

REVIEW OF 2006

From 1 January 2006 to 31 December 2006 (the “Reporting Period”), the Group realized sales revenue of RMB19,919,261,000, representing an increase of 33.46% from the same period last year. The audited loss after taxation attributable to shareholders was RMB122,196,000, representing a decrease of RMB444,132,000 in profit from the same period last year. The principal cause for losses was a one-time loss of RMB426,636,000, which was incurred from share reform loss of Great Wall Kaifa and CGC, which was implemented in May 2006. Besides, profits for the same period last year included a one-time gain of RMB334,674,000 from the sale of International Information Products (Shenzhen) Co., Ltd. (before minority interest).

Strengthening self-innovation, enhancing the corporate core competitiveness

In 2006, the Group continued stepping up its efforts on innovation. By pursuing a strategy of self-innovation; integrated innovation; and re-innovation through introduction, assimilation, and absorption; the Group worked to build the enterprise into a “core technology-oriented enterprise”, and made new strides in four major business areas, namely core computer components, computer manufacturing, software and system integration and broadband network and value-added services. We are heading in the direction of becoming “a major corporate group which is leading domestically and competitive internationally”.

Core Computer Components

At present, our scientific researches on, and technology for production of, magnetic heads, substrates, and hard disks are aligned with international standards. Among the product chains of our international peers, with our unique technology, a complementary balancing between market and production resources, high quality products, forefront production technology and a logistics management system of international standards, we have formed an operation mode with competitive advantages and a product value chain, playing an increasingly important role in the international arena for the manufacturing of hard disks and their components.

In the area of magnetic head production technology, we are internationally advanced in our magnetic heads automatic production technology, anti-vibration and anti-dirt control technology, anti-static disturbance technology, and high-grade purification chamber negative ions control technology, and have obtained a number of patents. We have achieved automation or semi-automation for 90% of our production of magnetic head products, an international state-of-the-art level.

Regarding the production of substrates, the Group established Great Wall Magnetic Recording Centre (長城磁記錄研究中心), and successfully developed R4N2, an internationally advanced substrate product applicable to the perpendicular magnetic recording technology. This constitutes not only a leap from longitudinal magnetic recording (LMR) to perpendicular magnetic recording (PMR), but also the launch of RN3, a new generation of PMR product. This scientific research achievement has not only enhanced the competitiveness of the Group on the international magnetic market, but also further consolidated the Group’s leading position in the field of international magnetic recording technology.

Regarding the production of hard disks, the Group has successfully developed the 160G GSTOR series of security hard disks, the unique properties of which has won attention and praise from both domestic and international markets. At the same time, there are also out-built security hard disks, ant-nest 1" intelligent E-disk (蟻巢1吋智能E盤), ant-nest 2.5" intelligent E-disk (蟻巢2.5吋智能E盤) and ant-nest 3.5" intelligent E-disk (蟻巢3.5吋智能E盤). The ant-nest intelligent E-disk and the DUO BAY 3.5 inch backup system (DUO BAY 3.5吋硬盤備份系統) were awarded with "Outstanding Product" awards in the 8th "Hi-Tech Products Convention".

Regarding power supply, the Group has launched a high-end series of products which are targeted at dual core computers. Meanwhile, the Group has stepped up its efforts to promote its current high-tech products of long-life power supply (長壽電源) and double-power electric source (雙動力電源).

Computer Manufacturing

Regarding security computer, the Group's subsidiary, CGC, consolidated various self-owned intellectual property rights, such as "Security BIOS", "Great Wall Encryption Algorithm", and "GSTOR Security Cache", integrated them with "the Great Wall Lightning Security Power Source and the Great Wall Monitor which applies the colour engine technology", successfully developed security computers upon research, and commenced its batch production in the first quarter of 2006.

Regarding notebook computers, in order to prevent any "hollowing-out of technology", the Group established Great Wall Security Notebook Computer Research and Development Centre (長城安全筆記本電腦研發中心) to bring the advantage of the Group's industry chain into play. It has made important technological breakthroughs in security, portability, mobile link, and battery life, promoted the independent design and the mass production of notebook computers in China, and enhanced the effectiveness of products as a result.

Regarding computer servers, the Group has made a lot of technological improvements and enhancement based on the development trend of the server market, and launched a number of new server products, in particular, Zhixiang R510G3, which is a new product for dual core computer servers, and Zhixiang S320G3, which meets the needs of industry and big and medium corporate users in key business application. Both are well-received by the market.

Regarding remote control meters, the Group has reformed the meter development and research program, with major breakthroughs in anti-tampering technology of metres. We have applied for 14 patents, including four overseas applications and have obtained eight copyrights on computer software. A Certificate of National Key New Product has been granted to long-distance metres DDSD67 and DTSD67.

