

# Report of Directors

The directors of the Company present this report together with the audited financial statements of the Company and its subsidiaries (the “Group”) for the year ended 31st December, 2004.

## PRINCIPAL ACTIVITIES

The Company is a holding company. The principal activities of its subsidiaries are set out in note 18 to the financial statements. The operating businesses of the Group are divided primarily into the manufacture and sale of (1) minibuses and automotive components and (2) sedans.

Prior to May 1998, the Company’s sole operating asset was its interest in Shenyang Automotive. As a result, the Company’s historical results of operations had been primarily driven by the sales price, sales volume and cost of production of Shenyang Automotive’s minibuses. With a view to maintain quality, ensure a stable supply of certain key components and develop new businesses and products, the Company acquired interests in various suppliers of components and established joint ventures in the PRC since May 1998. With additional investments and joint ventures, the Company’s income base has been broadened and its future financial performance will differ from that of Shenyang Automotive.

In May 1998, the Company acquired indirect interests in two components suppliers: a 51% equity interest in Ningbo Yuming, a wholly foreign-owned PRC enterprise primarily engaged in the production of automobile window molding, stripping and other auto components; and a 50% equity interest in Mianyang Xinchun Engine Co. Ltd., a Sino-foreign equity joint venture manufacturer of gasoline engines for use in passenger vehicles and light duty trucks. In October 1998, June 2000 and July 2000, the Company established Xing Yuan Dong, Ningbo Ruixing and Mianyang Ruian, respectively, as its wholly owned subsidiaries to centralize and consolidate the sourcing of auto parts and components for Shenyang Automotive. In 2001, in order to maintain their preferential tax treatment from the PRC government, all three companies began manufacturing automotive components as well.

In December 2000, the Company acquired a 50% equity interest in Shenyang Xinguang Brilliance Automobile Engine Co., Ltd., a Sino-foreign equity joint venture manufacturer of gasoline engines for use in passenger vehicles. In December 2001, the Company acquired a 100% equity interest in Dongxing Automotive, a foreign-invested manufacturer of automotive components in the PRC.

In May 2002, Shenyang Automotive obtained the approval from the Chinese Government to produce and sell its Zhonghua sedans in the PRC. The Zhonghua sedans were launched in the market in August 2002.

On 27th March, 2003, the Company, through its indirect subsidiary, Shenyang JinBei Automotive Industry Holdings Co., Ltd. (“SJAI”), entered into a joint venture contract with BMW Holding BV to produce and sell BMW-designed and branded sedans in the PRC. The registered capital and total investment cost of the joint venture is Euro 150 million and Euro 450 million, respectively. At that time, the Company’s effective interests in SJAI and the joint venture with BMW were 81% and 40.5%, respectively. On 28th April, 2003, the Company increased its effective interest in SJAI from 81% to 89.1% and thereby increased its effective interest in the joint

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venture with BMW from 40.5% to 44.55%. On 16th December, 2003, the Company further increased its effective interest in SJAI from 89.1% to 98.0% and thereby increased its effective interest in the joint venture with BMW from 44.55% to 49.0%.

On 29th December, 2003, the Company entered into agreements in relation to the proposed acquisition of an indirect 40.1% interest in Shenyang JinBei Automotive Company Limited (“JinBei”), the joint venture partner of Shenyang Automotive and a supplier of automotive components for the Group’s minibuses and sedans. Upon obtaining the approvals from the relevant government authorities and completion of the proposed acquisition, the Company’s effective interest in Shenyang Automotive will be increased from 51.0% to approximately 70.7%.

On 19th October, 2004, the Company, through its direct subsidiary, Beston Asia Investment Limited, entered into an agreement with Madam Chen Qiuling for the acquisition of her 49% interest in Ningbo Yuming. Approvals of the acquisition were obtained from the relevant PRC government authorities on 25th November, 2004 and Ningbo Yuming became a wholly owned subsidiary of the Company.

# Report of Directors (Cont'd)

## TURNOVER AND CONTRIBUTION

The Group's turnover and contribution to profit from operations for the year ended 31st December, 2004, analysed by product category, are as follows:

