

INDUSTRY OVERVIEW

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OVERVIEW OF THE PRC AUTOMOTIVE INDUSTRY

The PRC automotive industry started on 15th July, 1953 when the government-controlled First Auto Works (第一汽車制造廠) in Changchun was founded. In 1969, Second Automotive Works (第二汽車制造廠), the predecessor of Dongfeng Motor Corporation, was founded. The annual production volume of the PRC automotive industry exceeded one million vehicles for the first time in 1992, two million vehicles for the first time in 2000 and three million vehicles for the first time in 2002.

In 2004, China became the world's fourth largest automaker, ranking behind U.S., Japan and Germany, with total production output of approximately 5.1 million vehicles according to the China Automotive Industry Yearbook (中國汽車工業年鑑).

Global ranking of China's auto output in 2004

<u>Rank</u>	<u>Country</u>	<u>Units produced in 2004 (millions)</u>	<u>% change from 2003</u>
1	U.S.	12.0	-1.0
2	Japan	10.5	+2.0
3	Germany	5.6	+1.0
4	China	5.1	+14.0
5	France	3.7	+1.0

Source: China Automotive Industry Yearbook

China was also the world's third largest automobile market, ranking behind U.S. and Japan, with approximately 5.1 million motor vehicles sold in 2004, representing an increase of approximately 15.7% from 2003.

Global ranking of China's auto sales in 2004

<u>Rank</u>	<u>Country</u>	<u>Units sold in 2004 (millions)</u>	<u>% change from 2003</u>
1	U.S.	17.3	+1.9
2	Japan	5.8	+0.3
3	China	5.1	+15.7
4	Germany	3.6	+1.8
5	United Kingdom	3.0	+0.5

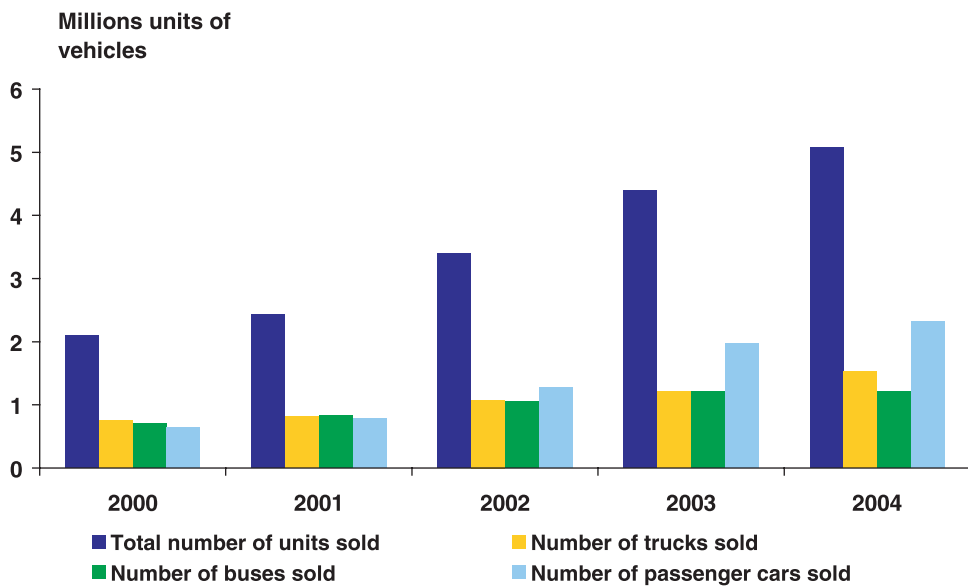
Source: China Automotive Industry Yearbook

Although the growth of China's total vehicle market has slowed down recently, the growth rate recorded by the PRC automotive market still significantly outstrips the automotive market growth rates recorded in most countries. Over the past ten years, China's total vehicle ownership registered a 10% compound annual growth rate, reaching approximately 27.1 million vehicles in 2004. 2002 and 2003

represent two rapid growth years for the PRC automotive market, with growth rates of 36.7% and 34.2%, respectively. Since May 2004, the growth of the PRC automotive market has slowed down. The growth rate in sales volume was 15.7% in 2004 compared to 2003 according to the China Automotive Industry Yearbook. According to the Development Research Center of the State Council, sales volume for automotive vehicles in the PRC is expected to reach 9.4 million vehicles in 2010, which, when compared with the sales volume in 2004, represents a 10.8% compound annual growth rate. In 2004, the rate of vehicle ownership was 21 vehicles per 1,000 people in China, as compared with the global average of more than 100 vehicles per 1,000 people, offering long-term potential growth.

The following chart shows the annual sales volumes of domestically manufactured vehicles in the PRC from 2000 to 2004.

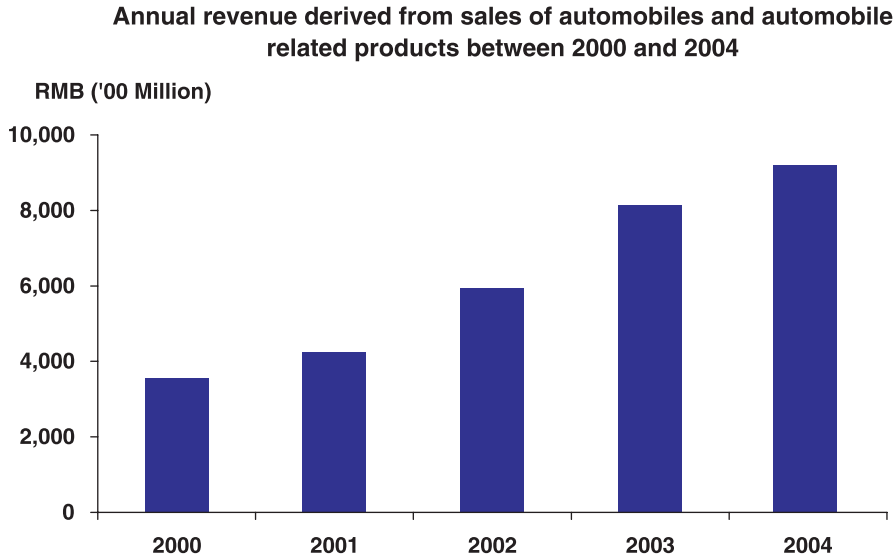
Annual sales volumes of vehicles in the PRC from 2000 to 2004



Source: China Association of Automobile Manufacturers (It is a national association of manufacturers of car, motorcycle and auto parts and related automotive enterprises constituted on an equal and voluntary basis. Its main functions consist of advising the relevant departments of the PRC government regarding automotive industry policy and collecting and distributing automotive industry market information, which are prepared based on the data provided periodically by its members according to the number of their products actually manufactured and sold.)

