.

Kaifa will enhance its production management and quality control for its remote-controlled meters so as to ensure that such products will be ready for delivery to the Italian Company as from the fourth quarter in accordance with the Meter Contract. Meanwhile, Kaifa will endeavor in a second bidding exercise relating to remote-controlled meters and to seek an entry point to the mainland market for remote-controlled meters. Kaifa will step up efforts on research and development on fiber optics communication products and to develop both the international market and the mainland market for them.

Kaifa is now preparing rights issue of new A shares. It is anticipated that the right issue will be implemented upon granting of permission thereof by the China Securities Regulatory Commission. Funds to be raised therefrom shall be applied mainly for magnetic heads' production automation project; GMR-HAS magnetic heads production expansion project; remote-controlled meter, cash terminal and Echelon network terminal projects; and research and development foundation project for Kaifa. Timely development of the aforementioned projects will be conducive to the long term interest and development of the Group.

**PROSPECTS – continued**

GWBNS will focus on the 13 cities stipulated by the Information Industry Bureau as the broadband pilot cities. GWBNS will adopt flexible product combination and pricing strategies to gradually increase the subscription rate for online users with a view to reversing its current loss making position to profits making.

**EMPLOYEES**

As at 30 June, 2001, the number of employees of the Group was approximately 10,000. Employees were remunerated according to their positions and contribution and the relevant companies' compensation and premium policies.

**INTERIM DIVIDEND**

The Board of Directors does not recommend payment of any interim dividends for the Period (for the six months ended 30 June, 2000: nil).

**DISCLOSURES OF MAJOR EVENTS****Litigation**

In relation to the claim by CGC as against Sichuan Yingtong Computer System Company Limited (四川銀通電腦系統有限責任公司) ('Yingtong') and Chengdu Commercial Bank (成都市商業銀行) ('Chengdu Bank') concerning debts and notes as disclosed in the Company's 2000 annual report, The People's High Court of Sichuan Province and The Supreme People's Court finally ruled that Yingtong shall pay CGC and Chengdu Bank shall be responsible for related payment obligations. Application was made to The People's High Court of Sichuan Province for coercive execution of this lawsuit. The People's High Court of Sichuan Province has taken certain measures and has served a 'Notice to Coercive Execution' on both of Yingtong and Chengdu Bank. The execution is now in progress.

Save as disclosed above, the Group was not involved in any other material litigations or arbitrations.

**Rights Issue of A share by a subsidiary of the Company**

The Company's 2000 annual report mentioned the proposed share placement of 60,174,630 A shares by Kaifa to the public shareholders in the proportion of 10:3. The proposed share placement was approved by Kaifa's shareholders in general meeting. It is anticipated that the share placement will be implemented upon granting of permission by the relevant governmental departments.

## Re-election of Board of Directors and Members of Supervisory Committee

On 6 June 2001, the Company held a general meeting and passed the resolution on the re-election of members of the board of directors and members of supervisory committee. Except that Mr. Li Yanda resigned as a non-independent director and was replaced by Mr. Li Sanli, the other directors and supervisors were re-appointed. The members of the senior management of the Company remained the same.

## Notice by Information Industry Bureau (regarding Notice on Pilot Scheme for Opening Up Local Customer Based Broadband Network Operational Market (“關於開放用戶駐地網運營市場試點工作的通知”))

According to the Notice on Pilot Scheme for Opening Up Local Customer Based Broadband Network Operational Market (信部電[2001] 411 號) ('Notice') issued by the Information Industry Bureau, the broadband network market and pilot cities were confined to 13 cities, namely Beijing, Shanghai, Guangzhou, Shenzhen, Jinan, Qingdao, Wuhan, Hangzhou, Nanjing, Ningbo, Xiamen, Chongqing and Chengdu and the respective relevant province/city authorities would undertake to implement the local customer based broadband network operational market scheme. Those completed and under-construction broadband networks outside the above-mentioned 13 cities were required by the Notice to stop operation or construction immediately. This new policy has a significant impact on the development of businesses of GWBNS outside the aforesaid pilot cities. In view of this policy, the Group is seeking a number of alternatives and adopt a number of measures to minimize the adverse effect this policy change has on the Group.

