

## MANAGEMENT DISCUSSION AND ANALYSIS

During the Period, the Group realized a turnover of RMB5,293,000,000 and a net profit of RMB66,918,000, representing an increase of RMB2,220,000,000 and RMB35,000,000 respectively, as compared to the corresponding period last year.

## FINANCIAL REVIEW

### *Liquidity and Financial Resources*

As at 30 June 2003, the Group's total cash and bank balances amounted to RMB1,813,062,000 and the Group's total borrowings amounted to RMB1,837,099,000. The structure of such borrowings were as follows:

- (1) 82.62% was denominated in Renminbi;
- (2) 15.74% was due and repayable within 2 to 5 years; and
- (3) 84.42% was made on fixed interest rates.

### *Gearing Ratio*

As at 30 June 2003, based on the Group's total borrowings and shareholder's equity of RMB1,837,099,000 and RMB2,989,447,000 respectively, as compared to RMB2,500,437,000 and RMB2,922,529,000 respectively as at 31 December 2002, the gearing ratio was 61.5%. The gearing ratio as at 31 December 2002 was 85.5%. The gearing ratio is defined as the ratio between total borrowings and shareholder's equity.

### *Current Ratio and Working Capital*

During the Period, the Group's current assets and current liabilities were RMB5,541,282,000 and RMB3,839,220,000 respectively. As at 30 June 2003, the Group's working capital amounted to RMB1,702,062,000, as compared to RMB1,704,831,000 as at 30 June 2002. The current ratio for the Period was 1.44.

### *Charge of Group Assets*

During the Period, the Group had pledged to banks its bank savings of approximately RMB764,908,000 to secure banking facilities for the Group. As at 30 June 2003, Great Wall Group acted as guarantor for approximately RMB300,000,000 of the Group's borrowings.

### *Exchange Rate Fluctuations*

The Group did not hedge against risks associated with foreign exchange fluctuations. During the Period, approximately 76% 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 had a negative impact upon the Group. Since the exchange rate of RMB to US dollars remained relatively stable, there were no substantial adverse effects to the Group's business performance or financial status as a result of foreign exchange fluctuations.

## **BUSINESS REVIEW AND PROSPECTS**

### *Business Review*

The Group's business includes research and development, manufacture and sales of PCs and PC peripheral products, HDDs and HDD related products, network terminals and fiber optical products, broadband network services and other telecommunications services, and products and services relating to software and system integration. These businesses were mainly conducted by the Company and its major subsidiaries and associated companies including: its 55.96% owned subsidiary Shenzhen Kaifa Technology Company Limited ("Kaifa"), its 51% owned subsidiary Shenzhen Kaifa Magnetic Recording Company Limited ("Kaifa Magnetics"), its 61.68% owned subsidiary ExcelStor Technology (Shenzhen) Limited ("ExcelStor Technology"), its 61.68% owned subsidiary ExcelStor Great Wall Technology Limited, its 60.47% owned subsidiary China Great Wall Computer (Shenzhen) Company Limited ("CGC"), its 58.35% owned subsidiary Great Wall Computer Software and Systems Incorporation Limited ("GWCSS"), its 35% owned associated company Great Wall Broadband Network Service Company Limited ("GWBNS") and its 35% owned associated company Beijing DigiPro Company Limited ("DigiPro").

### *HDDs and HDD Related Products*

During the Period, Kaifa realized a turnover of RMB3,770,000,000. The production and sales volume of its key product, magnetic heads, continued to rise and its market share continued to grow. The sales turnover of HDD heads increased by 57.89% as compared to the corresponding period last year. The products and services provided by Kaifa were well recognised by customers. While maintaining steady growth in production and sales, Kaifa further strengthened its internal management control by introducing advanced management models, improving production efficiency and enhancing human resource management so as to improve employee competency.

During the Period, Kaifa Magnetics' production and sales of substrates continued to increase. At present, Kaifa Magnetics has successfully completed two stages of production expansion and gained further improvement in its production skill and equipment. Kaifa Magnetics' production capacity has reached an amount double of that in the corresponding period last year, and the financial figures including revenue and profit have improved significantly. During the Period, the turnover and profit of Kaifa Magnetics increased by 148.54% and 327.27% respectively, as compared to the corresponding period last year.

Having achieved surpluses since the fourth quarter of 2002, the business of ExcelStor Technology has developed rapidly. ExcelStor Technology implemented an active marketing strategy and has now established a good cooperative relationship with Hitachi Global Storage Technologies Company. The two parties entered into a technology permission agreement at the end of June 2003 for 80G HDD production. ExcelStor Technology has strived to maintain steady growth in its OEM business, and has put considerable emphasis on its brand and market expansion within the domestic market, thereby continuing to build and improve its customer service system. So far, ExcelStor Technology has established and operated eight customer service centers in China.

#### *PCs and PC Peripheral Products*

During the Period, CGC made vast improvements in respect of its main business, such as increasing sales volume of PCs, monitors and power supply by 22%, 1.8% and 30% respectively as compared to the corresponding period last year. CGC devised and organised strategic marketing activities such as ("長城e選") and Great Wall IF Strategy ("長城IF戰略") and established a strategic cooperation relationship with Digital China (China) Limited and also reinforced the structure and management control of its PC distribution channel. During the Period, CGC further reduced production costs, enhanced operation and control levels of product quality, and stock and lead time, thereby efficiently controlling and reducing loss in its main business. CGC launched new businesses in respect of servers and notebooks. Owing to intensified market competition, drastic reduction of gross profit and the impact of SARS, the turnover and profit of CGC decreased as compared to the corresponding period last year, although the sales volume increased considerably during the Period.

### *Broadband Network*

During the Period, the aggregate number of users who had opened accounts with GWBNS increased by 40% as compared to the corresponding period last year. GWBNS improved operation efficiency and lowered costs by optimizing its backbone network and metropolitan area network ("MAN") and establishing comprehensive customer service centers. The sales turnover increased by 154% as compared to the corresponding period last year. In addition, GWBNS expanded the scope of its telecommunication services business and obtained a chain Net-Pub operation licence ("連鎖網吧") in the PRC.

However, owing to the impact of high initial capital investment in the construction of preliminary infrastructure and increased market demand for greater capital resources to satisfy heightened needs for network performance in the telecommunication market, GWBNS recorded a loss during the Period. These were the main factors that caused reduction to the Group's profitability.

### *Software Services and System Solutions*

GWCSS's business is mainly focused on the provision of software applications and system solutions to users in the areas of taxation, industry and commerce, social security and electronic administration systems for government authorities. During the Period, GWCSS's business was considerably affected by the delay of national projects caused by the outbreak of SARS. However, GWCSS strengthened its internal management and cost controls, and actively expanded its market in the above-mentioned areas. For example, GWCSS participated in the JinShui Project II with the National Taxation Bureau, the Hong Dun Project II with the National Industry and Commerce Administration Bureau, as well as a number of projects relating to electronic administration systems for government authorities.

### *Management and Technology*

During the Period, the Group reinforced and adopted advanced management models, e.g. Kaifa launched an AME work process to trace users' needs and took active action in strategic marketing. Also, Kaifa conducted IE engineering and obtained distinctive effect in product inspection. Kaifa Magnetics gained further improvements in respect of its production skills and equipment and capacity reached double the figure of that during the corresponding period last year. During the first half of 2003, the Company entered into and signed an acquisition agreement to acquire a 35% share in DigiPro. As a result, the Company's equity interest in DigiPro will be increased to 70%, establishing a solid foundation for the Company's technology development for the future.