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The following chart shows the annual revenue derived from sales of automobiles and automobile related products between 2000 and 2004.



Source: China Automotive Industry Yearbook

Please refer to Appendix VI — “Summary of Principal PRC Legal and Regulatory Provisions — 6. Regulation of the PRC Automotive Industry” of this prospectus for a summary of the key PRC regulations affecting the PRC automotive industry which are currently in force and pending.

GROWTH FACTORS DRIVING THE PRC AUTOMOTIVE INDUSTRY

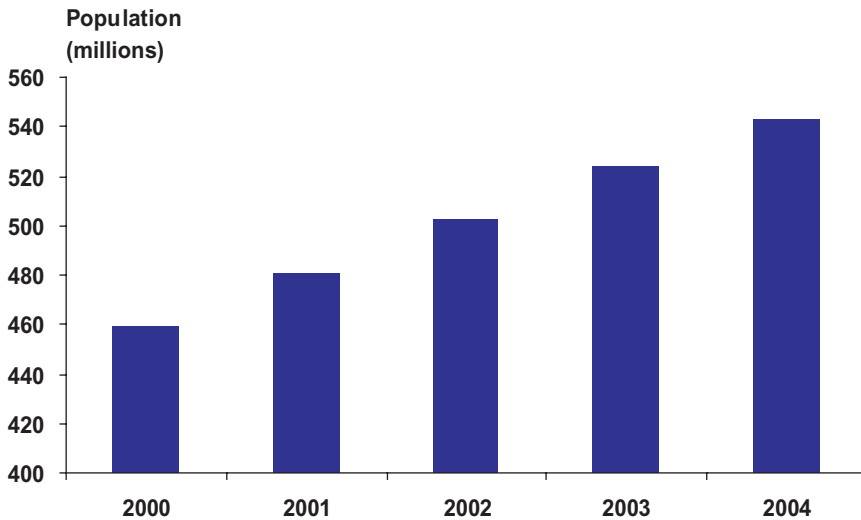
China’s growing GDP

China’s economy has been gradually liberalising and expanding since the PRC Government introduced market reforms more than 20 years ago. Between 1996 and 2004, China’s GDP (in real terms) recorded an average growth rate of approximately 8.3%. In 2004, China’s GDP (in real terms) grew by approximately 9.5%, its fastest rate since 1997, reaching approximately RMB13,688 billion (or approximately U.S.\$1,655 billion), representing a per capita GDP (in real terms) of RMB10,561 (or approximately U.S.\$1,277). The PRC Government expects to achieve a 8.5% annual GDP growth rate (in real terms) in 2005. According to statistics from Development Research Center of the State Council, China’s economy is expected to sustain an average GDP growth rate (in real terms) of approximately 7.5% between 2005 and 2010. The rapid growth in GDP is reflected in the rising standard of living in China, particularly in the urban centres, and in growing demand among the Chinese population for consumer and durable goods, including automobiles.

Urbanisation and increased mobility

Urbanisation creates opportunities in the automotive industry because of the increased need to travel in and out of cities. The PRC has become increasingly urbanised over the last five years. The following chart shows growth in the urban population in the PRC between 2000 and 2004.

Urban population in the PRC between 2000 and 2004



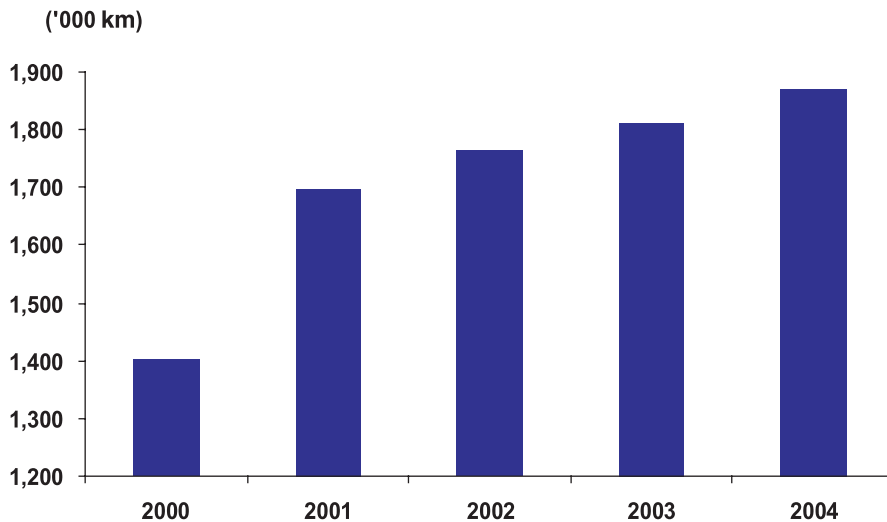
Source: PRC National Statistics Bureau

In 2000, the rate of urbanisation (being the percentage of the population living in urban areas) in the PRC was approximately 36.2%. By 2004, the rate of urbanisation in the PRC had grown to approximately 41.8%. With an urban population of approximately 542.8 million in 2004, the potential increase in demand for automobiles as a result of increased urbanisation offers potential growth opportunities for the PRC automotive industry, particularly in the passenger vehicle and bus segments of the market.

Improved road transportation infrastructure

The length of China's highway network has grown approximately 33.4% from approximately 1.4 million km in 2000 to approximately 1.9 million km in 2004. Continued highway extension promotes the use of motor vehicles. The PRC Government's commitment to develop the western regions of China, where highways dominate freight transport volume, will likely create new demand for commercial vehicles, particularly trucks, and will also facilitate the usage of passenger vehicles as well.

Length of China's highways between 2000 and 2004



Source: PRC National Statistics Bureau

According to the expressway construction plan (國家高速公路發展規劃) of the PRC Government, the total length of China's highways should reach between 2.1 million km and 2.3 million km and 90% of the cities in the PRC with a population of more than 200,000 should be linked by highways by 2010. If carried out as intended, the highway construction plan is likely to create greater opportunities for inter-city travel and, hence, greater demand for both commercial and passenger vehicles.

