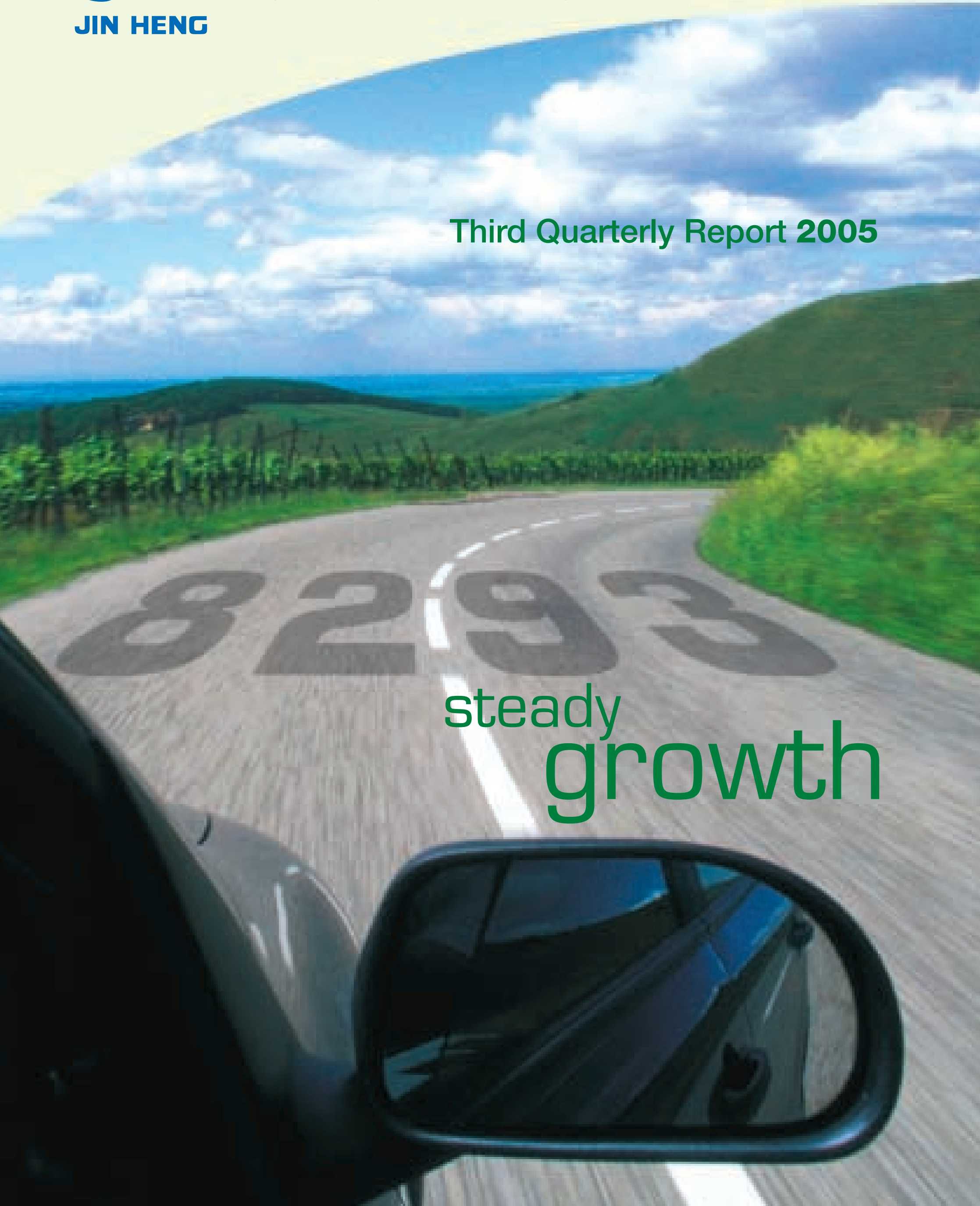
# JINHENG AUTOMOTIVE SAFETY TECHNOLOGY HOLDINGS LIMITED

# 錦恒汽車安全技術控股有限公司

*(Incorporated in the Cayman Islands with limited liability)*

JIN HENG

## Third Quarterly Report **2005**



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*This report, for which the directors of Jinheng Automotive Safety Technology Holdings Limited (the "Company") collectively and individually accept full responsibility, includes particulars given in compliance with the Rules Governing the Listing of Securities on GEM of the Stock Exchange (the "GEM Listing Rules") for the purpose of giving information with regard to the Company. Directors of the Company, having made all reasonable enquiries, confirm that, to the best of their knowledge and belief: (i) the information contained in this report is accurate and complete in all material respects and not misleading; (ii) there are no other matters the omission of which would make any statement in this report misleading; and (iii) all opinions expressed in this report have been arrived at after due and careful consideration and are founded on bases and assumptions that are fair and reasonable.*

*As at the date of this report, the Board comprises 5 executive directors, namely Messrs. Li Feng, Xing Zhanwu, Zhao Qingjie, Yang Donglin and Foo Tin Chung, Victor; 2 non-executive directors, namely Messrs. Li Hong and Zeng Qingdong; and 3 independent non-executive directors, namely Messrs. Chan Wai Dune, Huang Shilin and Zhu Tong.*

The board of directors of the Company (the "Board") announces the unaudited consolidated results of the Company and its subsidiaries (collectively, the "Group") for each of the three months and nine months ended 30 September 2005, together with the unaudited comparative figures for the corresponding periods in 2004 as follows:

