Management Discussion and Analysis

Operating environment

The automobile industry in the PRC has experienced significant growth in recent years. Such growth has mainly been attributable to the swift urbanisation process, stronger purchasing power of the urban population, increasing popularity of auto financing services and rapid development in highways and roads.

Nevertheless, the outbreak of Severe Acute Respiratory Syndrome ("SARS") and the war between the United States of America and Iraq in the first half of year 2003 have caused a short term disruption to the overall business environment in various sectors, including the automobile industry in the PRC. Competition has been keen for the pick-up truck and the Sport Utility Vehicles ("SUV") markets throughout 2003. Market players in the industry have been active in launching similar models and pursued aggressive promotional campaigns. There were a number of price cuts in the industry with an aim to boost sales for automobiles. As there has been a strong domestic demand for automobiles, the total amount of automobile sales in the PRC market continues to grow rapidly.

Business review

Products

The Group's principal products are pick-up trucks and SUVs. It also manufactures large-sized buses and special vehicles. In 2003, most of the automotive parts produced by the Group were used for the assembly of its pick-up trucks and SUVs, with the remaining (including primarily engines and drag ball pins assembly) being sold to independent third parties. The Group's gross profit margin and net profit margin for 2003 were 32.4% and 14.2% respectively, which were 4.0% and 2.9% higher than those of 2002. The directors of the Company (the "Directors") believe that it was an outcome of both correct market positioning and flexible production adopted by the Group. By capitalizing on these competitive strengths, the Group was able to adopt flexible pricing policy and exercise effective control over its production cost, which enabled it to manufacture products that are "value for money". Indeed, the impact of price cut was largely off-set by the Group's effective cost control, which in turn, was a result of the maximisation of efficiency in its production process.

Management Discussion and Analysis

(1) *Pick-up trucks*

Although the prices of some *Greatwall* (長城) pick-up trucks were reduced by RMB1,000 to RMB5,000 resulting in an average reduction price of RMB1,000 per unit in response to the market condition and the total number of pick-up trucks sold decreased from 28,947 units in 2002 to 25,169 units in 2003, the Group was able to maintain its dominant position in the market. According to 全國皮卡市場數據信息中心 (National Pick-up Truck Market Information Centre), the sales of *Greatwall* pick-up trucks have ranked first in the PRC market for five consecutive years since 1999. Of all the pick-up trucks sold, 12,791 units were *Deer* pick-up trucks, with sales revenue of RMB678,274,000; and 12,378 units were *Sailor* pick-up trucks, with sales revenue of RMB772,830,000.

(2) *SUVs*

In recent years, SUVs have become increasingly popular in the PRC. The renowned *Greatwall* brand name and trendy outlook of *Greatwall* SUVs together with an attractive pricing scheme enabled it to maintain continuous growth in sales since its initial launch in the market. According to the statistics of 全國乘用車市場聯席會 (National Passenger Vehicle Market Association), the sales volume of *Greatwall* SUV ranked first in the nationwide market, demonstrating the Group's leading position in the budget SUV market. A total of 27,091 units of SUVs were sold during 2003, with sales revenue of RMB1,849,729,000, representing an increase of approximately 150.9% from 2002. The *Safe* SUVs were commercially launched in June 2002 and recorded sales volume of 21,478 units in 2003, representing sales revenue of RMB1,483,221,000. Although *Sing* SUVs were only recently launched in June 2003, they already achieved a sales volume of 5,613 units representing sales revenue of RMB366,508,000.

(3) *Large-sized buses and special vehicles*

The sales of the large-sized buses and the special vehicles amounted to RMB54,410,000, representing an increase of about 150.7% when compared to that of 2002 and contributing approximately 1.5% to the total turnover of the Group in 2003.

(4) *Automotive parts and components*

The sales in parts and components amounted to RMB336,463,000, representing an increase of about 111.7% when compared to that of 2002 and contributing approximately 9.1% to the total turnover of the Group in 2003.

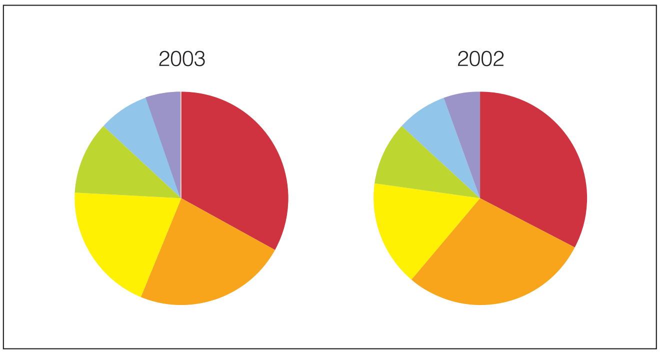
Management Discussion and Analysis

Domestic market

The Group has positioned itself in the niche market segments of pick-up trucks and SUVs. As at 31st December, 2003, there were altogether 319 models within its pick-up truck series (namely *Deer* and *Sailor*) and SUV series (namely *Safe* and *Sing*). The Group has achieved notable results during the year of 2003. In the last quarter of 2003, the Group made a successful bid in the largest pick-up truck tender project in terms of volume (namely the first batch of 河北省政府採購中心農稅徵管用車系統). The first batch of 560 units of pick-up trucks were delivered in January 2004.

