

BUSINESS REVIEW



The Group's major business areas include computer parts and components, computers, software and system integration, and broadband network value-added services. During the year ended 31 December 2004 (the Period), the businesses above

include R&D, manufacture and sale of HDDs and HDD related products, PCs and PC peripheral products, and products relating to software and system integration, as well as other telecommunications value-added services. These businesses are mainly conducted by the Company's subsidiaries and associated companies.

During the Period, the Group had implemented the strategy of strengthening principal business, invigorating industry and heading for high-end development, and had effectively integrated and optimized the Group's core resources. It had also achieved great success in aspects like operational effectiveness, market expansion, technological innovation and level of management, laying a strong foundation for strengthening the Group's competitiveness and facilitating the Group's long-term development.

During the Period, the Group had realized revenue from principal business of RMB11,419,186,000 with an increase of 2.78% from last year; realized a net profit of RMB199,773,000 with an increase of 12.45% from last year.

HDDs and HDD Related Products

The Group's HDDs and HDD related products are mainly comprised of magnetic heads of computer hard disk drives ("HDD heads", or "HDD head" when referred to singularly), substrates and computer HDDS. The manufacture and sale of the products are respectively from the Company's subsidiaries, namely Kaifa, Kaifa Magnetic, ExcelStor Technology and ExcelStor Great Wall.

HDD Heads

HDD head is the Group's product with nearly 20-year-history of success and its sales volume ranks second in the professional manufacturers of HDD heads worldwide. The process for mass production, production and processing skill and functions of the product are all come up to advanced world level. This product is mainly sold abroad and its customers are international leading HDD manufacturers. The sales volume of the product accounts for a market share of over 12% in the global HDD head market.

During the Period, with the popularization and implementation of advanced management systems like 6SIGMA and IE Engineering, and full utilization of the self-developed precision automatic processes, the Group's HDD head business had realized automation



and semi-automation in its over 90% of production lines. The unique manufacturing process had led to a competitive advantage characterized by high efficiency, low cost and mass production, and the strong capability to adjust to the ever-changing international market such that its competitive position in the global HDD head market was secured.

The sale and operation of the product is conducted by Kaifa, the Group's subsidiary, and product types are mainly high-volume magnetic heads of 80GB and 120GB. The Group holds a 55.96% shareholding interest in Kaifa.

HDD Substrates

The Group possesses the only and largest and most comprehensive manufacturing base of HDD substrate in China. The product is 100% sold overseas to the customers in the US, Singapore, Malaysia, Japan and Taiwan. Most of the customers are well-known HDD manufacturers worldwide, like MMC, TRACE, KOMAG, Showa Denko. Currently, the Company had been maintaining good and stable long-term cooperation relationship with the internationally renowned HDD manufacturers.

During the Period, the Group had increased the investment in scientific R&D of the product, improved its process design and conducted debugging on various test equipment, developed the SCI cleansing process to enhance the surface-cleanness of substrate and to refine its polishing and testing process. As a result, the Group had completed the upgrading and enhancement of the product in terms of function and quality. Meanwhile, as the expansion of HDD applications providing great room for development and market opportunities, the Group had, during the reporting period, expanded manufacturing plant and base of the product and improved the supporting facilities. This not only paved the way for further improvement of production capability

and expansion of scale, but also played a big role in propelling the Group's business towards high-end development.

Kaifa Magnetic, one of the Group's subsidiaries, is responsible for the R&D, manufacture and sale of HDD substrates. Substrate is one of the core components in computer HDD. The Group holds a 66.5% shareholding interest in Kaifa Magnetic.

HDD

With the promising prospect of HDD market, the application of HDD has expanded from the current application in the PC market to various electronic consumer products, like TV set-top boxes (STBs), mobile phones, video cameras and digital cameras and etc. Meanwhile, multi-media equipment with high quality-price ratio will also further spur the development of HDD accessories market and gradually increase the demand for HDD.



During the Period, the Group's existing HDD business was divided into two main streams: one was the R&D, manufacture and sale of its own branded HDDs; the other was the production and processing on an OEM basis. Thereof, the own branded ExcelStor hard disk was the only HDD product that was self-designed and mass-produced in the PRC. The Jupiter HDD series and Gemini HDD series self-developed by the Group had filled the

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vacuum of such products in China. As to the production and processing services on an OEM basis, the Group had cooperated with Hitachi, IOMEGA and EXABYTE respectively in manufacturing HDDs, with an annual production capacity of more than 8 million units. With the outstanding performance in product quality and cost control, the Group had been chosen by Hitachi as its important global strategic cooperation partner. During the Period, the Group had also introduced encrypted HDD – GSTOR safe storage and portable HDD under such product lines. Among them, the encrypted HDD had been the first of its kind in the world and had realized encouraging market demand.