## CONSOLIDATED INCOME STATEMENT — UNAUDITED FOR THE THREE MONTHS AND NINE MONTHS ENDED 30 SEPTEMBER 2005

| | | Three months ended 30 September | | Nine months ended 30 September | |
|---|---|---|---|---|---|
| | | **2005** | 2004 | **2005** | 2004 |
| | *Note* | ***HK$*** | *HK$* | ***HK$*** | *HK$* |
| **Turnover** | *4* | **47,109,750** | 37,050,303 | **141,739,778** | 137,331,097 |
| **Cost of sales** | | **(34,392,438)** | (21,506,028) | **(100,187,333)** | (84,675,965) |
| **Gross profit** | | **12,717,312** | 15,544,275 | **41,552,445** | 52,655,132 |
| **Other revenue** | | **317,950** | 112,032 | **676,633** | 430,286 |
| **Other net income/(loss)** | | **20,167** | (11,250) | **(105,931)** | (60,599) |
| **Research and development expenses** | | **(834,814)** | (1,815,783) | **(2,429,374)** | (3,790,195) |
| **Distribution costs** | | **(387,339)** | (711,143) | **(2,297,348)** | (2,603,094) |
| **Administrative expenses** | | **(4,513,106)** | (1,859,027) | **(13,446,812)** | (5,201,012) |
| **Profit from operations** | | **7,320,170** | 11,259,104 | **23,949,613** | 41,430,518 |
| **Finance costs** | | **(718,292)** | (1,089,407) | **(1,911,566)** | (3,575,386) |
| **Share of losses of jointly controlled entities** | | **(102,312)** | (18,774) | **(87,012)** | (474,676) |
| **Profit before taxation** | | **6,499,566** | 10,150,923 | **21,951,035** | 37,380,456 |
| **Income tax** | *5* | **(16,177)** | — | **42,901** | (47,684) |
| **Profit after taxation** | | **6,483,389** | 10,150,923 | **21,993,936** | 37,332,772 |
| **Attributable to:** | | | | | |
| Equity holders of the Company | | **6,477,107** | 10,159,131 | **22,004,907** | 37,366,105 |
| Minority interests | | **6,282** | (8,208) | **(10,971)** | (33,333) |
| **Profit after taxation** | | **6,483,389** | 10,150,923 | **21,993,936** | 37,332,772 |
| **Earnings per share** | | | | | |
| — Basic | *6(a)* | **HK1.70 Cents** | HK3.39 Cents | **HK5.78 Cents** | HK12.46 Cents |
| — Diluted | *6(b)* | **HK1.67 Cents** | N/A | **HK5.67 Cents** | N/A |

The notes on pages 3 to 9 form part of this financial report.

*Notes:*

### 1. Reorganisation

The Company was incorporated in the Cayman Islands on 26 February 2004 as an exempted company with limited liability under the Companies Law, Cap 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. Pursuant to a group reorganisation (the "Reorganisation") completed on 22 November 2004 to rationalise the structure of the Group in preparation for the public listing of its shares on the GEM of the Stock Exchange, the Company becomes the holding company of the subsidiaries now comprising the Group. The Company's shares were listed on GEM on 9 December 2004.

Details of the Reorganisation are set out in the prospectus (the "Prospectus") dated 30 November 2004 issued by the Company.

### 2. Basis of preparation

This quarterly report has been prepared in accordance with the applicable disclosure requirements of the GEM Listing Rules.

This quarterly report has been prepared in accordance with the same accounting policies adopted in the 2004 annual financial statements, except for the accounting policy changes that are expected to be reflected in the 2005 annual financial statements. Details of these changes in accounting policy are set out in note 3.

This quarterly report contains consolidated financial statements and selected explanatory notes. The notes include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the Group since the 2004 annual financial statements. This consolidated quarterly financial statements and notes thereon do not include all of the information required for full set of financial statements prepared in accordance with Hong Kong Financial Report Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA")..

The financial information relating to the financial year ended 31 December 2004 included in this quarterly report as being previously reported information does not constitute the Company's statutory financial statements for that financial year but is derived from those financial statements. Statutory financial statements for the year ended 31 December 2004 are available from the Company's registered office. The auditors have expressed an unqualified opinion on those financial statements in their report dated 23 March 2005.

## 3. Changes in accounting policies

The HKICPA has issued a number of new and revised HKFRSs (which term collectively includes Hong Kong Accounting Standards issued by HKICPA ("HKAS") and Interpretations) that are effective or available for early adoption for accounting periods beginning on or after 1 January 2005. The Board has determined the accounting policies to be adopted in the preparation of the Group's annual financial statements for the year ending 31 December 2005, on the basis of HKFRSs currently in issue.

The HKFRSs that will be effective or are available for voluntary early adoption in the annual financial statements for the year ending 31 December 2005 may be affected by the issue of additional interpretation(s) or other changes announced by the HKICPA subsequent to the date of issuance of this quarterly report. Therefore the policies that will be applied in the Group's financial statements for that period cannot be determined with certainty at the date of issuance of this quarterly report.

The following sets out further information on the changes in accounting policies for the annual accounting period beginning on 1 January 2005 which have been reflected in this quarterly report.

*(a) Summary of the effect of changes in the accounting policies*

(i) Effect on opening balance of total equity at 1 January 2005 (as adjusted)

The following table sets out the adjustment that has been made to the opening balance at 1 January 2005. This shows the effect of retrospective adjustment to the net assets as at 31 December 2004 and the opening balance adjustment made as at 1 January 2005.

| **Effect of new policy (increase/(decrease))** | *Note* | **Retained profits** *HK$* | **Capital reserve** *HK$* | **Total** *HK$* | **Minority interests** *HK$* | **Total equity** *HK$* |
|---|---|---|---|---|---|---|
| *Prior period adjustment:* | | | | | | |
| HKFRS 2 | | | | | | |
| Equity settled share-based transactions | *3(b)* | (345,000) | 345,000 | — | — | — |
| Total effect at 1 January 2005 | | (345,000) | 345,000 | — | — | — |

(ii) Effect on profit after taxation for the nine months ended 30 September 2005 (estimated) and 30 September 2004 (as adjusted)

In respect of the nine months ended 30 September 2005, the following table provides estimates of the extent to which the profits for that period are higher or lower than they would have been had the previous policies still been applied in that period, where it is practicable to make such estimates.