Geographical breakdown of the Group's domestic sales

The following charts set out the geographical breakdown of the Group's domestic sales in 2002 and 2003:



- Eastern region: Shanghai, Jiangsu, Zhejiang, Anhui, Fujian, Jiangxi, Shandong
- Central region: Henan, Hubei, Hunan, Guangdong, the Guangxi Zhuangzu Autonomous Region, Hainan
- Northern region: Beijing, Tianjin, Hebei, Shanxi, the Inner Mongolia Autonomous Region
- Northwestern region: Shaanxi, Gansu, Qinghai, the Ningxia Huizu Autonomous Region, the Xinjiang Uygur Autonomous Region
- Northeastern region: Liaoning, Jilin, Heilongjiang
- Southwestern region: Chongqing, Sichuan, Guizhou, Yunnan, the Tibet Autonomous Region

Management Discussion and Analysis

Export market

Export sales amounted to RMB70,320,000, representing 1.9% of the total sales of the Group. The export market mainly comprised of Middle Eastern countries including Saudi Arabia, United Arab Emirates, Bahrain and Kuwait. The sale volume of pick-up trucks and SUVs sold to the export market during the year were 1,015 units and 143 units, with sales amounting to RMB53,965,000 and RMB11,030,000, respectively. Such sale volume represented a decrease of 51.9% for pick-up trucks and an increase of 969.8% for SUVs when compared to the export sales in 2002.

Customers

There are two main groups of customers, namely (1) dealers, and (2) government entities and individual customers. The following table sets out details of the Group's domestic sales of automobiles to the two customer groups in the year of 2002 and 2003:

	Year ended 31st December,					
		2003			2002	
	Sale volume (units)	**RMB'000**	**Percentage to domestic automobiles sales revenue %**	Sale volume (units)	RMB'000	Percentage to domestic automobiles sales revenue %
Dealers	**49,439**	**3,167,727**	**96.4**	35,877	2,212,260	95.0
Government entities and individuals	**1,935**	**117,196**	**3.6**	1,806	116,735	5.0
Total	**51,374**	**3,284,923**	**100**	37,683	2,328,995	100

Management Discussion and Analysis

Quality control

The Group passed the 3C certification of 國家質檢總局 (the State Quality Examination Authority) and the Euro II exhaust emission level standard of 國家環保總局 (the State Environmental Department), whilst certain products have met the Euro III exhaust emission level standard.

Sales and after sales network

The Group expanded its sales and after sales services networks in more developed regions, such as Guangdong Province and Beijing. The Group is committed to building a comprehensive market information system so as to facilitate it to collect important market information in a timely manner. For the year ended 31st December, 2003, the distribution network of the Group comprised of more than 380 domestic and overseas dealers and more than 340 service centres.

Financial Review

Turnover

Sales of automobiles

During the year, the Group's turnover reached RMB3,691,706,000, representing an increase of 41.9% from 2002. The increase in turnover was mainly due to the increase in sale volume of SUVs from 10,827 units in 2002 to 27,091 units in 2003 which represented a 150.2% increase.

The Group sold 25,169 units of pick-up trucks in 2003, representing a 13.1% decrease from 28,947 units in 2002. The decrease in sales was mainly due to the adjustment of product mix. The Group sold 289 units of large-size buses and special vehicles during the year, representing a 38.3% increase from 209 units in 2002.

Analysis on automobile sales and production capacity

	Year ended 31st December,					
	2003			2002		
	Sale volume (units)	**RMB'000**	**Percentage to automobiles sales revenue %**	Sale volume (units)	RMB'000	Percentage to automobiles sales revenue %
Pick-up trucks	**25,169**	**1,451,104**	**43.3**	28,947	1,683,915	68.9
SUVs	**27,091**	**1,849,729**	**55.1**	10,827	737,276	30.2
Others (Note)	**289**	**54,410**	**1.6**	209	21,699	0.9
Total	**52,549**	**3,355,243**	**100.0**	39,983	2,442,890	100.0
Production capacity at the end of each year (units)	**70,000**			50,000		

Note: Others included large-sized bus and special vehicles

Management Discussion and Analysis

Sales of automotive parts and components

In addition to the production of automobiles, the Group also engages in the sales of principal automotive parts and components used in the production of pick-up trucks and SUVs. These mainly include self-manufactured engines, front and rear axles, air-conditioning equipment and drag ball pins and lever assembly. During the year, the Group recorded a 112% increase in sales of automotive parts and components from RMB158 million in 2002 to RMB336 million in 2003. The surge was mainly attributable to the increase in sale volume of engines from 9,082 units in 2002 to 21,314 units in 2003 as a result of the continuing growth in automobile market in the PRC. The sales of engines represented 69% of the Group's sales of automotive parts and components during the year.