## SHARE CAPITAL, SUBSTANTIAL SHAREHOLDERS AND DIRECTORS' AND SUPERVISORS' INTERESTS IN SECURITIES

### Share Capital

	As at 30 June 2001 Number of shares	As at 1 January 2001 Number of shares
State-owned legal person shares	743,870,000	743,870,000
Overseas listed foreign shares (H shares)	<u>453,872,000</u>	<u>453,872,000</u>
Total	<u><u>1,197,742,000</u></u>	<u><u>1,197,742,000</u></u>

Note: There was no change in share capital of the Company during the six months ended 30 June 2001 and during the period from 30 June 2001 to the reporting date.

## Substantial Shareholders

As at 30 June 2001, the following parties held an interest of 10% or more in the issued share capital of the Company or its subsidiaries according to the Company's records.

### (a) The Company

Name of shareholder	Class of shares	Number of shares held		Shareholding percentage	
		Direct interest	Deemed interest *	Direct interest	Deemed interest *
China Great Wall Computer Group Company ('China Great Wall')	State-owned legal person shares	743,870,000	–	62.11%	–

### (b) China Great Wall Computer Shenzhen Company Limited ('CGC')

Name of shareholder	Class of shares	Number of shares held		Shareholding percentage	
		Direct interest	Deemed interest *	Direct interest	Deemed interest *
China Great Wall	State-owned legal person shares	–	277,231,500 (Note 1)	–	60.47% (Note 1)
Company	State-owned legal person shares	277,231,500	–	60.47%	–



## Substantial Shareholders - continued

### (c) Shenzhen Kaifa Technology Company Limited ('Kaifa')

Name of shareholders	Class of shares	Direct interest	Number of shares held	Direct interest	Shareholding percentage
			Deemed interest *		Deemed interest *
China Great Wall	State-owned legal person shares	–	410,163,000 (Note 1)	–	55.96% (Note 1)
Company	State-owned legal person shares	410,163,000	–	55.96%	–

### (d) Great Wall Broadband Network Service Company Limited ('GWBNS')

Name of shareholders	Percentage holding in registered capital	
	Direct interest	Deemed interest *
China Great Wall	–	100% (Note 2)
Company	70%	30% (Note 2)
CGC	15%	–
Kaifa	15%	–

### (e) Shenzhen Kaifa Magnetics Company Limited ('Kaifa Magnetics')

Name of shareholders	Percentage holding in registered capital	
	Direct interest	Deemed interest *
China Great Wall	–	100% (Note 3)
Company	51%	49% (Note 3)
Kaifa	49%	–

\* Exclusive of direct interest

**Substantial Shareholders - continued**

Notes:

1. China Great Wall controlled over 1/3 of the rights to vote in the Company. As such, China Great Wall was (according to the Securities (Disclosure of Interests) Ordinance ('SDI Ordinance')) deemed to be interested in the relevant shares held by the Company.
2. China Great Wall controlled over 1/3 of the rights to vote in the Company and the Company controlled over 1/3 of the rights to vote in each of CGC and Kaifa. As such, China Great Wall and the Company (according to the SDI Ordinance) were deemed to be interested in the relevant registered capital held by CGC and Kaifa, and China Great Wall (according to the SDI Ordinance) was deemed to be interested in the relevant shares held by the Company. GWBNS' registered capital was RMB 300,000,000.
3. China Great Wall controlled over 1/3 of the rights to vote in the Company and the Company controlled over 1/3 of the rights to vote in Kaifa. As such, China Great Wall and the Company (according to the SDI Ordinance) were deemed to be interested in the relevant registered capital held by Kaifa, and China Great Wall (according to the SDI Ordinance) was deemed to be interested in the relevant shares held by the Company. Kaifa Magnetics' registered capital was RMB 224,033,300.