In respect of the nine months ended 30 September 2004, there are no adjustments required to be made to the profits as previously reported for that period.

## 3. Changes in accounting policies *(Continued)*

*(a) Summary of the effect of changes in the accounting policies (Continued)*

(ii) Effect on profit after taxation for the nine months ended 30 September 2005 (estimated) and 30 September 2004 (as adjusted) *(Continued)*

| | | Nine months ended 30 September 2005 | | | |
|---|---|---|---|---|---|
| **Effect of new policy (increase/(decrease))** | *Note* | **Equity holders of the Company** *HK$* | **Total** *HK$* | **Minority interests** *HK$* | **Total equity** *HK$* |
| HKFRS 2 | | | | | |
| Equity settled share-based transactions | *3(b)* | (4,347,750) | (4,347,750) | — | (4,347,750) |
| Total effect for the period | | (4,347,750) | (4,347,750) | — | (4,347,750) |
| Effect on earnings per share: | | | | | |
| — basic | | HK(1.14) cents | | | |
| — diluted | | HK(1.12) cents | | | |

*(b) Employee share option scheme (HKFRS 2, Share-based payment)*

In prior years, no amounts were recognised when employees (which term includes directors) were granted share options over shares in the Company. If the employees chose to exercise the options, the nominal amount of share capital and share premium were credited only to the extent of the option's exercise price receivable.

With effect from 1 January 2005, in order to comply with HKFRS 2, the Group recognises the fair value of such share options as an expense in the consolidated income statement, or as an asset, if the cost qualifies for recognition as an asset under the Group's accounting policies. A corresponding increase is recognised in a capital reserve within equity.

Where the employees are required to meet vesting conditions before they become entitled to the options, the Group recognises the fair value of the options granted over the vesting period. Otherwise, the Group recognises the fair value in the period in which the options are granted.

If an employee chooses to exercise the options, the capital reserve is transferred to share capital and share premium, together with the exercise price. If the options lapse unexercised the capital reserve is transferred directly to retained earnings.

The new accounting policy has been applied retrospectively with comparatives restated in accordance with HKFRS 2.

The amount of prior period adjustments and the effect on the results for the nine months ended 30 September 2005, and the reserves as of that date, are set out in note 3(a). The amount charged to the consolidated income statement as a result of the change of policy increased administrative expenses for the nine months ended 30 September 2005 by HK$4,347,750 (nine months ended 30 September 2004: HK$Nil), with the corresponding amounts credited to the capital reserve.

Details of the employee share option schemes can be found in "Share Option Schemes" and note 7 on this quarterly report.

### 3. Changes in accounting policies *(Continued)*

*(c) Leasehold land and buildings held for own use (HKAS 17, Leases)*

In prior years, leasehold land and buildings held for own use (including land use rights paid to the Peoples' Republic of China (the "PRC") government authorities) were stated at cost less accumulated depreciation and accumulated impairment losses.

With the adoption of HKAS 17 as from 1 January 2005, the paid land use right is reclassified as lease prepayment which is carried at cost and amortised on a straight-line basis over the land use right period of 20 years. Amortisation charge for the period is recognised in the consolidated income statement.

The adoption of this new accounting policy does not have a significant impact on the results of operations and financial position of the Group.

*(d) Minority interests (HKAS 1, Presentation of financial statements and HKAS 27, Consolidated and separate financial statements)*

In prior years, minority interests at the balance sheet date were presented in the consolidated balance sheet separately from liabilities and as deduction from net assets. Minority interests in the results of the Group for the year were also separately presented in the consolidated income statement as a deduction before arriving at the profit attributable to shareholders.

With effect from 1 January 2005, in order to comply with HKAS 1 and HKAS 27, minority interests at the balance sheet date are presented in the consolidated balance sheet within equity, separately from equity attributable to the equity holders of the Company, and minority interests in the results of the Group for the period are presented on the face of the consolidated income statement as an allocation of the total profit or loss for the period between the minority interests and the equity holders of the Company.

The presentation of minority interests in the consolidated balance sheet, income statement and statement of changes in equity for the comparative period has been restated accordingly.

*(e) Financial instruments (HKAS 39, Financial instruments: Recognition and measurement)*

In prior years, unlisted investments held on a continuing basis for an identifiable long-term purpose were classified as investment securities and stated at cost less any provision for diminution in value. With effect from 1 January 2005, and in accordance with HKAS 39, all non-trading investments are classified as available-for-sales securities and carried at fair value, except that if investments in equity instruments do not have a quoted market price in an active market and whose fair value cannot be reliably measured, the investments are measured at cost less impairment losses.

The adoption of this new accounting policy does not have a significant impact on the results of operations and financial position of the Group.

## 4. Turnover

The principal activities of the Group are production and sales of automotive safety products in the PRC.

Turnover represents the sales value of automotive safety products to customers net of sales tax and value added tax.

Turnover recognised during the year may be analysed as follows:

| | Three months ended 30 September | | Nine months ended 30 September | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***HK$*** | *HK$* | ***HK$*** | *HK$* |
| Sales of mechanical airbag systems | **18,035,279** | 20,563,600 | **50,560,523** | 89,065,520 |
| Sales of electronic airbag systems | **23,514,991** | 12,337,877 | **53,065,344** | 43,537,589 |
| Sales of automotive safety system components and other safety products | **5,559,480** | 4,148,826 | **38,113,911** | 4,727,988 |
| | **47,109,750** | 37,050,303 | **141,739,778** | 137,331,097 |

The Group's turnover and operating profit are almost entirely derived from the production and sales of automotive safety products in the PRC. Accordingly, no analysis by geographical and business segments has been presented.

