

### BUSINESS REVIEW

Continuous slowdown of the global economy has weakened the market of the information and communications industry, unfavorable market conditions have further intensified competition in the sector. However, worldwide economic recession that has prompted the overhaul of the industrial structure has also stimulated the transfer of international capital from developed countries to developing countries. With an edge in raw materials and labor cost, particularly as further merger was achieved with the global economy after China's accession to the World Trade Organization ("WTO"), manufacture industries worldwide have obviously hastened the removal of their factories to China. Under correctly foreseen economic conditions and market development trends, the Company succeeded in seizing the opportunity to take lead in collaborating with internationally renowned enterprises such as IBM, with a view to develop the joint venture into a new growth center. At the same time, facing complicated economic conditions, the Group strove to further strengthen internal cost management and control, perfect the industrial layout and develop the market to achieve desirable production-operation results. For the financial year ended 31 December 2002, the Group realized a business turnover of RMB8,742,580,000 and a net profit of RMB53,654,000 representing an increase of 50.34% and 139.57% respectively as compared to the corresponding period in last year.

#### HDD and HDD related products

For the financial year ended 31 December 2002, Shenzhen Kaifa Technology Company Limited ("Shenzhen Kaifa Technology"), a 55.96% owned subsidiary of the Company, had realized a sales revenue surpassing RMB6.1 billion. The production and sales volume of HDD magnetic heads, Shenzhen Kaifa Technology's principal product, continued to rise. In

2002, Shenzhen Kaifa Technology was again named the best supplier in an evaluation conducted by customers.

As production and sales revenue began to grow steadily, Shenzhen Kaifa Technology concurrently strengthened internal management and control. In an endeavor to import advanced management modes such as the adoption of 6-Sigma management concept and Enterprise Resource Planning (ERP) system, Shenzhen Kaifa Technology strove to raise management standards and strengthen cost control. Furthermore, Shenzhen Kaifa Technology worked hard to implement accounting and budgetary management and to reinforce the training of management staff to ensure that relevant mechanisms would be in place to tap new resources and cut consumption in the coming financial year.

In 2002, Shenzhen Kaifa Magnetics Recording Company Limited ("Kaifa Magnetics"), a 51% owned subsidiary of the Company, was subject to the challenge of an uncertain market. Apart from the implementation of technological reform and engineering modification to accommodate market demand, Kaifa Magnetics also strove to implement stringent cost control and develop new markets. As compared to the corresponding period in 2001, even though Kaifa Magnetics' sales revenue declined by 3.9% in the financial year of 2002, its realized net profit nevertheless rose by 6.6%. The decline in sales revenue was a result of the drop in sale price of the products, and the rise in profit was a result of the drop in price of certain raw materials accompanied by reinforced internal management and control as well as improvement in the production process.

ExcelStor Technology (Shenzhen) Limited ("ExcelStor Technology"), a 61.6% owned subsidiary of the Company, its principal business is to produce table-top hard discs by OEM methods in accordance with an

agreement signed with International Business Machinery China Company Limited ("IBM China") and concurrently develop this type of hard disc under its own brand name pursuant to an intellectual property agreement signed with IBM China. ExcelStor Technology started to design and produce IBM 40GB and 60GB table-top hard discs in May and November 2002 respectively which became profitable during the fourth quarter of 2002, with an aggregate sales turnover of RMB1,374,763,000 (US\$163,000,000) for the financial year ended 31 December 2002.

### Network terminals and fiber optical products

Network terminals and fiber optical products developed by Shenzhen Kaifa Technology had successfully entered into the domestic and international market and became the world's largest production base of remote-control electricity meters.