	<b>Manufacture and sale of minibuses and automotive components</b> RMB'000	<b>Manufacture and sale of Zhonghua sedans</b> RMB'000	<b>Manufacture and sale of BMW sedans</b> RMB'000	<b>Total</b> RMB'000
Segment sales	5,546,263	1,324,572	—	6,870,835
Intersegment sales	(328,837)	—	—	(328,837)
	<u>5,217,426</u>	<u>1,324,572</u>	<u>—</u>	<u>6,541,998</u>
Segment results	517,998	(596,667)	—	(78,669)
Impairment of intangible assets	—	(300,000)	—	(300,000)
Unallocated costs				<u>(58,754)</u>
Operating loss				(437,423)
Interest income				58,800
Interest expense				(182,458)
Share of profits less losses of:				
Jointly controlled entities	31,465	—	19,611	51,076
Associates	—	61,115	(679)	<u>60,436</u>
Loss before taxation				(449,569)
Taxation				<u>41,810</u>
Loss after taxation				(407,759)
Minority interests				<u>456,328</u>
Profit attributable to shareholders				<u>48,569</u>

# Report of Directors (Cont'd)

## FINANCIAL RESULTS

The results for the Group for the year ended 31st December, 2004, are set out in the financial statements of the Group on page 28.

## CASH FLOW POSITION

The cash flow position of the Group for the year ended 31st December, 2004 is set out and analysed in the consolidated cash flow statement on pages 32 and 33 and in note 37 to the financial statements.

## DIVIDEND

The directors recommend the payment of a final dividend of HK\$0.005 per share in cash for the year ended 31st December, 2004. The final dividend, if approved by the shareholders at the annual general meeting to be held on 24th June, 2005, will be paid on or before 4th July, 2005 to shareholders registered on 24th June, 2005. Details of the dividends paid and proposed are set out in note 9 to the financial statements.

## CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from Monday, 20th June, 2005 to Friday, 24th June, 2005, both days inclusive, during which period no transfer of shares will be registered. In order to qualify for the proposed final dividend and for attending the forthcoming annual general meeting of the Company, all properly completed transfer forms accompanied by the relevant share certificates must be lodged with the Company's branch registrar in Hong Kong, Computershare Hong Kong Investor Services Limited at Shops 1712-16, 17th Floor, Hopewell Centre, 183 Queen's Road East, Hong Kong for registration not later than 4:00 p.m. on Friday, 17th June, 2005.

## FIVE-YEAR FINANCIAL SUMMARY

A summary of the results, assets and liabilities of the Group for the past five financial years is set out on page 3.

## RESERVES

Movements in the reserves of the Group and the Company during the year ended 31st December, 2004 are set out in note 35 to the financial statements.

## PROPERTY, PLANT AND EQUIPMENT

The movements of property, plant and equipment of the Group for the year ended 31st December, 2004 are set out in note 16 to the financial statements.

# Report of Directors (Cont'd)

## **SUBSIDIARIES, ASSOCIATES AND JOINTLY CONTROLLED ENTITIES**

Particulars of the subsidiaries, associates and jointly controlled entities are set out in notes 18, 19 and 20, respectively to the financial statements.

## **SHARE CAPITAL AND SHARE OPTIONS**

Details of the Company's share capital and share options as of 31st December, 2004 are set out in note 34 to the financial statements.

On 2nd June, 2001, share options were granted to certain directors and employees entitling them to subscribe for ordinary shares of US\$0.01 each in the share capital of the Company (the "Shares") at HK\$1.896 per Share, totaling 31,800,000 Shares in aggregate, in accordance with the share option scheme of the Company adopted on 18th September, 1999, which came into effect on 20th October, 1999 (the "1999 Share Option Scheme"). Such share options vested immediately upon the grant and are exercisable within a period of ten years.

On 28th June, 2002, the 1999 Share Option Scheme was terminated. A new share option scheme was adopted at a special general meeting of shareholders on 28th June, 2002 (the "New Share Option Scheme") in compliance with the amendments to Chapter 17 of the Listing Rules, which came into effect on 1st September, 2001. The New Share Option Scheme came into effect on 15th July, 2002. Pursuant to Clause 13.1 of the 1999 Share Option Scheme, all the share options granted prior to such termination shall continue to be valid and exercisable in accordance with the terms of the 1999 Share Option Scheme.

During the year ended 31st December, 2004, 1,000,000 share options granted to a former employee had been lapsed in accordance with the terms of the 1999 Share Option Scheme. No options have been granted under the New Share Option Scheme since it came into effect.

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Details of the share options outstanding as at 31st December, 2004 under the 1999 Share Option Scheme are set out as follows:

## Category and name of participants

Directors	Number of share options
Wu Xiao An (also known as Ng Siu On)	2,800,000
Hong Xing	2,338,000
Su Qiang (also known as So Keung)	2,338,000
He Tao (also known as Ho To)	2,338,000
<b>Employees (in aggregate)</b>	<b>2,338,000</b>
<b>Others (Note)</b>	<b>2,338,000</b>
<hr/>	
Total	14,490,000

*Note:* The 2,338,000 share options were held by Mr. Yang Mao Zeng who was a director of the Company and resigned from his office with effect from 9th December, 2004. Following the resignation of Mr. Yang, such options lapsed on 9th January, 2005 in accordance with the terms of the 1999 Share Option Scheme.