## 5. Income tax in the consolidated income statement

Taxation in the consolidated income statement represents:

| | Three months ended 30 September | | Nine months ended 30 September | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | ***HK$*** | *HK$* | ***HK$*** | *HK$* |
| **Current tax** | | | | |
| PRC income tax for the period | **(18,232)** | — | **(66,029)** | — |
| Under-provision in respect of prior period | **—** | — | **—** | (47,684) |
| | **(18,232)** | — | **(66,029)** | (47,684) |
| **Deferred tax** | | | | |
| Origination and reversal of temporary differences | **2,055** | — | **108,930** | — |
| Total income tax (expense)/credit | **(16,177)** | — | **42,901** | (47,684) |

No provision for Hong Kong Profits Tax has been made as the Group did not have assessable profits subject to Hong Kong Profits Tax during the period.

Pursuant to the income tax rules and regulations of the PRC, Jinzhou Jinheng Automotive Safety System Co., Ltd. ("Jinheng Automotive"), a subsidiary of the Company, was liable to enterprise income tax at a rate of 33% for the year ended 31 December 2003. Subsequent to the transformation into a wholly owned foreign enterprise on 23 December 2003, Jinheng Automotive is entitled to a tax concession period in which it is fully exempted from PRC income tax for 2 years starting from its first profit-making year, followed by a 50% reduction in the PRC income tax for the next 3 years. Jinheng Automotive is in the second year following the first profit-making year.

Pursuant to the income tax rules and regulations of the PRC, Harbin Hafei Jinheng Automotive Safety System Co., Ltd., ("Hafei Jinheng") a subsidiary of the Company, is liable to enterprise income tax at a rate of 33% for the period.

Pursuant to the rules and regulations of the Cayman Islands and the British Virgin Islands, the Group is not subject to any income tax in the Cayman Islands and the British Virgin Islands.

## 6. Earnings per share

(a) *Basic earnings per share*

The calculations of basic earnings per share for each of the three months and nine months ended 30 September 2005 are based on the profit attributable to equity holders of the Company of HK$6,477,107 and HK$22,004,907 and on the weighted average of ordinary shares of 381,000,000 and 381,000,000 respectively. The calculations of basic earnings per share for each of the three months and nine months ended 30 September 2004 were based on the profit attributable to equity holders of the Company of HK$10,159,131 and HK$37,366,105 respectively and on the 300,000,000 shares of the Company in issue as at the date of the Prospectus, as if the shares were outstanding throughout the period ended 30 September 2004.

(b) *Diluted earnings per share*

The calculations of diluted earnings per share for each of the three months and nine months ended 30 September 2005 are based on the profit attributable to equity holders of the Company of HK$6,477,107 and HK$22,004,907 and on the weighted average number of ordinary shares of 388,152,941 and 388,152,941 respectively after adjusting for the effects of all dilutive potential ordinary shares under the Company's share option scheme. There were no potential dilutive ordinary shares in issue during the period ended 30 September 2004.

(c) *Reconciliation*

| | **Three months ended 30 September 2005 Number of shares** | **Nine months ended 30 September 2005 Number of shares** |
|---|---|---|
| Weighted average number of ordinary shares used in calculating basic earnings per share | 381,000,000 | 381,000,000 |
| Deemed issue of ordinary shares for no consideration | 7,152,941 | 7,152,941 |
| Weighted average number of ordinary shares used in calculating diluted earnings per share | 388,152,941 | 388,152,941 |

## 7. Reserves

| | Attributable to equity holders of the Company | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share premium HK$ | Merger reserve HK$ | Statutory surplus reserve HK$ | Statutory public welfare fund HK$ | Capital reserve HK$ | Exchange reserve HK$ | Retained profits HK$ | Total HK$ | Minority interests HK$ | Total HK$ |
| At 1 January 2004 | – | 16,341,254 | 3,070,378 | 1,535,188 | – | – | – | 20,946,820 | 1,226,415 | 22,173,235 |
| Issue of new shares | 19,999,982 | – | – | – | – | – | – | 19,999,982 | – | 19,999,982 |
| Profit/(loss) for the period | – | – | – | – | – | – | 37,366,105 | 37,366,105 | (33,333) | 37,332,772 |
| At 30 September 2004 | 19,999,982 | 16,341,254 | 3,070,378 | 1,535,188 | – | – | 37,366,105 | 78,312,907 | 1,193,082 | 79,505,989 |
| At 1 October 2004 | 19,999,982 | 16,341,254 | 3,070,378 | 1,535,188 | – | – | 37,366,105 | 78,312,907 | 1,193,082 | 79,505,989 |
| Arising on Reorganisation | (19,999,982) | 19,999,982 | – | – | – | – | – | – | – | – |
| Profit/(loss) for the period (as restated) | – | – | – | – | – | – | 14,091,057 | 14,091,057 | (5,900) | 14,085,157 |
| Appropriations to statutory reserves | – | – | 5,679,071 | 2,839,535 | – | – | (8,518,606) | – | – | – |
| Share premium from issuance of shares | 94,770,000 | – | – | – | – | – | – | 94,770,000 | – | 94,770,000 |
| Share issuance expenses | (15,039,976) | – | – | – | – | – | – | (15,039,976) | – | (15,039,976) |
| Capitalisation issue | 438,100 | – | – | – | – | – | – | 438,100 | – | 438,100 |
| Equity settled share-based transactions | – | – | – | – | 345,000 | – | – | 345,000 | – | 345,000 |
| At 31 December 2004 (as restated) | 80,168,124 | 36,341,236 | 8,749,449 | 4,374,723 | 345,000 | – | 42,938,556 | 172,917,088 | 1,187,182 | 174,104,270 |
| At 1 January 2005 | | | | | | | | | | |
| – as previously report | 80,168,124 | 36,341,236 | 8,749,449 | 4,374,723 | – | – | 43,283,556 | 172,917,088 | 1,187,182 | 174,104,270 |
| – prior period adjustment in respect of: – Equity settled share-based transactions | – | – | – | – | 345,000 | – | (345,000) | – | – | – |
| As restated | 80,168,124 | 36,341,236 | 8,749,449 | 4,374,723 | 345,000 | – | 42,938,556 | 172,917,088 | 1,187,182 | 174,104,270 |
| Equity settled share-based transactions | – | – | – | – | 4,347,750 | – | – | 4,347,750 | – | 4,347,750 |
| Dividend approved in respect of prior year | – | – | – | – | – | – | (20,955,000) | (20,955,000) | – | (20,955,000) |
| Exchange differences arising on translation of accounts of overseas subsidiaries | – | – | – | – | – | 2,457,478 | – | 2,457,478 | – | 2,457,478 |
| Profit/(loss) for the period | – | – | – | – | – | – | 22,004,907 | 22,004,907 | (10,971) | 21,993,936 |
| At 30 September 2005 | 80,168,124 | 36,341,236 | 8,749,449 | 4,374,723 | 4,692,750 | 2,457,478 | 43,988,463 | 180,772,223 | 1,176,211 | 181,948,434 |