Gross profit and gross profit margin

During the year, the Group's gross profit increased by 61.6% from RMB740,172,000 to RMB1,196,188,000. The increase in gross profit was mainly due to the increase in the sale volume from 39,983 units in 2002 to 52,549 units in 2003 and the increase of gross profit margin from 28.4% to 32.4%, respectively. The increase in gross profit margin was mainly attributed to (1) the increase in reliance on self-manufactured automotive parts and components produced by the subsidiaries of the Group and the decrease in purchase price for raw materials from other accessories manufacturers as the result of the increase in purchase volume; (2) the decrease in production cost per unit benefited from the economy of scale arising from the increase in sale volume of automobiles and the stringent cost control; and (3) the increase in the sales of SUVs with a higher gross profit margin.

Profit attributable to shareholders and earnings per share

The Group's profit attributable to shareholders for the year of 2003 reached RMB523,398,000 (which was slightly higher than the profit forecast (i.e. not less than RMB512,000,000) as stated in the prospectus of the Company dated 3rd December, 2003) representing an increase of 77.8%, as compared to about RMB294,367,000 in 2002. The increase in profit attributable to shareholders was mainly due to the increase in the sale volume of SUVs which enjoyed a higher profit margin and the growth in overall gross profit margin of the Group during the year.

For the year ended 31st December, 2003, the basic earnings per share of the Company were RMB1.51. No diluted earnings per share have been presented as the Company did not have any potentially dilutive ordinary shares during the year.

Management Discussion and Analysis

Selling and distribution costs and administrative expenses

During the year 2003, the selling and distribution costs and administrative expenses of the Group was about RMB304,918,000, representing an increase of 52.6%, as compared to 2002 of about RMB199,854,000. The selling and distribution costs and administrative expenses increased from 7.7% to 8.3% of the Group's turnover from 2002 to 2003, and such increase was mainly attributable to (1) the increase in staff costs due to the increase in staff welfare benefits of the Group's Sino-foreign joint ventures and the increase in staff headcount of the Group; (2) the increase in transportation costs as a result of the increase in sale volume; and (3) the increase in advertising and marketing expenses due to the increase in marketing and promotion activities.

Finance costs

During the year 2003, the Group recorded a net interest income of approximately RMB2,394,000 as compared to the net interest expenses of approximately RMB4,073,000 in 2002. Since the Group repaid most of its bank loans at the beginning of 2003 and interest income increased accordingly by about RMB4,942,000, and therefore net interest income was recorded during the year.

Liquidity and financial resources

The Group continued to be in strong financial position, with cash and cash equivalents amounting to RMB2,515,369,000 as at 31st December, 2003. As a result of the receipt of a net IPO proceeds of approximately HK$1,664,000,000 (equivalent to approximately RMB1,773,488,000) arising from the listing of H shares of the Company in the main board of the Stock Exchange in December 2003, the Group's current ratio improved from 1.3 in 2002 to 2.5 in 2003.

Management Discussion and Analysis

Acquisitions

On 16th January, 2003, the Company acquired an additional 26% equity interest in Baoding Changfu Pressings Company Limited ("Changfu Pressings") for an aggregate consideration of RMB7,280,000 from Shenyang Shuangfu Machinery Company Limited. Changfu Pressings Company then became a 75% owned subsidiary of the Group. The Group already held a 49% equity interest in Changfu Pressings Company prior to 16th January, 2003. The consideration was settled with cash in the amount of RMB3,512,000 and netting off against other receivables from Shenyang Shuangfu Machinery Company Limited in the amount of RMB3,768,000.

On 13th July, 2003, the Group also acquired 49% equity interest in Baoding Xincheng Automobile Development Company Limited ("Xincheng Company") for a cash consideration of RMB12,950,000 from a related party and subsequently Xincheng Company became a wholly-owned subsidiary of the Group as the Group already owned 51% equity interest in Xincheng Company prior to that date.

Capital structure

The Group generally finances its operation with internally generated cash flows and banking facilities provided by its principal bankers. As at 31st December, 2003, the Group had total banking facilities of about RMB100,000,000. Unutilised banking facilities amounted to RMB99,000,000 as at 31st December, 2003. The utilised banking facilities are denominated in RMB and carried fixed interest rates.

As at 31st December, 2003, the Group was almost at debt free position as the gearing ratio was less than 0.1% (bank loans/total assets).