Government policies which encourage the purchase of automobiles in the PRC

The implementation in 2003 of "Administrative Rules Governing Auto Financing Companies" in 2003 was intended to encourage the development of automotive financing, enabling more people to purchase automotive vehicles. See paragraph headed "Availability of auto financing" of this section. The "Restrictions on Fuel Consumption Level of Passenger Vehicles", adopted in 1st July, 2005, to some extent encourages the development of economy-size vehicles, and the guidelines and encouragements on the development of environmentally friendly small cars as set out in the new "PRC Automobile Industry Policy" also promote the development of economy-size vehicles. From 2004, China began a country-wide action to stop over-loading of vehicles by requiring manufacturers to register the load capacity of each vehicle in accordance with its actual capacity and at the same time to instruct customers not to overload the vehicle. In the short term, this undertaking will encourage many customers that were over-loading their medium trucks to purchase heavy trucks. In the long term, this undertaking will benefit the competitiveness of the heavy trucks market. Accordingly manufacturers of heavy trucks should also benefit from this government undertaking.

Availability of auto financing

On 3rd October, 2003, the China Banking Regulatory Commission (“CBRC”) promulgated the “Administrative Rules Governing Auto Financing Companies”, signifying China’s move to strengthen management of auto financing services by incorporating a new category of specialised financial institution, the auto financing company (“AFC”). As of 30th June, 2005, six auto financing companies have been approved.

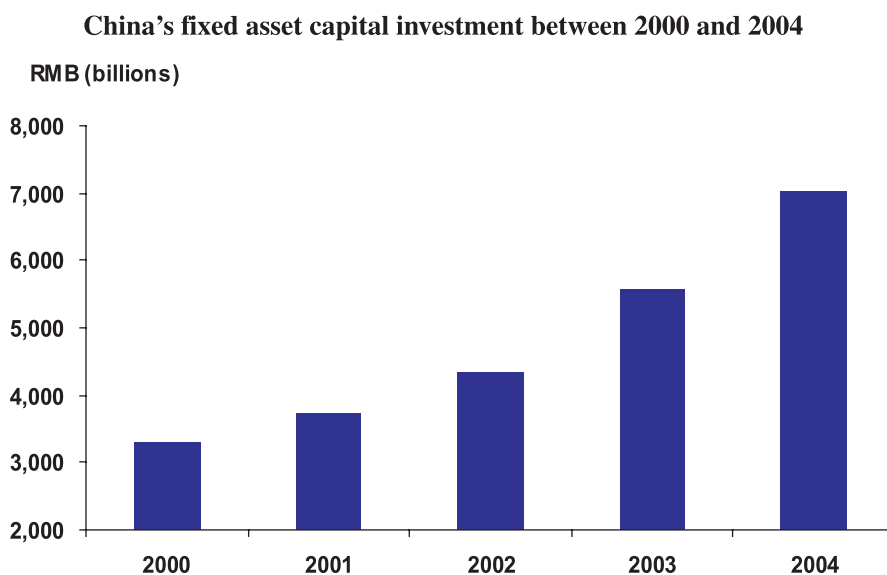
The introduction of the AFC as a specialised entity to provide auto financing is expected to increase competition among auto financing institutions and make it easier for consumers in the PRC to purchase automobiles. A tightening of lending practices among commercial banks contributed to the slowdown in the growth rate of the vehicle sales (especially the sales of passenger cars) recorded in 2004, as compared to 2003. Nonetheless, the new PRC Automotive Industry Policy issued in June 2004 states that the PRC government supports private vehicle ownership and auto loans. In addition, a recently adopted regulation setting out the terms and conditions under which individuals and other entities in the PRC can finance the purchase of automobiles became effective in October 2004. The terms of the regulation provide, among other things, that individuals meeting certain credit and other criteria may borrow up to 80% of the automobile’s price for up to five years. The Company expects that this regulation will ultimately contribute to increased auto financing by consumers in the PRC.

Please refer to Appendix VI — “Summary of principal PRC legal and regulatory provisions — 6. Regulation of the PRC Automotive Industry — Automobile Financing” for further details of the PRC regulations relating to auto financing in the PRC. Please refer to the risk factor entitled “Future increases in defaults in automobile consumption loans, if they occur, may have an adverse effect on growth in the PRC automobile market” in the “Risk Factors” section of this prospectus.

Commercial vehicle segment drivers

Increased fixed asset capital investment

The following chart shows China’s fixed asset capital investment between 2000 and 2004.



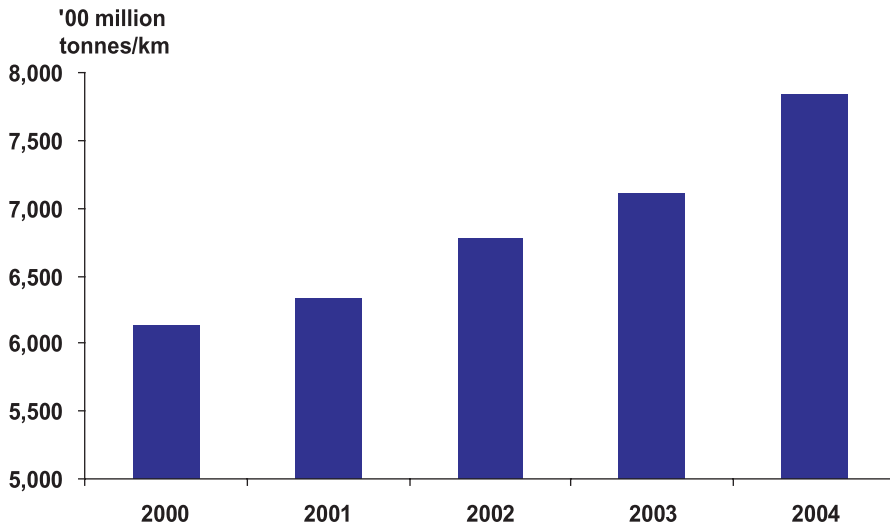
Source: PRC National Statistics Bureau

China's continued growth and the accompanying increase in fixed asset capital investment is expected to fuel the demand for commercial vehicles as infrastructure construction continues to expand and more construction projects are undertaken.

Increased trade activity in the PRC

China's growing GDP has brought about increasing trade activity. The following chart shows the amount of freight carried on China's highways between 2000 and 2004.