On 22 November 2004, 11,400,000 share options were granted for nominal consideration to three directors and seven employees of the Company under the Company's Pre-IPO Employee Share Option Scheme. Each option gives the holder the right to subscribe for one ordinary share of HK$0.01 each of the Company. These share options will be vested on 9 December 2005, and then be exercisable until 9 December 2008. The exercise price is HK$0.38.

No options were exercised during the nine months ended 30 September 2005.

## MANAGEMENT DISCUSSION AND ANALYSIS

### Business Review

The Group's income from sales for the nine months ended 30 September 2005 was approximately HK$141.7 million representing an increase of approximately 3% as compared to the corresponding period in 2004 because, during this quarter, there was a steady sale of two new automobile safety airbag system models, which were launched for sale last quarter. The income from sales for the three months during this quarter achieved a growth of approximately 27% as compared to the corresponding period in 2004. Despite the sluggish recovery of the automobile industry in the PRC, the Group's sales has been steadily returned to last year's level driven by the continuous launch of new automobile safety airbag system models.

During the period, the Group is expanding its overseas markets and has secured a development contract from an overseas automobile manufacturer, pursuant to which the Group will provide the manufacturer with automobile safety airbag systems in the fourth quarter this year or at the beginning of next year. This is the first time that the Group undertakes the development of the entire system of an automobile model for an overseas automobile manufacturer and becomes the system supplier of an overseas client. The landing of this overseas client proves that the Group's technological level, capacity in quality assurance, as well as cost control and manufacturing capacity have gained preliminary recognition by overseas clients, paving the way for it to become a global supplier.

During this quarter, the negotiation between the Group and a U.S. company regarding the joint production of electronic inflator was still underway and substantial progress has been made. Directors of the Company believe that this joint venture, once forged, will become a cornerstone of the Group's cost reduction plan.

To leverage the market upturn and to maintain its leading position in the PRC market, the Group has been well-prepared itself in its business operation. During this quarter, the Group has entered into development contracts with a renowned domestic joint venture in relation to the localization of safety airbag systems of two automobile models. The production volume of these two automobile models exceeded 100,000 units in 2004.

The Company, through its wholly-owned PRC subsidiary, has also contracted with an automobile spare part supplier in the PRC in relation to the joint investment of steering wheels, of which the business and industry registration is under process. This joint venture will involve an annual production capacity of 300,000 steering wheels for various automobile models. This could reduce system cost and contribute significantly to the enhancement of integrated competitiveness.

Furthermore, the Group is in the progress of raising its equity interests in Shenyang Jinbei Jinheng Automotive Safety System Co., Limited ("Jinbei Jinheng"). This undertaking is expected to be completed in the fourth quarter of 2005.

The Group has commenced the expansion of the new manufacturing premises in Jinzhou Economic & Technical Development Zone, Liaoning Province this quarter. The Group has entered into a contract to introduce a state-of-the-art slope trial system, which is scheduled to be completed and put into application in the second quarter of 2006. This will substantially enhance the Group's development capacity.

## Financial Review

For the three months and nine months ended 30 September 2005, the Group recorded a turnover of approximately HK$47.1 million and approximately HK$141.7 million respectively, representing an increase of 27% and 3% from the same period of last year respectively. The increase was resulted from the sluggish recovery from the weakened automotive industry started in second quarter of last year.

The Group managed to maintain the gross profit margin of both airbag systems in the current quarter of 2005 at a level similar to the last quarter. However, owing to changes in the sales mix of our mechanical airbag systems, the gross profit margin of both airbag systems for the nine months ended 30 September 2005 recorded slight decrease of approximately 1% to 35% compared to last quarter.

Sales of automotive safety components and other automotive safety products for the three months and nine months ended 30 September 2005 increased by approximately HK$1.4 million or 34% and approximately HK$33.4 million or 7.1 times from the corresponding periods of last year. The increase was mainly due to new orders on components of airbag systems from an international renowned airbag supplier. Owing to components normally generate a relatively lower gross profit margin than airbag systems, the average gross profit margin of 27% for the three months ended 30 September 2005 was lower than the 42% recorded in the corresponding quarter of last year. Nevertheless, our average gross profit margin for the nine months ended 30 September 2005 has slight decrease of approximately 1% to 29% in comparison with the average of last quarter.

Other revenue was mainly contributed by the interest income earned by the Group. For both three months and nine months ended 30 September 2005, it increased by approximately HK$0.2 million from the corresponding periods of last year.

Research and development expenses for the three months and nine months ended 30 September 2005 decreased by approximately HK$1.0 million and HK$1.4 million respectively in comparison to the corresponding periods of last year. The decrease was mainly due to the undertaking of an additional six automotive airbag research and development projects last year.

Distribution costs were approximately HK$0.4 million and HK$2.3 million for the three months and nine months ended 30 September 2005 in comparison with approximately HK$0.7 million and HK$2.6 million for the corresponding periods of last year. The decrease was mainly due to improved operational efficiency in marketing activities during the gradual recovery period of the industry.