Exposure to foreign exchange risk

All the Group's domestic sales were settled in RMB while sales to overseas customers were settled in US dollars or Euro. During the year under review, the Group did not experience any material difficulties or negative effects on its operations or liquidity as a result of fluctuations in currency exchange rates. The Directors believe that the Group will have sufficient foreign exchange reserves to meet its foreign exchange requirements.

Employment, training and development

As at 31st December, 2003, the Group employed a total of about 6,000 employees, 800 more as compared to 2002. Employees were remunerated on the basis of their performance, experience and prevailing industry practices. The Group's remuneration policies and packages were reviewed on a regular basis. Bonuses and commissions may also be awarded to employees based on individual performance evaluation. These measures provided flexibility and incentives to staff for better performance and motivation. Total staff cost accounted for 2.7% of the Group's turnover for the year ended 31st December, 2003.

Management Discussion and Analysis

Taxation

Tax payable by the Group grew from RMB117,413,000 in 2002 to RMB187,608,000 in 2003, representing an increase of 59.8%. This increase was primarily due to the increase in profit before taxation. The effective tax rate decreased from 22.5% in 2002 to 21.5% in 2003.

Segment information

During 2003, over 90% of the Group's revenue and results were derived from the manufacture and sale of automobiles and, therefore, no business segmental analysis is presented.

No geographical segmental analysis is presented as the Group's operations were substantially carried out in the PRC. During the year, over 90% of the Group's turnover was derived from customers in the PRC.

Contingent liabilities

As at 31st December, 2003, except for the fact that the Group's bills receivables amounting to RMB60,151,000 are pledged to banks for issuing an equivalent amount of bills payables, the Group did not have any significant contingent liabilities.

Outlook

In view of the escalating demand of the PRC consumers for automobiles, the Directors believe that the sales markets of the pick-up trucks and SUVs remain strong. The Group is committed to maintaining its leading position in the PRC pick-up truck and SUV markets.

In anticipation of the increasing market demand in the years to come, the Group has deployed necessary resources to expand its existing production capacity. Construction of new production facilities has commenced since the third quarter of 2003. It is expected that the new production facilities will be completed in the last quarter of 2004. The trial production of pick-up trucks and SUVs (including *K* series) will also commence at that time. It is expected that the commercial production of pick-up trucks and SUVs will start at the beginning of 2005. With the new production facilities, the annual aggregate production capacity of pick-up trucks and SUVs will gradually increase to 150,000 units.

The installation and testing in preparation for upgrading the existing production facilities for parts and components is expected to be completed in the second half of 2004. The Group has commenced trial production of a new internal combustion engine. The upgrade of production facilities is to be completed by 2004. The Group will also strive to develop the wholesale market, such as orders from government authorities in large quantities, with a view that they would become one of the Group's major clientele.

Management Discussion and Analysis

One of the key factors towards the Group's future success is its ability to research and develop by itself and/or through collaboration with third parties and business partners. As such, it is the intention of the Company to expand and enrich its product mix and the Company is exploring the possibility of developing and producing two series of multiple purpose vehicle, one for family use and the other for business use (the "Project"). A thorough feasibility study is being performed in this respect. If the Project would be materialized, the Company expects that the construction of the related production facilities will commence in mid 2004 and will be completed in two years time. It is estimated that in 2004 and 2005 approximately RMB500 million and RMB400 million, respectively, will be invested in the Project which will be financed by internal resources. By leveraging on the Group's expanded product range, the Directors expect that the average production costs will be lowered and greater economy of scale will be achieved.

In 2004, the Group also plans to cooperate with leading domestic and overseas parts and components manufacturers in producing higher quality parts and components including air-conditioning equipment for automobiles, carpet, upholstery components, seats and wire, etc. In the first half of 2004, the Company entered into two joint venture agreements with certain independent third parties for the purpose of forming two joint venture companies (the "JVs"). The first JV has been formed to engage in the manufacture and sale of air conditioning equipment and other parts and components for automobiles (the "First JV"). The total investment amount for the First JV is expected to be RMB23.1 million. The registered capital of the First JV is RMB16.5 million. The Company will contribute RMB8.415 million in exchange for 51% of the equity interest in the First JV. The second JV is to be formed to engage in the manufacture and sale of upholstery components and other parts and components for automobiles (the "Second JV"). At present, the Company is in the process of applying the relevant business registration licence. The registered capital of the Second JV will be RMB10 million. The Company will contribute RMB5.1 million in exchange for 51% of the equity interest in the Second JV. Both of the funding requirements for the establishment of the JVs would be satisfied from the Company's internal resources.

In addition, by strengthening its sales and marketing forces in overseas markets, the Board believes that the Group can expand its sales in overseas markets even further.

In order to maintain the Company's competitiveness in the automobile industry, the Group will also actively assess the possibility of acquiring related businesses.