Freight carried on China's highways between 2000 and 2004

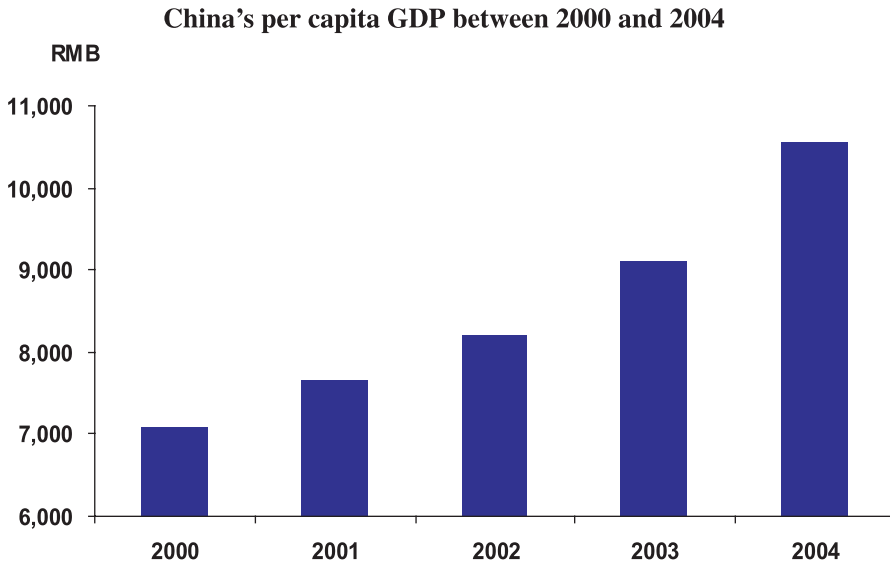


Source: PRC National Statistics Bureau

The increased amount of freight being transported on China's highways as a result of increased trade activity should lead to an increasing demand for trucks in China.

Passenger vehicle segment drivers**Strong personal income growth**

The following chart shows the rise in China's per capita GDP between 2000 and 2004.



Source: PRC National Statistics Bureau

There is a high correlation between rising per capita GDP and increasing personal income. According to the PRC National Statistics Bureau, the per capita disposable income of China's urban residents was approximately RMB6,280 in 2000. By 2004, this figure had risen to approximately RMB9,420, representing a compound annual growth rate of approximately 10.7%.

China's rising per capital income and increasing wages have led to increasing private purchases of motor vehicles. Before China began its economic transition in the early 1980s, the majority of passenger cars in China were purchased by the state. In 1998, less than one third of total vehicles ownership registered were owned by private individuals and families, according to the State Information Center. By 2004, the number of private owned vehicles had risen to approximately 15.0 million, and accounted for approximately 55.3% of the total number of registered vehicles in China.

China's passenger car market is entering a mass consumption era. Private households, taxis and corporations are now the three main sources of demand for passenger cars in China, with private households being the fastest growing source out of the three. Most car buyers are making their first purchase, and private purchases are expected to be the major propellant of future car sales.

Increased choice and enhanced purchasing experience

Attracted by the growth potential in the PRC automotive sector and potentially attractive returns on investment, more and more players, including both domestic and international manufacturers, are entering the the market. This will lead to increased choice as more vehicle models are introduced into the PRC, making it more likely that a potential customer will find a vehicle which interests him or her or which meets his or her requirements. As the PRC automotive industry matures and becomes more competitive, the sales and after-sales services which are available to customers are also becoming increasingly sophisticated, making it easier and more pleasant for potential purchasers to buy a car in China.

DOMESTIC AUTOMOTIVE MANUFACTURERS

In 2004, the PRC automotive industry comprised approximately 128 automotive manufacturers, led by three state-level automotive companies, the Dongfeng Motor Corporation Group, consisting of the Parent Group and the Dongfeng Motor Group, First Automobile Group Corporation and Shanghai Automotive Industry (Group) Corp. These three state-level automotive companies accounted for approximately 64% of revenues from, and approximately 46.9% of sales volumes of, the sale of domestically manufactured vehicles in the PRC in 2004.

The following table shows the top five PRC vehicle manufacturers in 2004 by revenue from sales of domestically manufactured vehicles in the PRC, according to a joint announcement by the China Machinery Industry Federation, the China Association of Automobile Manufacturers and the department of industrial and transport statistics of the PRC National Statistics Bureau:

<u>Automotive Manufacturer</u>	<u>Sales Revenues¹ in 2004 (RMB billions)</u>
First Automobile Group Corporation	135.6
Shanghai Automotive Industry (Group) Corp	119.5
Dongfeng Motor Corporation Group	96.1
Beijing Automotive Industry Corp.	46.9
Guangzhou Automobile Industry Group	40.1

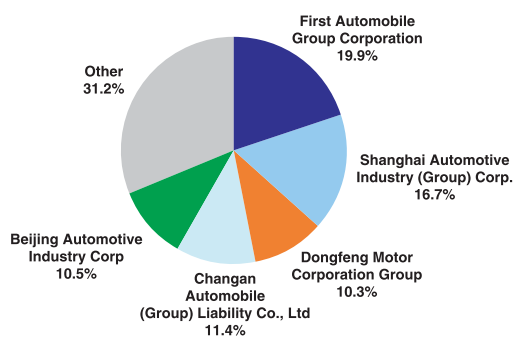
Source: China Machinery Industry Federation etc.

Note:

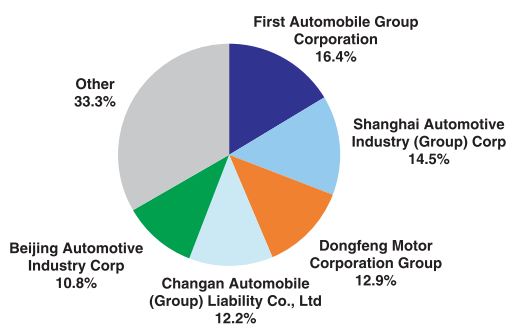
(1) The above figures are unaudited and are simple aggregate of the sales revenue of these companies.

The following chart illustrates the market share (in terms of sales volumes of domestically manufactured vehicles) of major PRC vehicle manufacturers in 2004 and for the six months ended 30th June, 2005.

Market share of major PRC vehicle manufacturers in 2004 (in terms of sales volumes)



Market share of major PRC vehicle manufacturers for the six months ended 30th June, 2005 (in terms of sales volumes)



Source: China Association of Automobile Manufacturers

Note: Discrepancies between total amounts stated and sums of amounts are due to rounding.