Administrative expenses were approximately HK$4.5 million and HK$13.4 million for the three months and nine months ended 30 September 2005 respectively, representing an increase of approximately HK$2.7 million and approximately HK$8.2 million in comparison with the corresponding periods of last year. The increase in the current nine months period figure was mainly due to increase in the headcounts of administration personnel, provision of pre-IPO share options of approximately HK$4.3 million caused by the adoption of new accounting policy and directors' emoluments amounting approximately to HK$2.2 million.

### Financial Review *(Continued)*

Finance costs for the three months and nine months ended 30 September 2005 decreased by approximately HK$0.4 million or 34% and approximately HK$1.7 million or 47% for the corresponding periods of last year to approximately HK$0.7 million and HK$1.9 million respectively. The decrease was mainly attributed to the repayment of long-term loans and to an interest expense subsidy, the latter of which was designated to cover the actual interest expenses on the loan of RMB28.0 million utilized for financing the technological reform project.

Share of losses of jointly controlled entities for the three months and nine months ended 30 September 2005 were approximately HK$0.1 million and HK$0.09 million respectively in comparison with the losses of approximately HK$0.02 million and HK$0.5 million for the corresponding periods of last year. This was mainly attributed by Shanxi Jinheng Automotive Spare Parts Co., Ltd., who has started recording a profit of approximately HK$0.6 million for the current nine months period, and by Jinbei Jinheng, who recorded a slightly high loss as it made final preparations for commencement of operation.

Profit after taxation for the three months and nine months ended 30 September 2005 were approximately HK$6.5 million and HK$22.0 million respectively. Although the Group has benefited from the recovery of the automotive industry and recorded a 27% and 3% increase in turnover as compared to the corresponding periods of last year, the decrease in overall gross profit and the increase in administrative expenses have led to a reduction in the profit after taxation for the three months and nine months ended 30 September 2005 by approximately HK$3.7 million and HK$15.3 million respectively in comparison with the corresponding periods of last year.

### Outlook and Future Prospects

The Group's efforts in exploring overseas markets initially achieved fruitful results in this quarter. It is expected that with this experience, the Group can devote further efforts in exploring new markets for its supply in order to grasp more opportunities in supplying its products to overseas markets.

Leveraging on its successful experience in providing safety systems to PRC based manufacturers of internationally-reputed automobile models, the Group will double its efforts in market exploration and enrich the knowledge of these manufacturers about the Group's products, quality, services and management. The Group aspires to become the supplier of safety systems for more world-class automobile models manufactured in the PRC.

In addition, the Group will continue its efforts in localizing the production of components and on researching, investigating and negotiating with other partners for cooperation plans. It is expected that the entire system production can be localized in the near future. This enables the Group to control its production cost and maintain its edges in the competitive market.

Directors of the Company believe that, with the gradual accomplishment of the Group's future plans of development, the Group will be able to substantially enhance its competitiveness and consolidate the Group's leading position in the safety airbag industry in the PRC. The management will devote its best endeavor and efforts to bring fruitful returns to shareholders.

## INTERIM DIVIDEND

The Board does not recommend the payment of an interim dividend for the nine months ended 30 September 2005 (nine months ended 30 September 2004: HK$Nil).

## DIRECTORS' AND CHIEF EXECUTIVE'S INTEREST AND SHORT POSITIONS IN SHARES, UNDERLYING SHARES AND DEBENTURES

As at 30 September 2005, the interests and short positions of the directors and chief executives in shares and underlying shares and in debentures of the Company and its associated corporations (within the meaning of Part XV of the Securities and Futures Ordinances (the "SFO") as recorded in the register required to be kept under section 352 of SFO or as otherwise notified to the Company and the Stock Exchange pursuant to Rules 5.46 to 5.67 the GEM Listing Rules were as follows:

### (a) Long positions in issued shares

| Name of director | Capacity | Number of shares | Approximate percentage of shareholding |
|---|---|---|---|
| Li Feng | Interest of a controlled corporation *(Note)* | *(Note)* | *(Note)* |
| Xing Zhanwu | Interest of a controlled corporation *(Note)* | *(Note)* | *(Note)* |
| Li Hong | Interest of a controlled corporation *(Note)* | *(Note)* | *(Note)* |
| Yang Donglin | Interest of a controlled corporation *(Note)* | *(Note)* | *(Note)* |
| Zhao Qingjie | Interest of a controlled corporation *(Note)* | *(Note)* | *(Note)* |

*Note:* As at 30 September 2005, the following shareholders of the Company held an indirect interest in the Company through their interests in Applaud Group Limited which held approximately 62.63% in the Company:

| Shareholder | | Number of shares held in Applaud Group Limited | | % |
|---|---|---|---|---|
| The controlling group | | 5,467 | | 54.67 |
| Li Feng | 2,286 | | 22.86 | |
| Xing Zhanwu | 1,281 | | 12.81 | |
| Xu Jianzhong | 719 | | 7.19 | |
| Li Hong | 616 | | 6.16 | |
| Yang Donglin | 565 | | 5.65 | |
| Zhao Qingjie | | 1,750 | | 17.50 |
| Gao Xiangdong | | 1,500 | | 15.00 |
| Zhao Jiyu | | 400 | | 4.00 |
| Lin Qing | | 223 | | 2.23 |
| Zhou Yuquan | | 214 | | 2.14 |
| Cao Feng | | 133 | | 1.33 |
| Zhang Chengyu | | 128 | | 1.28 |
| Zhang Chenye | | 100 | | 1.00 |
| Zhang Meina | | 85 | | 0.85 |
| Total | | 10,000 | | 100 |

### (b) Interests in underlying shares

The directors and chief executive of the Company have been granted options under the Pre-IPO Employee Share Option Scheme, details of which are set out in the section headed "Share Option Schemes" below.

Apart from the foregoing, none of the directors and chief executive of the Company or any of their spouses or children under eighteen years of age has interests or short positions in shares, underlying shares or debentures of the Company, any of its holding company, subsidiaries or fellow subsidiaries, as recorded in the register required to be kept under section 352 of the SFO or Rules 5.46 to 5.67 of the GEM Listing Rules or required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of the SFO.

