

MANAGEMENT DISCUSSION AND ANALYSIS

During the period under review, the Group had a realised turnover of RMB3,072,750,000 and a net profit of RMB31,726,000, representing an increase of 17% and a decrease of 52% respectively as compared to the corresponding period in last year. Personal computers ("PC") and PC peripheral products, harddisk drives ("HDD") and related products, network transmission and add-on products, broadband network services and other businesses accounted for 22.9%, 70.7%, 0.2%, 1.6% and 4.6% of the Group's realised turnover respectively.

FINANCIAL REVIEW

Liquidity and Financial Resources

As at 30 June 2002, the Group's total cash and bank balances amounted to RMB2,858,629,000 and the Group's total borrowings was RMB3,980,956,000. The structure of such borrowings is as follows:

- (1) 92% was denominated in Renminbi ("RMB");
- (2) 35% was due and repayable within 2 to 5 years; and
- (3) 98% was made on fixed interest rates.

Gearing Ratio

As at 30 June 2002, based on the Group's total borrowings and shareholder's equity of RMB3,980,956,000 and RMB2,900,601,000 respectively, as compared to RMB3,176,276,000 and RMB2,868,875,000 respectively as of 31 December 2001, the gearing as of 30 June 2002 was 137.2%. (The gearing ratio as of 31 December 2001 was 110.7%. The gearing ratio was the ratio between total bank borrowings plus other borrowings and shareholder's equity).

Current Ratio and Working Capital

During the period under review, the Group's working capital amounted to RMB1,704,831,000, as compared to RMB1,327,169,000 as of 31 December 2001; with the Group's current liabilities amounted to RMB4,920,124,000, the current ratio was 1.35.

Charge on Group Assets

During the period under review, the Group had pledged to banks its bank savings of approximately RMB664,884,000 to secure banking facilities for the Group. As at 30 June 2002, China Great Wall was the guarantor to approximately RMB1,029,000,000 of the Group's borrowings.

Exchange Rate Fluctuations

The Group did not hedge against risks associated with foreign exchange fluctuations. During the period under review, approximately 60% of the Group's turnover was revenue in US dollars. The Group's borrowings were predominantly denominated in RMB. If US dollars had risen against the RMB, it would have affected the Group favorably. If US dollars had fallen against the RMB, it would have a negative effect on the Group. Since the exchange rate of the RMB for US dollars had been relatively stable, no substantial adverse effect to the Group's business performance or financial status was expected to result from foreign exchange fluctuations.

BUSINESS REVIEW

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

Such business was mainly conducted by the Company and its six subsidiaries: China Great Wall Computer (Shenzhen) Company Limited ("CGC"), Shenzhen Kaifa Technology Company Limited ("Kaifa"), Great Wall Broadband Network Service Company Limited ("GWBNS"), Shenzhen Kaifa Magnetics Recording Company Limited ("Kaifa Magnetics"), Great Wall Computer Software and Systems Incorporation Limited ("Great Wall Software") and ExcelStor Technology (Shenzhen) Limited ("ExcelStor Technology"). The Company acts as investment holding company; CGC's principal business included PCs and PC peripheral products; Kaifa's key products were HDD magnetic heads, network transmission products and add-on products; GWBNS's principal business was the provision of broadband network services to communal users, Kaifa Magnetics' key products were HDD substrates, Great Wall Software's main business was software development and ExcelStor Technology's main products were HDD and HDD relative products.

Review on Operations

PCs and PC Peripheral Products

During the period under review, CGC launched the “Blue-Silver New World (藍銀新世界)” home system based on the three core series of Jia Xiang II (嘉翔 II)、Jia Xiang (嘉翔) and Jia Yi (嘉宜) equipment and the “MBA New Trunk Line” commercial system comprised of M series (management), B series (business) and A series (operations) equipment, securing a distinctive position for its products. At the same time, CGC gradually implemented its regional distribution policy, with a view to set up a comprehensive market mobilization mechanism based on the essence of the brandname and establishment of sales channels. Upon adjusting various aspects of product development, positioning, price-fixing and brandname selecting, CGC succeeded in setting up a highly effective management structure and in lowering costs and heightening efficiency, creating a solid foundation for the Company’s future operations and management.

During the period under review, CGC’s operations and business were in a stage of adjustment and consolidation. Affected by various factors such as intensified market competitions and the incomplete process of adjustment, both the sales and profits of CGC’s products had declined as compared to the corresponding period in last year. The sales volume of entire computers and monitors was 67,000 sets and 331,000 sets respectively, representing a decline of 50.4% and 38.9% respectively as compared to the corresponding period in 2001. However, the sales volume of power supply amounted to 1,190,000 sets, representing a 13.3% increase as compared to the corresponding period in 2001.