The PRC automotive sector has become increasingly competitive in recent years. Many international automotive companies, which are eager to take advantage of the growth in the PRC automotive sector, entered into joint ventures with domestic automotive manufacturers. Most of the major international automotive manufacturers have established joint ventures in the PRC. However, the government has imposed certain restrictions on foreign investment in the Chinese automotive sector. In particular, a foreign joint venture partner may not hold more than a 50% stake in the sino-foreign joint venture (unless the joint venture company is located in one of China's export processing zones and

produces products for export to overseas markets), and an international automotive manufacturer may not enter into more than two sino-foreign joint ventures to produce the same category of motor vehicle in the PRC.

Recent data from the China Association of Automobile Manufacturers shows that the explosive rate of growth recorded in recent years is slowing down. According to the China Association of Automobile Manufacturers, output and sales of domestically manufactured vehicles stood at approximately 2.8 million and 2.8 million, respectively during the first six months of 2005, representing year-on-year increases of approximately 5.2% and 9.4%, respectively, compared to year-on-year increases of approximately 27.1% and 24.2%, respectively for the first six months of 2004.

Please refer to Appendix VI — “Summary of Principal PRC Legal and Regulatory Provisions — 6. Regulation of the PRC Automotive Industry — Manufacturers’ qualification and compulsory authentication of automobile products” of this prospectus for a detailed account of the regulations relating to PRC automotive enterprise’s right to manufacture and sell automotive products in China.

MAJOR MARKET SEGMENTS

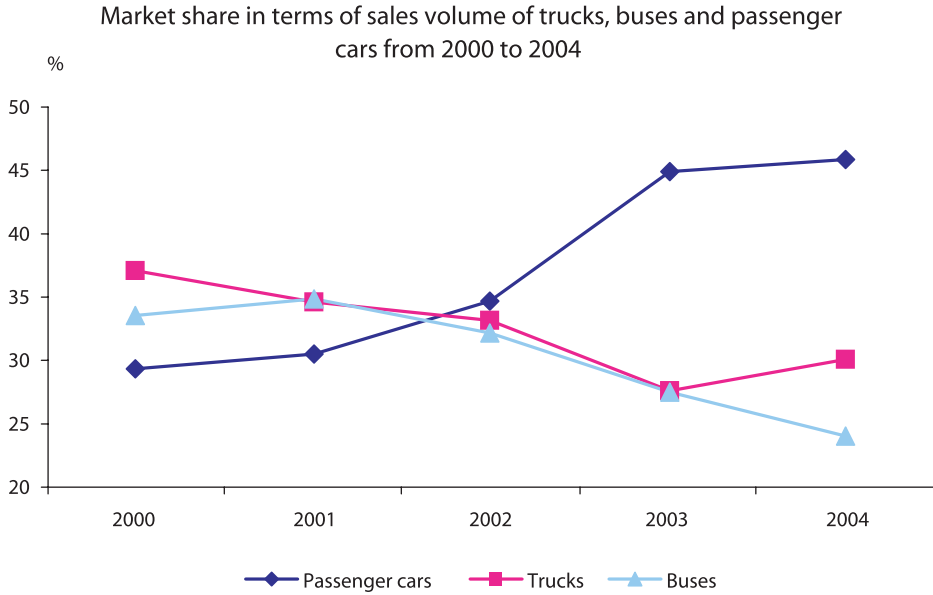
Before 2005, the PRC automobile market was categorised into trucks, buses and passenger cars. MPVs and SUVs are normally categorised as light buses. In 2004, the market share of trucks, buses and passenger cars in terms of production volume was approximately 29.9%, 24.4% and 45.7%, respectively, and the market share of these three market sectors in terms of sales volumes was approximately 30.1%, 24.0% and 45.9%, respectively.

Since 2005, the China Association of Automobile Manufacturers implemented a new vehicle categorisation standard. Vehicles are divided into commercial vehicles and passenger vehicles. Commercial vehicles consist of trucks and buses (not including mini buses or light buses with capacity of less than nine seats). Passenger vehicles, on the other hand, consist of standard sedans (including standard passenger vehicles with capacity of less than nine seats including a driver seat), MPVs, SUVs and cross-over vehicles (including mini buses and light buses with capacity of less than nine seats).

However, in order to maintain the comparability of each of the figures in these periods, cross-over vehicles are still considered as commercial vehicles in this prospectus.

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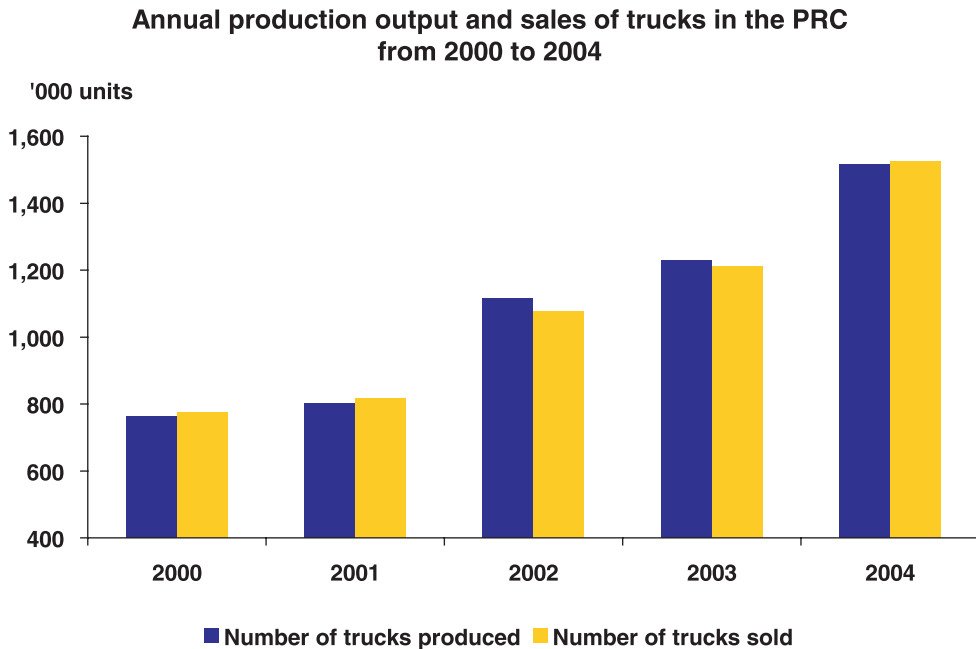
The following chart shows the market share in the PRC in terms of sales volume of trucks, buses and passenger cars from 2000 to 2004.