### PC and PC peripheral products

For the financial year ended 31 December 2002, China Great Wall Computer (Shenzhen) Co., Ltd. ("CGC"), a 60.47% owned subsidiary of the Company, realized a sales turnover of 189,000 sets of CGC PCs. In a weak market where competition had further intensified, the sales turnover of CGC PCs had declined slightly as compared to the corresponding period in 2001, but the sales turnover of CGC monitors and CGC power supply packs continued to maintain growth. During the second half of 2002, the sales turnover of CGC PC, CGC monitors and CGC power supply packs grew by 67.01%, 43.04% and 31.56% respectively, as compared to the first half of 2002.

In 2002, CGC's computer repair business succeeded in steadily changing over from the nationwide central agency system to the regional distribution system, with a view to strengthen market development and coverage

and to lay down a solid foundation for growth in 2003. Furthermore, CGC implemented organizational streamlining in respect of personnel organization, budgetary management, production cost and inventory control in a bid to cut expenditure. To reduce cost, stringent control and regulatory measures were adopted as a result of which the number of employees at the end of 2002 was reduced by 24.3% as compared to the beginning of 2002.

### Broadband network

In 2002, China International Trust and Investment Corporation ("CITIC") acquired 50% interest in the registered capital in Great Wall Broadband Network Service Co., Ltd. ("GWBNS"), hence bringing to GWBN a rich source of funds and enhancing the function and scope of GWBNS's services. As at the end of 2002, GWBNS's completed projects had an aggregate of 2,303,700 users, and the number of connected users grew from 870,000 at the end of 2001 to 1,761,300, generating an aggregate revenue of RMB135 million for the financial year under review.

While striving to develop the market, GWBNS had further reformed and refined the management structure of its internal organization by setting up four major organizational systems: administration, finance, operation and technology. The SAP system that started operation on 1 January 2002 had allowed procurement, inventory and material flow to be managed properly. GWBNS had further refined the structure of its backbone network by collaborating with the CITIC Group. In 2002, GWBNS erected key operating facilities aiming to strengthen network management and customer services and actively developed service businesses relating to short messages, Internet Protocol voice and broadband 800.

In 2002, owing to the continuous contraction of the telecommunications market and investment used to develop network infrastructure, GWBNS continued to sustain a loss of RMB148,734,430, a principal reason for the negative impact on the Group's profitability.

### Software services and system resolutions

Great Wall Computer Software and Systems Incorporation Limited ("GWCSS"), a 58.35% owned subsidiary of the Company, its main business is focused on the provision of service software and resolutions to users in the domain of taxation, industry and commerce, social security and electronic administration of government authorities. In 2002, the business results of GWCSS were satisfactory. The aggregate sales revenue for the financial year is 229 million.

## MANAGEMENT AND RESEARCH AND DEVELOPMENT

In 2002, the Group's principal subsidiaries, including CGC and Shenzhen Kaifa Technology further intensified reform on the internal management mechanism and implemented stringent cost control measures. By refining the ERP system, it endeavored to reduce operation and production cost and raise the Group's operation and management efficiency. At the same time, additional investment was contributed to technology development and technological reserve to ensure sustainable growth for the Group's subsidiaries.

### PROSPECTS IN 2003

Looking into 2003, the IT and communications industry will continue to be subjected to exceptionally harsh market conditions. Taking into account the various challenges, the Group will further strengthen internal management and control, reduce production and operation cost, bring into full play its edge in

manufacturing to further upgrade projects under development and key investment projects and nurture new centers of profitability. As the China market continues to grow amidst persistent worldwide economic recession, the Group will take full advantage of opportunities offered by the domestic market to further develop its international market on the basis of a solid domestic market.

Shenzhen Kaifa Technology will continue to generate high sales revenue and develop new centers for economic growth at the same time. It will strengthen management, implement comprehensive budgetary control, share resources, reduce cost, reinforce supervision over cost indices, provide guidance to cost control, combine the accounting and budgetary systems with advanced management concepts such as 6-Sigma to raise the overall standard of enterprise management.

Kaifa Magnetics will hasten to put the newly procured equipment into operation to improve productivity, enlarge market share and heighten economic return. Also, additional investment will be contributed to technological reform; continuous development, research and manufacture of new products; enhance production engineering; upgrade production lines; strengthen cost control; reduce consumption; raise the qualification rate and ultimately heighten economic return.