## SHARE OPTION SCHEMES

The Company has two share option schemes namely, the Pre-IPO Employee Share Option Scheme and the Share Option Scheme as defined in the Prospectus which were adopted on 22 November 2004. A summary of principal terms of the share option schemes were disclosed in Appendix VI to the Prospectus.

The total number of securities available for issue under the share option schemes as at 30 September 2005 was 49,500,000 shares (including options for 11,400,000 shares that have been granted but not yet lapsed or exercised) which represented approximately 12.99% of the issued share capital of the Company as at 30 September 2005.

As at 30 September 2005, the directors and employees of the Company had the following interests in options to subscribe for shares of the Company (market value per share at 30 September 2005 is HK$1.01) granted for at a consideration of HK$1 under the share option schemes of the Company. The options are unlisted. Each option gives the holder the right to subscribe for one ordinary share of HK$0.01 each of the Company.

### (a) Pre-IPO Employee Share Option Scheme

On 22 November 2004, the Company granted options to subscribe for a total of 11,400,000 Shares under the Pre-IPO Employee Share Option Scheme to three directors of the Company and seven other employees of the Group, with the following details:

| Name | Position | No. of options outstanding at the beginning of the year | No. of options outstanding as at 30 September 2005 | Date granted | Period during which options exercisable | No. of share acquired on exercise of options during the period | Exercise price per share | * Market value per share at date of grant of options | * Market value per share on exercise of options |
|---|---|---|---|---|---|---|---|---|---|
| Mr. Li Feng (李峰) | Executive director and chairman of the Company | 2,600,000 | 2,600,000 | 22 November 2004 | 9 December 2005 to 9 December 2008 | – | HK$0.38 | HK$0.788 | N/A |
| Mr. Xing Zhanwu (邢戰武) | Executive director and chief executive officer of the Company | 2,000,000 | 2,000,000 | 22 November 2004 | 9 December 2005 to 9 December 2008 | – | HK$0.38 | HK$0.788 | N/A |

## SHARE OPTION SCHEMES *(Continued)*

### (a) Pre-IPO Employee Share Option Scheme *(Continued)*

| Name | Position | No. of options outstanding at the beginning of the year | No. of options outstanding as at 30 September 2005 | Date granted | Period during which options exercisable | No. of share acquired on exercise of options during the period | Exercise price per share | * Market value per share at date of grant of options | * Market value per share on exercise of options |
|---|---|---|---|---|---|---|---|---|---|
| Mr. Foo Tin Chung, Victor (傅天忠) | Executive director and financial controller of the Company | 800,000 | 800,000 | 22 November 2004 | 9 December 2005 to 9 December 2008 | – | HK$0.38 | HK$0.788 | N/A |
| Mr. Hao Dianqing (郝殿卿) | Employee, general manager of Jinheng Automotive | 1,080,000 | 1,080,000 | 22 November 2004 | 9 December 2005 to 9 December 2008 | – | HK$0.38 | HK$0.788 | N/A |
| Mr. Xing Zhanwen (邢占文) | Employee, deputy general manager of Jinheng Automotive | 880,000 | 880,000 | 22 November 2004 | 9 December 2005 to 9 December 2008 | – | HK$0.38 | HK$0.788 | N/A |
| Mr. Zhang Qiming (張啟明) | Employee, deputy general manager of Jinheng Automotive | 1,000,000 | 1,000,000 | 22 November 2004 | 9 December 2005 to 9 December 2008 | – | HK$0.38 | HK$0.788 | N/A |
| Mr. Zhu Jiangbin (朱江濱) | Employee, deputy general manager of Jinheng Automotive | 880,000 | 880,000 | 22 November 2004 | 9 December 2005 to 9 December 2008 | – | HK$0.38 | HK$0.788 | N/A |
| Ms. Zhang Liping (張麗萍) | Employee, head of the finance department of Jinheng Automotive | 840,000 | 840,000 | 22 November 2004 | 9 December 2005 to 9 December 2008 | – | HK$0.38 | HK$0.788 | N/A |
| Mr. Zhao Chengming (趙成明) | Employee, general manager of Jinbei Jinheng | 720,000 | 720,000 | 22 November 2004 | 9 December 2005 to 9 December 2008 | – | HK$0.38 | HK$0.788 | N/A |
| Mr. Chen Lixin (沈立新) | Employee, general manager of Hafei Jinheng | 600,000 | 600,000 | 22 November 2004 | 9 December 2005 to 9 December 2008 | – | HK$0.38 | HK$0.788 | N/A |
| | | **11,400,000** | **11,400,000** | | | **–** | | | |

The options granted to the directors/employees are registered under the names of the directors/employees who are also the beneficial owners.

* being the weighted average closing price of the Company's ordinary shares immediately before the dates on which the options were granted or exercised, as applicable.

### (a) Pre-IPO Employee Share Option Scheme *(Continued)*

The weighted average value per option granted on 22 November 2004 and had not vested at 1 January 2005 using binomial lattice pricing model was HK$0.788. The calculation of the weighted average value per option granted during the period does not take into account options granted and forfeited during the period. The weighted average assumptions used are as follows:

| | **2005** |
|---|---|
| Risk-free interest rate | 2.1% |
| Expected life (in years) | 4 years |
| Volatility | 50.0% |
| Expected dividend per share | 2.3% |

The binomial lattice pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, such option pricing model requires input of highly subjective assumptions, including the expected stock price volatility. Because the Company's share options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, the binomial lattice pricing model does not necessarily provide a reliable measure of the fair value of the share options.

Apart from the foregoing, at no time during the period was the Company or any of its subsidiaries a party to any arrangement to enable the directors of the Company to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

### (b) Share Option Scheme

As at 30 September 2005, no option has been granted under the Share Option Scheme.