Source: China Association of Automobile Manufacturers

Trucks

The following chart shows the number of trucks produced and sold in the PRC from 2000 to 2004.



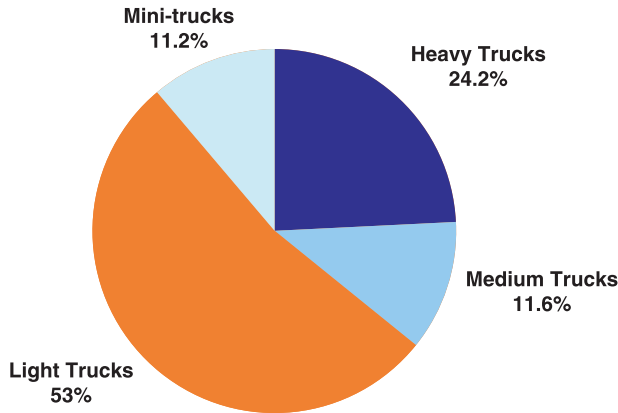
Source: China Association of Automobile Manufacturers

Most trucks purchased within the PRC are domestically produced. In addition, the PRC has only just begun to develop a fledgling truck export market. In 2004, over 52,000 trucks manufactured domestically were exported overseas.

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The PRC truck market is generally split into four main sub-sectors — heavy trucks, medium trucks, light trucks and mini-trucks. In 2004, heavy trucks, medium trucks, light trucks and mini-trucks accounted for approximately 24.2%, 11.6%, 53% and 11.2% of the total truck sales in the PRC, respectively.

Proportion of Heavy, Medium, Light and Mini-trucks sold in the PRC in 2004



Source: China Association of Automobile Manufacturers

The following table shows data concerning the sale and production of trucks in the PRC in 2003 and 2004.

<u>Product</u>	<u>Units produced in 2004</u>	<u>% change from 2003</u>	<u>Units sold in 2004</u>	<u>% change from 2003</u>
Trucks	1,514,734	+23.2	1,525,908	+26.0
— <i>Heavy trucks</i>	368,803	+40.9	370,795	+45.0
— <i>Medium trucks</i>	173,010	+27.1	175,644	+28.8
— <i>Light trucks</i>	805,641	+17.0	808,018	+18.5
— <i>Mini-trucks</i>	167,280	+17.3	171,451	+25.0

Source: China Association of Automobile Manufacturers

The heavy truck sector in the PRC is dominated by two leading players, the Dongfeng Motor Corporation Group and First Automobile Group Corporation. In 2004, these two leading players together accounted for approximately 64.5% of sales of heavy trucks. The medium truck sector is also dominated by the Dongfeng Motor Corporation Group and First Automobile Group Corporation, which together accounted for approximately 71.5% of the sales of medium trucks in 2004. The light truck sector is more fragmented, comprising 39 light truck manufacturers with the top five manufacturers, including the Dongfeng Motor Corporation Group, accounting for approximately 64.2% of the sales in 2004. The mini-truck sector comprised 10 manufacturers in 2004, with a concentration on five major players.

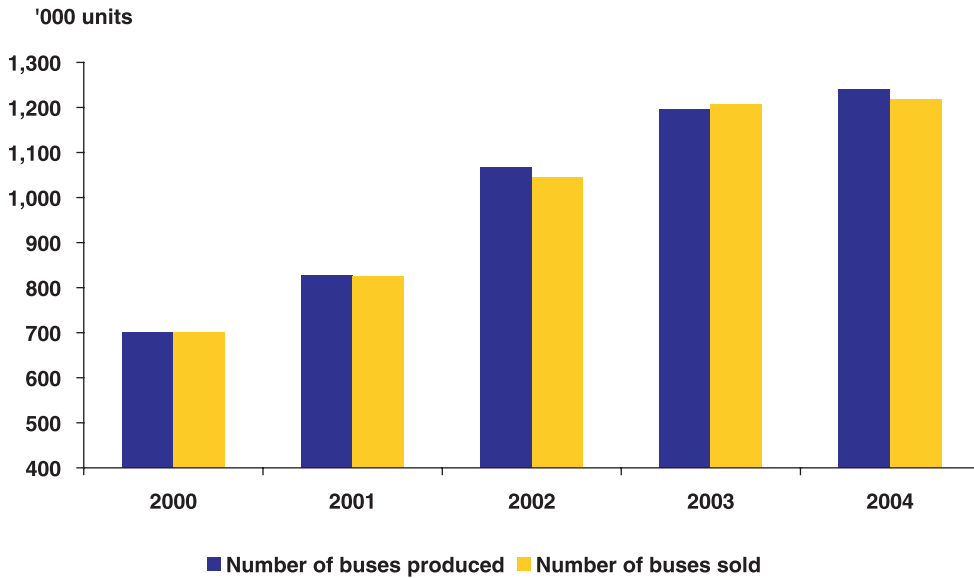
Trends in the truck sector in most developed countries indicate that the truck market is likely to diverge gradually towards heavy trucks, light trucks and specialised vehicles. This is because short-distance transportation normally relies on light trucks, and medium and long-haul transportation on heavy trucks. A similar trend has emerged in the truck sector in China, as evidenced by brisk heavy truck sales at the expense of medium trucks in recent years. China's demand for heavy trucks is

expected to increase, driven by rapid road infrastructure development and the development of China's western regions. While the fixed asset investment drives demand for heavy trucks, the growing rural economy underpins light truck sales.

Buses

The following chart shows the number of buses produced and sold in the PRC from 2000 to 2004.

**Annual production output and sales of buses in the PRC
from 2000 to 2004**

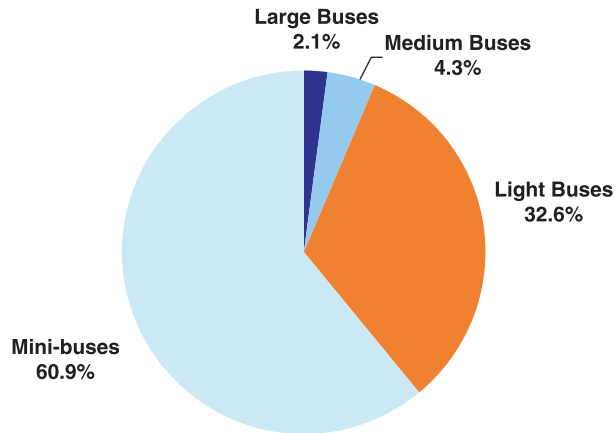


Source: China Association of Automobile Manufacturers

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Before 2005, the PRC bus market was split into 4 main sub-sectors — large buses, medium buses, light buses and mini-buses (which were re-categorized as passenger vehicles from 2005 according to the new 2005 calculation standards). In 2004, large buses, medium buses, light buses and mini-buses accounted for approximately 2.1%, 4.3%, 32.6% and 60.9% of the total bus sales in the PRC, respectively.