Regarding tax controlling cashing machines, during the Reporting Period, there was a new breakthrough in the Group's development and research of tax controlling products. A patent on tax controlling machine and a copyright on tax-controlling software were granted to the Group. The Tax Controlling Cashing Machine, a newly-developed product, passed the national accreditation test.

Software and System Integration

The Group possesses a leading comprehensive development system in China, which develops independent system software, support software and application software. The Group has a first-rate software development team and a national software industry base in China. In the areas of financial administration, finance, taxation and customs, the Group has contracted for and completed major engineering and system works which relate to electronic administrative affairs, electronic commercial affairs, national economic life and information security. During the Reporting Period, the sales revenue of GWCSS, a subsidiary of the Company, increased by 93% as compared with the same period last year.

Broadband Network and Value-added Services

The Group's associated company, GWBNS, has brought its self-owned resources into full use for network optimization, further enhanced the network quality, and solved key issues such as user accreditation. Meanwhile, the construction of service platform was enhanced; efforts on independent research and development were stepped up; a business system with self-owned intellectual property right was actively developed, and an operating service system was formed through integration. During the Reporting Period, its losses fell by 11% as compared with the previous year.

Expansion of production scale, optimization of products and heightening of economies of scale

In 2006, the main business line of the Group continued to grow. The production scale of electronic components expanded continuously, realizing sales amounts of RMB17.447 billion, representing an increase of 37% from the same period last year, and a profit of RMB593 million, representing an increase of 39% from the same period last year.

During the Reporting Period, the Group continued increasing its support for backbone enterprises which had mastery of core technology, renowned brands, advanced management and core competitiveness, so as to promote development at an even higher speed and a more satisfactory manner. In 2006, the Group subsidiaries, namely CGC, Great Wall Kaifa, Kaifa Magnetic and ExcelStor Technology, all carried out updating, expansion, and reform of production line.

The new base established by Great Wall Kaifa in Suzhou has commenced production of the PCBA board for hard disks. The establishment of the base not only provides customers with the most effective ancillary services, but also fulfilled a further extension of the products of Great Wall Kaifa in the area of hard disk components, hence further opportunities on the market.

Our electroplating production capacity has been greatly increased after the Shiyan base of Kaifa Magnetic, a subsidiary of the Group, was completed and production commenced. The bottleneck of polishing disk substrates has been effectively broken through with a significant increase in daily production capacity.

ExcelStor Technology, the Group's subsidiary, invested substantial funds in a project on asset increase, production expansion and technology reform. The project smoothly passed acceptance inspection in June 2006. The production expansion project has brought about a substantial increase in both output and sales, and a significant rise in the proportion of export, which has reached 93.4% at present. Production of the 160G and 3.5" big capacity hard disk under the ExcelStor brand was commenced in the second quarter in 2006. Meanwhile, 2006 saw three more hard disk production lines built collaboratively by ExcelStor Technology and Hitachi, with a further increase in production capacity.

During the Reporting Period, sales of the Group's substrates amounted to 98,450,000 pieces, with an increase of 24% from the same period last year. Sales of hard disks reached 18.51 million sets, with an increase of 40% from the same period last year. Sales of power source amounted to 5.56 million, with an increase of 30% from the same period last year. Sales of monitors amounted to 2.31 million sets, with an increase of 34% from the same period last year.

In 2006, while bringing the advantage of large-scale production in manufacturing into play, the Group endeavoured to optimize its product structure, continued enhancing the technological level and added value of its products, accelerated its resources input to high-end product markets and emerging markets, expanded the production scale of products with high added value and increased the proportion of exports in such products, and made efforts to fulfill high-end and sustainable development. Currently, the technology structure of products is being updated continuously, with an accelerating pace towards high-end transformation.

Proactive implementation of internationalization strategy, and a further expansion of strategic cooperation with multinational companies

During the Reporting Period, the Group further expanded its strategic cooperation with multinational companies; selectively promoted the joint development of technology; used its integration and innovation capability as a foundation and focus; strengthened, introduced, assimilated and absorbed re-innovation capability; and fostered and accumulated originality and innovation strengths. The Group also endeavoured to establish in-depth cooperation with international top-class companies; expanded its cooperation with other enterprises IBM, Hitachi, and INTEL; established centres in China for joint research and development of core technology; accelerated the enhancement of technology level; quickened the pace of industrialization and internationalization in key areas; promoted and fulfilled industry development by leaps and bounds and internationalized operations of the Group; and sought to become a base of assimilation, absorption, introduction and re-innovation.