## SUBSTANTIAL INTEREST IN THE SHARE CAPITAL OF THE COMPANY

As at 30 September 2005, the following persons (other than the directors and chief executive of the Company) had interests and short positions in the shares and underlying shares of the Company as recorded in the register required to be kept under section 336 of the SFO.

| | Capacity | Ordinary shares held | Approximate percentage of total issued shares |
|---|---|---|---|
| Applaud Group Limited | Beneficial owner | 238,620,000 | 62.63% |
| Direct Sino Holdings Limited | Beneficial owner | 37,410,000 | 9.82% |

### Long positions in underlying shares

No long positions of other persons and substantial shareholders in the underlying shares of equity derivatives of the Company were recorded in the register.

### Short positions in shares

No short positions of other persons and substantial shareholders in the shares of the Company were recorded in the register.

### Short positions in underlying shares

No short positions of other persons and substantial shareholders in the underlying shares of equity derivatives of the Company were recorded in the register.

Save as disclosed above, as at 30 September 2005, the directors or chief executive of the Company were not aware of any other person (other than the directors or chief executive of the Company) who had an interest or short position in the shares or underlying shares of the Company which would fall to be disclosed to the Company under the provisions of Divisions 2 and 3 of Part XV of the SFO or, who is, directly or indirectly, interested in 5% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any other members of the Group, or any other substantial shareholders whose interests or short positions were recorded in the register required to be kept by the Company under Section 336 of the SFO.

## COMPETING INTERESTS

None of the directors or management shareholders of the Company (as defined in the GEM Listing Rules) had an interest in a business which competes or may compete with the businesses of the Group as at 30 September 2005.

## SPONSOR'S INTEREST

Pursuant to an agreement dated 29 November 2004 entered into between the Company and VC Capital Limited, the VC Capital Limited would receive a monthly fee for acting as the Company's retained sponsor for the remainder of the year ended 31 December 2004 and for the period of two years thereafter until 31 December 2006.

As at 30 September 2005, VC Capital Limited had indirect interest in the shares of the Company held by VC Strategic Investments Limited through its interests in certain associated companies, both VC Capital Limited and VC Strategic Investments Limited are wholly-owned subsidiaries of Value Convergence Holdings Limited, a company listed on GEM. As at 30 September 2005, VC Strategic Investments Limited was beneficially interested in 11% of the issued capital of Top Growth Assets Limited, and Top Growth Assets Limited was beneficially interested in 81.5% of the issued capital of WAG (Greater China) Limited. WAG (Greater China) Limited is beneficially interested in 9,000,000 shares of the Company, representing approximately 2.36% of the total issued capital of the Company.

Save as disclosed above, none of VC Capital Limited, its directors, employees or their respective associates had any shareholding interests in the securities of the Company or any member of the Group nor have any right or option (whether legally enforceable or not) to subscribe for or nominate persons to subscribe for the securities of the Company or any member of the Group as at 30 September 2005.

## DIRECTORS' INTERESTS IN CONTRACTS

No contract of significance to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the period or any time during the period save and except for the agreements as stated in section headed "Connected transactions" in the Prospectus.

## PURCHASE, SALE OR REDEMPTION OF SHARES

During the nine months ended 30 September 2005, neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares.

## PRE-EMPTIVE RIGHTS

There is no provision for pre-emptive rights under the Company's articles of association although there are no restrictions against such rights under the law in the Cayman Islands.

## THE CODE OF CORPORATE GOVERNANCE PRACTICES

The Company established an audit committee on 22 November 2004 with written terms of reference in compliance with Rules 5.28 to 5.33 of the GEM Listing Rules. The primary duties of the audit committee are to review and to provide supervision over the financial reporting process and internal control system of the Group. The audit committee comprises the three independent non-executive directors, namely Mr. Chan Wai Dune, Mr. Huang Shilin and Mr. Zhu Tong.

Effect from 1 November 2005, Mr. Huang Shilin has been appointed as an independent non-executive director and a member of the audit committee of the Company. Mr. Zhong Zhihua ("Mr. Zhong") has resigned as independent non-executive director and a member of the audit committee of the Company with effect from 1 November 2005, as he accepted the assignment as the headmaster of University of Wunan placed by the Ministry of Education. He would like to devote more time in the new position and thus resigned from the Company. Mr. Zhong has confirmed to the Board that he has no disagreement with the Board and there are no other matters in relation to Mr. Zhong's resignation that need to be brought to the attention of the Stock Exchange and the shareholders of the Company.

The audit committee had reviewed the Group's unaudited results for the three months and nine months ended 30 September 2005 and had provided advice and recommendation to the Board.

The Company has adopted a code of conduct regarding directors' securities transactions on terms no less exacting than the required standard set out in Rules 5.48 to 5.67 of the GEM Listing Rules. Having made specific enquiry, all directors of the Company have complied with the required standard of dealings and the code of conduct regarding securities transactions by directors of the Company adopted by the Company throughout the nine months ended 30 September 2005.

The Company has complied with the requirement to appoint a sufficient number of independent non-executive director as set out in Rule 5.05(1) of the GEM Listing Rules. Throughout the nine months ended 30 September 2005, the Company has appointed three independent non-executive directors, namely Mr. Chan Wai Dune, Mr. Zhong Zhihua and Mr. Zhu Tong.

All the non-executive directors and independent non-executive directors are not appointed for specific terms but are subject to rotation and re-election at annual general meeting of the Company in accordance with the Articles of Association of the Company.

The Company has been looking for several candidates to be the members of Remuneration Committee and Nomination Committee but now has not been identified yet. The Board estimates that it will take a few months to identify and confirm the most suitable candidate and will ensure that such appointment will be completed within few months. Save as disclosed above, throughout the period, the Company was in compliance with the Code on Corporate Governance Practices as set out in Appendix 15 of the GEM Listing Rules.

By order of the Board
**Jinheng Automotive Safety Technology Holdings Limited**
**Li Feng**
*Chairman*

Hong Kong, 11 November 2005