Proportion of Large, Medium, Light and Mini-buses sold in the PRC in 2004



Source: China Association of Automobile Manufacturers

Note: Discrepancies between total and sums of amounts stated are due to rounding.

The following table shows data concerning the sale and production of buses in the PRC in 2003 and 2004.

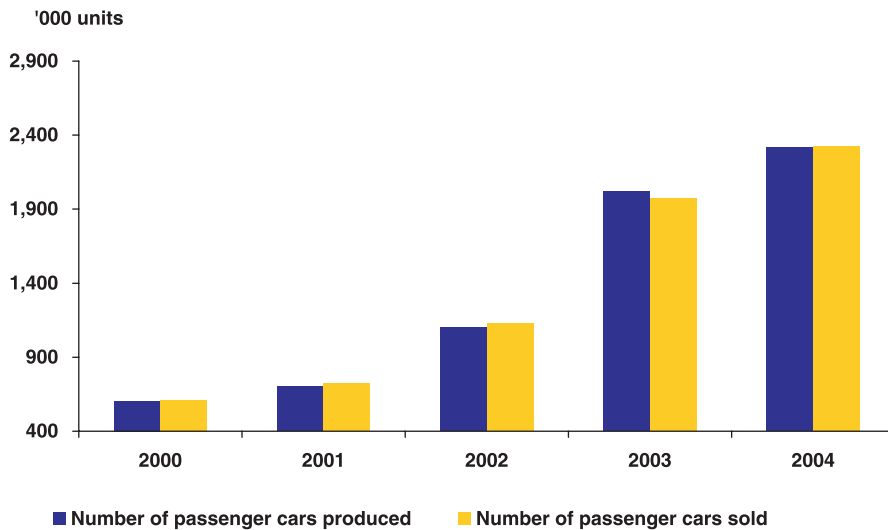
Product	Units produced in 2004	% change from 2003	Units sold in 2004	% change from 2003
Buses	1,239,531	+3.7	1,218,661	+0.9
— large buses	26,207	+33.6	26,125	+37.5
— medium buses	52,505	-2.2	52,726	-0.7
— light buses (including MPVs and SUVs)	403,060	-9.1	397,722	-9.7
— mini-buses	757,759	+11.7	742,088	+6.7

Source: China Association of Automobile Manufacturers

Passenger Vehicles

The most significant shift in China’s motor vehicle sales in recent years has been the rise in passenger vehicle sales, a result of reduced passenger vehicle prices and increased private wealth. In 2004, the number of units of passenger cars sold was approximately 2.3 million, representing an increase of approximately 15.2% from the previous year. The following chart shows the number of passenger cars produced and sold in the PRC from 2000 to 2004.

**Annual unit production output and sales of passenger cars
in the PRC from 2000 to 2004**



Source: China Association of Automobile Manufacturers

Since 2005, the PRC passenger vehicle market has been generally split into four main sub-sectors - standard sedans, MPVs, SUVs and cross-over vehicles (including mini buses and light buses with capacity of less than nine seats). However, in order to maintain the comparability of each of the figures in these periods, cross-over vehicles are still considered as commercial vehicles in this prospectus. For the six months ended 30th June, 2005, standard sedans, MPVs and SUVs accounted for approximately 88.7%, 5.4% and 6.0% of the total passenger vehicles (not including cross-over vehicles) sold in the PRC, respectively.

Recent data from the China Association of Automobile Manufacturers shows that the rate of growth of passenger vehicle sales recorded in recent years may be slowing down largely due to the return to normal growth rates after several years of explosive growth in the passenger vehicles market. At the same time in 2004, banks imposed more restrictive car financing policies and car manufacturers steadily decreased prices, both of which had a negative effect on consumers’ buying enthusiasm. According to the China Association of Automobile Manufacturers, the number of units of passenger vehicle sold (not including cross-over vehicles) was approximately 1.4 million for the six months ended 30th June, 2005, representing an increase of approximately 9.5% from that for the six months ended 30th June, 2004.

Nevertheless, many PRC automotive manufacturers and their foreign joint venture partners remain optimistic about the PRC car market’s long term growth potential. To meet growing demand, most carmakers are increasing capacity. Over the past five years, passenger vehicle production has

increased from approximately 604,677 units in 2000 to 2,316,262 units in 2004, with further capacity expansions in progress or being planned by most manufacturers.

THE PRC AUTO PARTS INDUSTRY

The rapid growth of the PRC automotive industry has led to increased demand by automotive manufacturers for auto parts in the PRC.

The growing PRC auto parts manufacturing industry has attracted many participants, resulting in a fragmented industry dominated by the auto parts manufacturing divisions of whole vehicle manufacturers. An increasing number of leading international auto parts manufacturers, including Visteon Inc, Delphi, Bosch and Denso, have also formed sino-foreign joint ventures with local auto parts manufacturers.

The development in the PRC auto parts industry is concentrated on two major areas within the PRC, the supply of automobile components to automotive manufacturers, and the supply of auto parts to end-users for after-sales servicing requirements.

Driven by lower labour cost advantages and bolstered by local demand for automotive parts, export sales of domestically manufactured auto parts are also growing rapidly. In 2004, the revenue from auto parts exported out of the PRC approached approximately U.S.\$9.2 billion, representing an increase of approximately 46.3% from 2003 and approximately 71.7% of the entire export revenue of the PRC automotive industry in 2004 (including revenues from export sales of whole vehicles). Encouraged by the recent success achieved by auto parts exports, the PRC Government plans to introduce governmental policies aimed at encouraging further growth in the Chinese auto parts export industry.

REGULATION OF THE PRC AUTOMOTIVE INDUSTRY — CHINA'S NEW AUTOMOTIVE INDUSTRY POLICY

The PRC automotive industry is controlled and regulated by the central PRC government through the state industrial policy regulations.