Strengthening risk management to provide safeguards for the healthy and harmonious development of the enterprise

With rapidly changing operation environment and intensifying market competition, the enterprise is faced with an increasing variety of risks. To protect the enterprise against risks and to ensure healthy development, the Group has taken a series of measures to educate its management on risk awareness and strengthen its corporate capability for risk control:

1. to enhance its risk awareness through education and training;
2. to establish a risk control team to enhance guidance and leadership on risk control; to carry out serious checks on points of risk; to further standardize the operation of the enterprise; to plug loopholes in the process of operation and management; and to establish, on a gradual basis, a mechanism to control operation risks with long-term effect;
3. to introduce advanced international management system; and to strengthen the process of supervision and control, for instance, the introduction and implementation of the 6 SIGMA Management Method by Great Wall Kaifa, Kaifa Magnetic and ExcelStor Technology, which has effected a substantial savings of costs and an effective supervision and control of the operation process;
4. to strengthen the management of financial funds; to enhance risk resistance and forewarning capability; during the year, in accordance with the specific requirements of the Procedures of CEC for Financial Information Management, efforts were made by the Group to procure continuing improvement of financial information quality by subsidiaries; to make serious analysis of the enterprise's risk exposure, so as to bring the forewarning role of financial analysis into full play.

PROSPECTS FOR 2007

I. Promoting focused infrastructure projects, continuing increasing support for dominant enterprises

1. *Phase 2 Construction Works of the Shiyan base of CGC*

To meet the requirements of Kaifa Magnetic for further expansion of production and the requirements of CGC in the next stage of its development, CGC will build a new plant of 180,000 square metres in the Shiyan base, which will integrate research and development. The works are scheduled to be completed in 2007.

2. *Expansion of production line of magnetic recording polishing substrates*

To meet the demand of increasing orders, Kaifa Magnetic intends to invest and construct a new electroplating production line. Upon completion of the project, the production capacity of polishing substrates will increase by more than 50%.

3. *ExcelStor Hard Disk Project*

To meet business development needs, ExcelStor Great Wall intends to invest and build a new production base in a major industrial area, which will focus on the production of hard disks, security cache products and consumer micro-hard disks. The new plant construction works under the project was commenced in December 2006, and production for phases 1, 2 and 3 were scheduled to commence in the first quarter of 2008, 2009 and 2010 respectively. Meanwhile, ExcelStor Technology intends to add four new production lines to its existing ones, increase its output of 3.5" 160G double-head hard disks with rotational speed of 7200 RPM and to make front-end preparation for the output of 250G hard disks for the first quarter of 2008.

II. **Increasing technology investment, enhancing core competitiveness**

1. The business of computer manufacturing will be focused on the area of security computer products, and will be targeted at new business areas, such as information security, data recording and data family, so as to further expand the market share, form new production capacity and seek entry to high quality and new electronic ancillary services.
2. The hard disk business will be focused on increasing the variety of hard disks. On the basis of batch production of 160G hard disks, the development and research of new variety will be speeded up, so as to promptly develop the "1", 1.8" and 2.5" mobile caches" into a series to form new profit-growing points.
3. Regarding the magnetic recording business, efforts will be made to expand scientific research and development in order to adapt the application of high-end hard disk development. Meanwhile, we will seek for inclusion of the products as key items with State support, and to seek further support from the National Development and Reform Commission, and the Ministry of Science and Technology.
4. Products like metres and tax controlling cashing machines will be given key support with a view to increasing product competitiveness, expanding market sales and increasing the proportion of the benefits contributed by ODM products in the total benefits of the Company.
5. Regarding software and system integration, we will further explore the model of software delivery production line, carry out strategic in-depth industry pilot projects, and build up the brands of Great Wall in software industry services.

III. Expanding areas of international cooperation, implementing outwards expansion in full swing

1. With a market-oriented approach, we will study and explore ways to develop the Vietnam market for our computers and meter products.
2. Regarding the hard disk business, in addition to existing international cooperation with Hitachi, Iomega, Exabyte and FreeCom, we are proactively developing new OEM customers.
3. Regarding the magnetic recording substrate business, we shall further strengthen our cooperation with Hitachi, Komag, Showa Denko and other customers, so as to increase the quantity of supply and balance the proportions of customers.

IV. Strengthening corporate risk management, perfecting the risk management system

In 2007, on the basis of continuing implementation of the system and program for risk control, we shall study, explore and establish a comprehensive risk control mechanism and system, which will be focused on rules to guard against operating risks and decision-making risks, so as to provide support and protection to the Company for sustainable and healthy development.