Save as disclosed, no other parties were recorded as having an interest of 10% or more of the issued share capital of the Company or its subsidiaries in the register of interests required to be kept by the Company under Section 16(1) of the SDI Ordinance.

**Directors' and Supervisors' Interests in Securities**

As at 30 June 2001, the Company's directors and supervisors, (as recorded in the register maintained by the Company pursuant to Section 29 of the SDI Ordinance or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited ('Stock Exchange') pursuant to the Model Code for Securities Transactions by Directors of Listed Companies ('Model Code') of the Rules Governing the Listing of Securities on the Stock Exchange) held the following interests in the equity or debt securities in the Company and/or its associated corporations (as defined in SDI Ordinance):

**Securities***(a) The Company*

<b>Name/ position</b>	<b>Personal interest</b>	<b>Family interest</b>	<b>Corporate interest</b>	<b>Total</b>
Tam Man Chi (Director)	-	-	44,988,000 H shares (Note 1)	44,988,000 H shares

## Directors' and Supervisors' Interests in Securities - continued

### (b) CGC

Name/ position	Personal interest	Family interest	Corporate interest	Total
Wang Zhi (Chairman)	95,400 CGC employee shares	–	–	95,400 CGC employee shares
Wang Zhirong (Director)	63,600 CGC employee shares	–	–	63,600 CGC employee shares
Lu Ming (Director)	63,600 CGC employee shares	–	–	63,600 CGC employee shares
Huang Rongfang (Director)	63,600 CGC employee shares	–	–	63,600 CGC employee shares

### (c) Kaifa

Name/ position	Personal interest	Family interest	Corporate interest	Total
Wang Zhi (Chairman)	214,207 Kaifa employee shares	–	–	214,207 Kaifa employee shares
Wang Zhirong (Director)	35,699 Kaifa employee shares	–	–	35,699 Kaifa employee shares
Tam Man Chi (Director)	714,025 Kaifa employee shares	–	68,952,000 Kaifa legal person shares (Note 2)	69,666,025 shares
Huang Rongfang (Director)	278,512 Kaifa designated legal person shares	–	–	278,512 Kaifa designated legal person shares

#### Notes:

- These shares were held by High Expectations Investments Limited ('High Expectations') and Mr. Tam held 80.73% of the issued share capital of High Expectations.
- These shares were held by Broadata (H.K.) Limited, a wholly owned subsidiary of High Expectations and Mr. Tam held 80.73% of the issued share capital of High Expectations.

Save as disclosed above, as at 30 June 2001, none of the Directors or supervisors or their associates had any personal, family, corporate or other interests in the equity or debt securities of the Company or any of its associated corporations as recorded in the register maintained pursuant to Section 29 of the SDI Ordinance or which was notified to the Company and the Stock Exchange according to the Model Code.

## **PURCHASE, SALE AND REDEMPTION OF THE LISTED SECURITIES OF THE COMPANY AND/OR ITS SUBSIDIARIES**

During the period, the Company or its subsidiaries did not purchase, sell or redeem any of the listed securities of the Company and/or its subsidiaries.

## **CODE OF BEST PRACTICE**

None of the Directors of the Company is aware of any information that would reasonably indicate that the Company was not, at any time during the six months ended 30 June, 2001, in compliance with the Code of Best Practice set out in Appendix 14 of the Rules Governing the Listing of Securities issued by The Stock Exchange of Hong Kong Limited.

## **AUDIT COMMITTEE**

The Company's audit committee member, Mr. Li Yanda did not continue to serve on the Company's audit committee after his previous appointment term expired. Non-executive director, Mr. Li Xiaoru was appointed to replace Mr. Li. The audit committee has reviewed with management and discussed auditing, internal controls and financial reporting matters, including this unaudited interim report. In addition, the Group's external auditors have reviewed this unaudited interim results in accordance with Statement of Auditing Standards 700 issued by the Hong Kong Society of Accountants.

By Order of the Board

**Wang Zhi**

Chairman

27 August, 2001