CGC will position its new strategy for development on new products and new business through large-scale strategic investment. It is anticipated that investment in new business will launch the Group's brand name for public recognition, prompt the Group's distribution channels to reform and simultaneously mobilize the development of the Group's business in table-top computers. Operation management and regulatory systems will be further refined to reduce cost and heighten efficiency.

The hard disc business relating to the agreement signed by ExcelStor Technology and IBM China was sold to Hitachi Global Storage Technologies, Inc. ("Hitachi Global") in IBM China's bid to restructure its business. ExcelStor Technology will continue to collaborate with Hitachi Global on OEM production and strive to obtain the permit to manufacture 80GB and 120GB products on the basis of existing products. At the same time, ExcelStor Technology will also establish and develop the domestic and international market for products carrying its own brand name.

GWBNS, on the basis of strengthening network management and customer services, will reinforce management and control, continue to reduce expenditure, strengthen market development and improve the account-opening rate of existing customers to ensure that a huge increase in revenue is possible in 2003.

GWCSS will further improve its internal management mechanism and organization structure. With the advantage generated by refined technology, coupled with the general ability in the integration of software and systems, GWCSS has maintained a leading position in the mainstream market and become the main supplier of its customers. Through project implementation, GWCSS endeavors to create strong product development abilities.

## INVESTMENT

### The capital increase and share expansion of GWBNS

During the period under review, the Company, Shenzhen Kaifa Technology, CGC and CITIC entered into a shareholders' agreement of GWBNS on 10 April 2002. GWBNS's share capital changed with the joining of a new shareholder. After the increase in GWBNS's share

capital, GWBNS's shareholders comprised of CITIC, the Company, Shenzhen Kaifa Technology and CGC, accounting for 50%, 35%, 7.5% and 7.5% of GWBNS's equity respectively. The registration for and filing of all legal documents relating to the share issue have been completed.

### The capital increase and share expansion of GWCSS

Upon contributing to the capital of GWCSS, the capital structure of GWCSS was as follows:

The registered capital of GWCSS was increased from RMB33,000,000 to RMB100,000,000; where the Company contributed RMB58,350,000 in cash, representing 58.35% of GWCSS'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 GWCSS's equity. With the original contribution of RMB660,000 and RMB990,000, Fu Qiang and Huo Jicai held 0.66% and 0.99% of GWCSS's equity respectively. This connected transaction was approved in GWCSS'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. GWCSS 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.

### **Sale 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 IBM China on 22 February 2002, wherein 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 and 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 and 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.

### **Beijing DigiPro Information Technology Company Limited ("DigiPro") share transfer issues**

On 15 April 2003, the Company and DigiPro entered into an equity acquisition arrangement having the following content:

DigiPro has a registered capital of US\$7,000,000, before the acquisition stated herein 35% was held by the Company; 30% was held by Dongfang Communications Holdings Company Limited (Dongfang Communications); 30% was held by American Texas Instrument China Limited (Texas Instrument) and 5% was held by China Putian Information Industry Group Company (Putian Information). On 15 April 2003, upon consulting with and approval by shareholders, the

Company signed the agreements to acquire 30% of the equity of Dongfang Communications and 5% of the equity of Putian Information at the consideration of RMB15,385,714 and RMB2,564,286 respectively. After the acquisition, the Company and Texas Instrument now possess 70% and 30% of the equity composition of DigiPro respectively. The Company has paid a total consideration of RMB17,950,000 to acquire the shares of Dongfang Communications and Putian Information.

## **GRATITUDE**

On behalf of the board of directors of the Company, I would like to take this opportunity to express my heartfelt thanks to the staff of the Group for their dedication in the past year and to all shareholders for their support and concern for the Company.

By Order of the Board

**Wang Zhi**

*Chairman*

23 April 2003