HDD and HDD Related Products

Magnetic Heads

During the period under review, the sales turnover of magnetic heads, Kaifa’s key products, grew by 70% as compared to the corresponding period in 2001. At the same time, the level of automation of such products had also been improved substantially, and the memory of a single magnetic head was expanded from 40G to 60G. Again, Kaifa was identified by clients as the best supplier. Nevertheless, affected by global economic contraction and requests by clients to lower prices, in addition to various factors including the rapid upgrade of the technology applicable to such products and unstable market conditions, profits generated by such products failed to grow in proportion to the marketing and sales volume thereof.

Substrates

During the period under review, substrates produced by Kaifa Magnetics had a realized sales income of RMB105,160,000 and profits of RMB11,425,000.

Under increasingly fierce competitions, production engineering processes and product technology used in substrates produced by Kaifa Magnetics became increasingly matured. As the qualification rate and market reputation of such products continued to improve, profits generated by these products became a crucial source of contribution to the Group's operation revenue.

HDDs

During the period under review, ExcelStor Technology entered into collaboration and signed a collaboration agreement with an internationally renowned company to create a new mode of operation for the production and operation of its HDD products. During the period under review, to conduct designated collaboration projects, ExcelStor Technology had set up a series of ancillary facilities together with 7 modern integrated production lines. At the same time, based on its original concept, ExcelStor Technology managed to make significant improvement on production equipment commissioning, product technology, product engineering and management, its efforts and ability were hence highly commended by such internationally renowned companies. At present, for the purpose of creating a solid foundation for the full-fledge implementation of collaboration projects with such internationally renowned company's participation, substrates produced by ExcelStor Technology have already entered into the stage of mass production. At the same time, in view of the favorable results created by the quality and market reach of HDD products bearing the ExcelStor Technology brandname, a bright future is predicted for ExcelStor Technology in the market.

Nevertheless, owing to factors such as fierce market competitions, continuous decline of the selling price and short start-up time, no scale has yet been formed to manufacture such products. As a result, during the period under review, this business continued to operate in deficit.

Broadband Network Services

During the period under review, GWBNS adjusted its operation strategy and shifted the implementation of its strategy from construction to operation. Every subsidiary in different districts was instructed to adopt an operation policy focusing on reactivating existing assets, exploiting existing resources to open up more social sectors, developing more products, recruiting more users so as to achieve maximum return in investment." Taking into consideration its construction and operation status, together with characteristics of different districts and cities, GWBNS concentrated its strength on key cities and districts in order to implement projects aiming to achieve key breakthroughs, with a view to create characteristics unique only to such districts. Furthermore, GWBNS endeavored to adopt various flexible methods in calculating the service charge to enhance its operation capacity in various districts and cities.

During the period under review, GWBNS completed the installation of services for 1,750,000 households and 1,430,000 households were connected to such services (accounting for 81% of completed installations plus connections).

During the period under review, GWBNS had 68,700 paid-online users. At present, with its broadband business covering more than 60 medium to large cities in China, GWBNS had also entered into cooperation with more than 1,200 property developers and management companies. It had also set up a complete set of construction standards for broadband community service networks.

During the period under review, besides providing large-scale software applications, solutions and general consultancy services to government authorities and important industries such as finance and social security, Great Wall Software also exported its software and services to the international market. In certain State-level projects, including the "Gold Tax", "Gold Card" and "Gold Gate" projects, Great Wall Software played a particularly important role.

Network Transmission and Add-on Products

During the period under review, Kaifa signed a purchase order of US\$153,000,000 with an Italian Company for remote-control smart electricity meters. Kaifa has started mass-producing the products that have been able to achieve a high qualification rate and meet various indicators. Affected by a contracting market, photoelectron products have not been able to meet its anticipated target.

Management

During the period under review, on the basis of perfecting and improving the ERP system, Kaifa carried out the comprehensively implementation of the 6-Sigma management system. This was a big step of advancement made in the direction to create a management system compliant with international standards. By "recruiting the best staff and simplifying management" and "exploiting resources and reducing costs," CGC's internal management managed to rise to new heights. Furthermore, Kaifa Magnetics and ExcelStor Technology also made significant improvement in production management and internationalization.

PROSPECTS FOR THE LAST SIX MONTHS OF 2002

CGC will focus its operations on five key areas: sales promotion, progressive operation, human resources reorganization, management structure perfection and pay attention to production development. By eliminating obstacles that may affect the development of its business to maturity, CGC will strive to obtain better progress in product effectiveness in the six months to come.

Kaifa will implement the 6-Sigma management system in all aspects to further enhance its management standard, explore opportunities for product development and increase the market share of non-dominant products.

ExcelStor Technology will overcome the pressure on its operations created by a slowdown in the market, expand the scale of production of its products, heighten the capacity of production and strive to obtain better earning in the six months to come.