ExcelStor Technology and ExcelStor Great Wall are responsible for the Group's HDD business, with ExcelStor Technology responsible for the manufacture and home-land sale and R&D of HDD and ExcelStor Great Wall responsible for the R&D and sale of HDD overseas. The Group holds a 61.68% shareholding interest in each of ExcelStor Technology and ExcelStor Great Wall.

PCs and PC peripheral products

During the Period, the Group had achieved impressive results in establishing sales channels, increasing brand-value, reinforcing R&D and in diversifying products in the sphere of PC business. During the Period, through friendly consultation, the Group had adjusted the sales mode with the sole agent of Digital China, creating favorable conditions for autonomic development. For now the Group has set up 33 directly-subordinated customer service centers nationwide, and has built up strategic service alliance with over 300 professional cooperation partners to cover up business over 200 cities in the PRC. Meanwhile, the degree of fame and market share of Great Wall power supply and monitors in the PRC market has both witnessed remarkable enhancement. During the Period, the Group had also successfully launched the fully digital high definition all-in-one television display series and



the high definition television. Besides, by adopting physical isolation method to isolate the users' intranet from the external Internet network, the self-developed newborn safe computer had also been launched in addition to two new light and trendy 12-inch notebook computer items – A10 and A11.

During the Period, CGC had signed equity transfer agreements with IBM Far East Holdings B.V. ("IFEH") and IBM Products AP Limited ("IPA") to wholly transfer the 20% equity interest in International Information Products (Shenzhen) Co. Ltd. (abbreviated as "IIPC") held by the Company to IPA at a consideration of US\$ 44 million. Please refer to the circular of the Company dated 18 February 2005 for details of such transaction.

CGC, one of the subsidiaries, was responsible for the Group's PC business. The Group holds a 60.47% shareholding interest in CGC.

Software Services and System Solutions

GWCSS, a subsidiary of the Group, possess the endowments of domestic system integration supplier and total application solution supplier, and this business mainly involves providing large application software, high-added value solutions and general advisory and consultancy services for key industries such as government, finance and social security sectors.

During the Period, GWCSS had signed contracts with a number of well-known manufacturers like IBM, MICROSOFT, SYMANTEC and BEA, the world's largest intermediate software supplier, to become the general agency in the PRC for their products.

During the Period, GWCSS had made some achievements in respects of market development, scientific R&D and resources integration.

During the Period, the Group holds a 82.54% shareholding interest in GWCSS.

Information Product Design Business

DigiPro, one of the Group's subsidiaries, is responsible for the information product design business. DigiPro is a sino-foreign equity joint-venture co-invested by the Company and Texas Instruments Incorporated (TI) of the US, and it is principally engaged in digital product design. Such business mainly involves providing product design, solutions and sample machines services for manufacturers of computers, communication and digital consumer products at home and abroad, and providing test guidance in the course of production. Its products and technologies are divided into two main streams, one is the DSP development tool and application platform and the other is network video server product. The Group holds a 70% shareholding interest in DigiPro.

New products and projects

During the Period, CGC, a subsidiary of the Group, had formally entered into a contract with IBM to form International System Technology Company, hereafter abbreviated as "ISTC", to jointly establish a strategic production base for IBM. The newly established ISTC had its headquarter situated in Technology Park, Shenzhen and its export production base situated in Futian Free Trade Zone, Shenzhen. The capital contribution ratio of IBM and China Great Wall Computer

(Shenzhen) Co., Ltd. are respectively 80% and 20%. After completion and going into production, the newly established ISTC will be principally engaged in the production and manufacture of server products. The Group thinks that this new cooperation is conducive to the Group's industry structure adjustment and its' development into the high-end technological product field. It is expected that this new joint venture will go into production formally in May 2005.

During the Period, the Group had co-invested with Marubeni Corporation (日本丸紅株式會社) (Marubeni) and Toyo Kohan Corporation (日本東洋鋼板株式會社) to form a sino-foreign equity joint-venture to manufacture glass substrates in Shenzhen, with an aim to further enhance the Group's competitiveness in the international market, to seize the emerging market opportunities and to conform with the need of technological development of HDD substrate products. The project involves a total investment of US\$17.5 million, with US\$7 million as the registered capital. Shenzhen Kaifa Magnetic Recording Co., Ltd. ("Kaifa Magnetic"), a subsidiary of the Group, holds 49% of equity of this joint-venture. The establishment of this company signifies the Group's another advancement into the high-end product field for its manufacture of core components and parts. Meanwhile, it also heralds a narrowing gap between our country and the advanced world level in respect of magnetic recording product in the short run.