FINANCIAL REVIEW

During the Reporting Period, the Group realized a turnover of RMB19,919,261,000, representing an increase of RMB4,994,487,000 as compared to the corresponding period of last year, and loss after tax attributable to the shareholders of the Company amounted to RMB122,196,000, representing a decrease in profits of RMB444,132,000 when compared with the corresponding period last year.

LIQUIDITY AND FINANCIAL RESOURCES

As at 31 December 2006, the Group's total cash and bank balances were RMB2,980,882,000 and the Group's total borrowings were RMB449,247,000. The structure of such borrowings was as follows:

- (1) 48.94% was denominated in Renminbi;
- (2) 75% was made on fixed interest rates.

None of the above borrowings was due and repayable within 2 to 5 years.

As at 31 December 2005, the Group's total cash and bank balances was RMB2,321,961,000 and the Group's total borrowings was RMB391,322,000. The structure of such borrowings was as follows:

- (1) 89.14% was denominated in Renminbi;
- (2) 89.14% was made on fixed interest rates.

None of the above borrowings was due and repayable within 2 to 5 years.

SEGMENT INFORMATION

Detailed segment information in respect of the Group's turnover and contribution to profit from operations for the year ended 31 December 2006 as well as other information by business segment and geographical segment is shown in note 4 to the financial statements.

GEARING RATIO

As at 31 December 2006, the Group's total borrowings and shareholder's equity were RMB449,247,000 and RMB3,559,816,000 respectively, as compared to RMB391,322,000 and RMB3,564,752,000 respectively as at 31 December 2005.

As at 31 December 2006, the gearing ratio was 12.62%, and the gearing ratio as at 31 December 2005 was 10.98%. The gearing ratio was defined as the ratio between total borrowings and shareholder's equity.

CURRENT RATIO AND WORKING CAPITAL

As at 31 December 2006, the Group's current assets and current liabilities amounted to RMB6,248,992,000 and RMB3,562,371,000 respectively, and the Group's working capital was RMB2,686,621,000 while the current ratio was 1.75.

As at 31 December 2005, the Group's current assets and current liabilities amounted to RMB6,204,452,000 and RMB3,449,050,000 respectively, and the Group's working capital was RMB2,755,402,000 while the current ratio was 1.80.

CHARGE OF GROUP ASSETS

As at 31 December 2006, the Group had pledged to banks its bank savings of approximately RMB9,581,000 to secure general banking facilities for the Group. As at 31 December 2006, no borrowings were guaranteed by CEC, the ultimate holding company of the Group.

As at 31 December 2005, the Group had not pledged bank savings. As at 31 December 2005, no borrowings were guaranteed by the CEC, the ultimate holding company of the Group.

CONTINGENT LIABILITIES

The Group's contingent liabilities are set out in detail in note 36 to the financial statements.

EXCHANGE RATE FLUCTUATIONS

During the Reporting Period, approximately over 81% of the Group's turnover was revenue in US dollars. If US dollars had fallen against RMB, it would have had a negative impact upon the Group.

BUSINESS RISKS AND RISK MANAGEMENT POLICIES

The Company's associate, GWBNS, was established in 2000. Up to the date of this annual report, GWBNS is owned as to 50% by 中信網絡有限公司, and the Company also holds a 35% direct interest in GWBNS and each of Great Wall Kaifa and CGC, both being subsidiaries of the Company, holds a 7.5% interest in GWBNS.

Due to the fierce competition in the industry and substantial capital requirement, as at the end of 2006, GWBNS has recorded an accumulated loss of RMB964 million. As at 31 December 2006, the Company has provided a guarantee in respect of the loan granted to GWBNS, which amounted to RMB470 million and provided a loan of approximately RMB473 million to GWBNS, of which approximately RMB37 million was accumulated loan interest. There are certain risks inherent to the above guarantee and repayment of the loan due to increasing competition in the PRC broadband service industry and the State's macro-economic policies.

In order to maintain control over its risk exposure, the operation team of GWBNS has implemented a series of reforms under the leadership of the board of GWBNS. The 2006 results of GWBNS have improved such that the annual loss for the financial year 2006 was RMB15.96 million less than that of last year.

EMPLOYEES

As at 31 December 2006, the number of employees of the Group was approximately 14,000. The salaries of the employees were determined according to the rank in and contribution to the respective company of any individual employee with reference to the remuneration and incentive system of the respective company.

As at 31 December 2005, the number of employees of the Group was approximately 13,000. The salaries of the employees were determined according to the rank in and contribution to the respective company of any individual employee with reference to the remuneration and incentive system of the respective company.

RETIREMENT BENEFIT SCHEME FOR EMPLOYEES

Details of the retirement benefit schemes for employees of the Group are set out in note 2.4 to the financial statements.