GWBNS will make effective adjustments on product expansion and services. It will also develop the telecommunications and value-adding business, expand the construction of its operation service system and network management system, in order to achieve the prompt balance between profit and loss.

Great Wall Software will further strengthen its expansion in the domain of electronic administration for government authorities and strive to obtain better growth in software development and application in the six months to come.

Kaifa Magnetics will actively seek new opportunities for business development and co-operation by maintaining its existing business.

The Company will enhance the intensity of management over the entire Group, implement policies in budgetary management and strengthen control over and analysis of investment risks. It will also implement new incentive policies, enhance the value of talented individuals, promote young talents and adopt modern and scientific management, so that its staff may bring their best ability into play and it may hasten its pace to catch up with international practice.

INVESTMENT*The Capital Increase and Share Expansion of GWBNS*

During the period under review, GWBNS' share capital changed with the joining of a new shareholder. After increasing GWBNS' share capital, GWBNS' shareholders will comprise of China Trust Investment Company Limited, the Company, Kaifa and CGC, accounting for 50%, 35%, 7.5% and 7.5% of GWBNS' equity respectively. The registration for and filing of the legal documents relating to the share issue have not been completed and GWBNS is awaiting approval therefor.

The Capital Increase and Share Expansion of Great Wall Software

Upon contributing to the capital of Great Wall Software, the capital structure of Great Wall Software was:

The registered capital of Great Wall Software was increased from RMB33,000,000 to RMB 100,000,000; where the Company contributed RMB58,350,000 in cash, representing 58.35% of Great Wall Software's equity. With the original contribution of RMB31,350,000 together with RMB8,650,000 in cash, the total contribution of CGC was RMB40,000,000, representing 40% of Great Wall Software's equity. With the original contribution of RMB660,000 and RMB990,000, Fu Qiang and Huo Jicai held 0.66% and 0.99% of Great Wall Software's equity respectively. This connected transaction was approved in Great Wall Software's 2001 Annual General Meeting held on 17 May 2002. Announcements relating to the board resolution, Hong Kong Stock Exchange and resolution of the Annual General Meeting were published in the "China Securities Post", "Securities Times" and "Shanghai Securities Post" on 12 April, 10 May and 18 May 2002 respectively. Great Wall Software completed its capital increase and share expansion on 12 June 2002, and the progress announcement was published in the "China Securities Post", "Securities Times" and "Shanghai Securities Post" on 18 June 2002.

The Sale of Equity of International Information Products (Shenzhen) Company Limited's Equity ("International Information")

Upon approval by the second meeting of the 4th board of directors, the Company signed an equity transfer agreement with 國際商業機器中國有限公司 on 22 February 2002, whereas the Company would transfer 10% of International Information's equity to that company at the consideration of US\$9,000,000. The assignment was disclosed in the "China Securities Post", "Securities Times" and "Shanghai Securities Post" on 28 February 2002 and approved by Shenzhen Foreign Trade & Economic Cooperation Bureau on 7 March 2002 (Approval Document No. [2002] 0060 Shen Wai Jing Mao Zi Fu (深外經貿資復 [2002] 0600)). Registration change was completed at the Shenzhen Administration for Industry & Commerce on 25 March 2002. The sum applicable to the transfer was paid on 16 May 2002 and progress on the transaction was disclosed in the "China Securities Post", "Securities Times" and "Shanghai Securities Post" on 18 May 2002.

EMPLOYEES

As at 30 June 2002, the Group had approximately 10,000 employees. The Group's employees were remunerated according to their position in and contribution to the relevant companies as well as the companies' compensation and incentive policies.

INTERIM DIVIDEND

The board of directors does not recommend payment of any interim dividend for the period ended 30 June 2002 (for the six months ended 30 June 2001: nil).

DISCLOSURES OF MAJOR EVENTS

Litigation

The loan dispute between CGC, Sichuan Yingtong Computer System Company Limited and Chengdu Commercial Bank had recently been accepted by the Middle People's Court of Chengdu for handling. For this reason, civil judgment (2000) Cheng Jing Chu Zi Nos. 489 and 568 were issued in support of RMB2,000,000 in liabilities. CGC promptly appealed to the High Court of Sichuan Province, but the original judgment was maintained. CGC already applied in protest and in defense to the Higher People's Procuratorate and Supreme People's Court of Sichuan Province respectively. The Middle People's Court of Chengdu already issued an "Enforcement Notice" for RMB2,000,000 in liabilities that was sustained by the court. The "Enforcement Notice" is being enforced at present. As for liabilities in the amount of RMB5,000,000 that were not supported by the court, the Supreme People's Court had already opened file and accepted the handling thereof and requested the High Court of Sichuan Province to review, retry the case which is presently under reexamination.