Other non-mainstream products

While consolidating its principal business, the Group had paid close attention to the development of non-mainstream products like smart electric meter series, RAM products, tax control products and mobile phone related products. As a result, the market competitiveness market share of the non-mainstream products had been enhanced, laying a firmer foundation for long-term development of the Company.

Management and Technology

During the Period, the Group had attached importance to regulate corporate governance structure and actively promoted the reform and innovation of its management system by introducing international corporate management models, thus resulting in effective integration of resources and general enhancement of the Group's economic effectiveness.

After implementing and promoting the 6SIGMA management initiatives in the recent years, Kaifa had greatly improved its production efficiency and acceptance rate of products in process, such that the Company's management corporate management system had come up to advanced international management system. The implementation of e-purchasing platform, e-Hub logistics management system had also reduced the waste of materials and operation costs of the departments and had brought about considerable financial returns.

ExcelStor Technology had reduced costs year by year with the help of the 6SIGMA management initiatives. Meanwhile, it had further optimized the production flow and streamlined its staff composition. The introduction of automatic conveying system and the development of automatic assembly equipment had also greatly improved its production efficiency of magnetic HDD products.

Kaifa Magnetic had emphasized R&D of products. By improving the product process design and flow, the company had its production efficiency and acceptance rate of products improved, costs lowered and product competitiveness enhanced. Meantime, the company had been expanding into high-end products and in keeping abreast of the most updated market trend.

CGC had continued its all-round implementation of the operational budget approval system and had put

more emphasis on the modern intensive and meticulous operational management mode, thus strengthening the regulation and control of business course and lowering corporate costs. On the other hand, the company had re-programmed its ERP system and had it on-lined in February 2004. The new ERP system is expected to reflect the operation status of the business divisions and business units timely and accurately, and to provide prompter support in decision-making.

In order to strengthen the company's competitiveness and establish a scientific and standardized software development course management system consistent with the standard of the international software market, GWCSS had carried out the CMM (Capability Maturity Model for Software) evaluation. On 30 September 2004, the company had successfully passed the Grade II evaluation of CMM, signifying that the company is scaling new heights in its project management and quality management to come up to international standard.

Outlook for 2005

In 2005, in line with the mounting demand for HDD and related products resulted from the development of global electronic consumer products, the Group will further accomplish its rationalization and integration of resources allocation. It will also fully utilize the advantage of the current resources possessed by the Company to push on the strategy that centers on strengthening principal business, so as to enlarge the scale and competitive advantage of products like magnetic heads, substrates and HDDs in the industry, striving for new development in products of high-tech PC and software. In 2005, the Group is expected to explore and make use of the resources from the existing market, research and development and production management, as well as to fully capitalize on the competitive strength possessed by the Group in the international market and high-tech manufacturing industry, with an aim to pursue

a product chain or a profit powerhouse that is fairly large-scale, rich in high-tech elements and with strong competitiveness.

HDD and related products

The Group will continue to enlarge the market share of its HDD head product, maintain its market position, further reduce and eliminate the risks associated with its business model and to do well in its upgrading and enhancement. The Group will also make good use of the successful experience of such product to facilitate the development of other products.

As for substrate products, the Group will intensify the R&D of product with higher recording density, exert itself to support and promote the development of new projects like glass substrates and further expand the production capacity of aluminium chips and nickel chips, in order to augment the competitive advantage of such products of the Group, and to consolidate and strengthen their market position and sustainable development potentials.

As for HDD business, the Group will continue strengthening the advantage on product quality and cost control of ExcelStor Technology and will also continue expanding the production scale, enlarging market share and reinforcing R&D efforts. What is more, the production scale and the sales volume of portable hard disk and encrypted hard disk will be enhanced, and 2.5-inch HDD will be timely released in response to market demand as well, with an aim to become one of the leading storage equipment manufacturers in the world.

PCs and PC peripheral products

As for PC business, the Group is expected to implement the strategy of exploring market and heading for high-end development. Notebook computer, as one

of the key businesses in computers, remains the development focus in the PC business of the Group; The Group will proceed to increase input in R&D to improve the technology content to forge new products with core competitive advantage. It is expected that the co-investment with IBM to set up a joint venture, namely ISTC, will realize the transformation of both parties hand in hand towards high-end business and will speed up the implementation of the strategy of advancing towards the high-end product sphere.

Software Services and System Solutions

As for software and system integration, GWCSS is expected to ruggedize and extend the superiority of the Company in the electronic government businesses sphere and bolster business and endeavor to make more major breakthroughs in other sectors. Apart from the above, the results of agent distribution and software out-sourcing of the Company will be improved to complement the principal business of the Company, optimize cost operation and freshen the economic effectiveness.

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 unceasing support and care for the Company.

By Order of the Board

Chen Zhaoxiong
Chairman

8 April 2005