On 21st May, 2004, the PRC Government, through the NDRC, issued a new industrial policy for the automotive sector in a bid to enhance the international competitiveness of the PRC automotive industry as a whole, enable the PRC automotive industry to better meet the demands resulting from China's entry into the WTO and ensure the healthy and sustainable growth of the PRC automotive industry. According to the new Automotive Industry Policy, the PRC Government has set the following goals to be achieved by 2010:

- China should become one of the world's major automotive manufacturing countries. Domestically manufactured automobiles should not only meet substantially all domestic demand, but should be exported to overseas markets in bulk.
- China should have its own famous brands of automobiles and automotive-related products.
- China should have a few large and internationally competitive automotive manufacturing conglomerates which rank amongst the top 500 companies in the world.

Among other things, the new Automotive Industry Policy promotes the following:

Industry consolidation and the formation of a few large, strong players

The PRC Government has long encouraged industry consolidation and the domination of the PRC automotive industry by a few large, strong automotive manufacturers with the ability to compete on the global stage, with China's Tenth Five-Year Plan envisaging that these leading players will eventually account for approximately 70% of the domestic market and achieve export sales. The new Automotive Industry Policy continues to promote industry consolidation, and encourages the formation of a few large, internationally competitive domestic automotive conglomerates, by:

- Directing automotive manufacturers to merge or undergo strategic restructuring in order to form large auto groups in China with sufficient scale to be able to take advantage of substantial economies of scale, achieve efficient allocation and use of resources, and avoid scattered, disorderly and low-grade projects;
- Revising the rule that the Chinese party must hold at least a 50% stake in a sino-foreign automotive manufacturing joint venture;
- Permitting a foreign automotive manufacturer to have no more than two sino-foreign joint ventures producing the same category of whole vehicle products and treating as one single entity two foreign automotive manufacturers if one of these foreign automotive manufacturers holds a controlling stake in the other. Therefore, any joint venture partner of the Company that has not reached this threshold may enter into other competing joint ventures;
- Permitting foreign automotive manufacturers to have more than two sino-foreign joint ventures producing the same category of vehicles if they join together with their existing Chinese partners to merge with other companies in China; and
- Raising the barriers to entry in the PRC automotive industry by requiring that:
 - total initial investment in a new motor vehicle manufacturing enterprise be at least RMB2 billion, including a minimum investment of at least RMB500 million in the research and development facilities for that new motor vehicle manufacturing project;
 - the new vehicle engine manufacturer has the technological capability to develop their own products and must in addition have a total investment of at least RMB1.5 billion;
 - the new automotive manufacturer, which manufactures vehicle products in a category different from other categories of products, maintains its asset/liability ratio within 50%, has an AAA credit rating and earns after-tax profits in aggregate exceeding RMB1 billion in the last three years of operation; and
 - all new passenger vehicle and heavy truck manufacturers also produce their own engines, and have a minimum production capability of 10,000 heavy trucks, 50,000 four cylinder passenger vehicle engines or 30,000 six cylinder passenger vehicle engines.

At the same time, the new PRC Automotive Industry Policy also seeks to prevent small players and newcomers from gaining entry to the industry indirectly by banning non-automotive manufacturers and private investors from buying the business licences of loss-making automotive manufacturers.

The raising of domestic research and development standards and own-brand development capabilities

The new PRC Automotive Industry Policy strongly supports independent development and technical innovation, and the development of products, with the relevant intellectual property rights being owned by Chinese parties. In addition, it also encourages Chinese automotive enterprises to attach importance to cultivating their own brands and branded products and services systems. Accordingly, the new PRC Automotive Industry Policy:

- encourages international co-operation between domestic and international automotive manufacturers with the aim of bringing into China leading edge technology which is relevant to the development by Chinese companies of internationally competitive and commercially desirable automotive products;
- requires that, starting from 2005, all domestically manufactured vehicles and assembly components should bear the registered trademark of the domestic manufacturer, and all vehicles sold in China should display prominently the trademark and name of the manufacturer and the place in which the relevant vehicles are manufactured;
- states that certain tax benefits will be provided to automotive manufacturers in respect of their research and development activities; and
- stipulates that all new automotive manufacturing companies must have the ability to develop their own products and must also include a product research and development organization with an investment of at least RMB500 million.

Development of the PRC into a major global automotive manufacturing base

The PRC Government has stated that it aims to develop China into one of the world's major automotive manufacturing countries by 2010. To encourage exports, although PRC laws and regulations generally prevent foreign automotive manufacturers from holding a stake of more than 50% in their sino-foreign PRC automotive manufacturing joint ventures, the new PRC Automotive Industry Policy makes an exception in the case of ventures which are located in China's export processing zones and which produce automobiles for export to overseas markets.

Usage of domestically manufactured automotive products

It is the aim of the PRC Government that, by 2010, domestic demand for automobiles will be largely satisfied by domestically manufactured products. The new Automotive Industry Policy raises the cost of vehicle imports by closing a tax loophole which previously allowed foreign companies to import vehicles in bulk, store them in the PRC, and only pay taxes when the vehicles were sold. Under the new Automotive Industry Policy, taxes must now be paid as the vehicles are imported into China.

Development and widespread use of passenger cars with small engine capacities and other environmentally friendly automotive products

In order to address environmental concerns, the new PRC Automotive Industry Policy states that the PRC Government will encourage and support the development of environmentally friendly passenger cars with small engine capacities, electric vehicles, mix-fuel vehicles and diesel engine passenger cars.

Development of the auto parts manufacturing industry

The new Automotive Industry Policy also expresses the PRC Government's aim to foster and develop a thriving auto parts manufacturing industry in the PRC that is able to satisfy both domestic demand and the requirements of overseas export markets. To this end, the new Automotive Industry Policy:

- states that the Chinese Government will support the development of domestic auto parts manufacturers with recognised brand names,
- exhorts Chinese automotive conglomerates with auto parts manufacturing operations to develop these operations into independent specialist auto parts manufacturers which produce auto parts not merely to support their intra-group whole vehicle manufacturing operations, but also for sale to external third parties, both within China and abroad; and
- explicitly states that auto parts manufacturers which are capable of catering to the needs of multiple whole vehicle manufacturers and which are capable of entering international auto parts procurement networks will be favored by the Chinese Government through various policies, including preferential financing policies.