During the year ended 31st December, 2004, none of the above share options had been exercised. Accordingly, the weighted average closing price of the Shares immediately before the dates on which the share options were exercised is not disclosed herein.

The directors consider that it is not appropriate to state the value of the outstanding share options given that the variables which are critical for the calculation of the value of such outstanding share options cannot be determined. The variables which are critical for the determination of the value of such share options include the subscription price for the shares upon the exercise of the subscription rights attaching to the share options, which may be adjusted under certain circumstances, and whether or not such share options will be exercised by the grantees. The directors are of the view that the value of the share options depends on a number of variables which are either difficult to ascertain or can only be ascertained subject to a number of theoretical bases and speculative assumptions, and accordingly, believe that any calculation of the value of the share options will not be meaningful.

# Report of Directors (Cont'd)

## DIRECTORS

The directors of the Company who held office during the year ended 31st December, 2004 and up to the date of this report are:

### *Executive directors:*

Mr. Wu Xiao An

(also known as Mr. Ng Siu On) (*Chairman*)

Mr. Lin Xiaogang (*Chief Executive Officer*) (appointed on 9th December, 2004)

Mr. Hong Xing (*Vice Chairman*)

Mr. Su Qiang (also known as Mr. So Keung)

Mr. He Tao (also known as Mr. Ho To) (resigned on 14th January, 2005)

Mr. Yang Mao Zeng (resigned on 9th December, 2004)

### *Non-executive directors:*

Mr. Wu Yong Cun

Mr. Lei Xiaoyang

### *Independent non-executive directors:*

Mr. Xu Bingjin

Mr. Song Jian (appointed on 17th September, 2004)

Mr. Jiang Bo (appointed on 27th September, 2004)

Mr. Yi Min Li (retired on 25th June, 2004)

Mr. Chen Jianming (appointed on 25th June, 2004 and resigned on 17th September, 2004)

Pursuant to bye-law 102(B) of the bye-laws of the Company, Mr. Lin Xiaogang, Mr. Song Jian and Mr. Jiang Bo, all of whom were appointed by the Board after the annual general meeting held on 25th June, 2004, will hold office until the forthcoming annual general meeting of the Company.

Mr. Hong Xing and Mr. Su Qiang (also known as Mr. So Keung) will retire by rotation in accordance with bye-law 99 of the bye-laws of the Company at the forthcoming annual general meeting of the Company.

Each of Mr. Lin Xiaogang, Mr. Song Jian and Mr. Jiang Bo, being eligible, will offer themselves for re-election and the Board has recommended them for election at the forthcoming annual general meeting of the Company. Mr. Hong Xing and Mr. Su Qiang (also known as Mr. So Keung) have indicated their intention not to be re-

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elected at the forthcoming annual general meeting of the Company. Details of the directors standing for re-election at the forthcoming annual general meeting are set out in the circular dated 29th April, 2005 sent together with this annual report.

## SUBSTANTIAL SHAREHOLDERS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 31st December, 2004, so far as is known to the directors or chief executives of the Company, the following persons other than a director or chief executive of the Company had an interest or a short position in the shares and underlying shares of the Company as recorded in the register required to be kept by the Company under Section 336 of the Securities and Futures Ordinance (the "SFO"):

Name of shareholder	Number of shares held/Approximate shareholding percentage					
	Long		Short			
	Position	%	Position	Lending Pool	%	
Huachen Automotive Group Holdings Company Limited ("Huachen")	1,446,121,500	39.42	—	—	—	

Save as disclosed herein, as at 31st December, 2004, there was no other person so far known to the directors or chief executives of the Company, other than a director or chief executive of the Company as having an interest or a short position in the shares and underlying shares of the Company as recorded in the register required to be kept by the Company under Section 336 of the SFO.



# Report of Directors (Cont'd)

## DIRECTORS' INTERESTS AND SHORT POSITIONS IN SHARES AND UNDERLYING SHARES

As at 31st December, 2004, the interests and short positions of each director, chief executive and their respective associates in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which he was taken or deemed to have under such provisions of the SFO); or were required pursuant to Section 352 of the SFO to be entered in the register referred to therein; or were required pursuant to the Model Code for Securities Transactions by Directors of Listed Companies to be notified to the Company and the Stock Exchange, are set out below:

Name of Director	Type of interests	Number of Shares held		Approximate shareholding percentage	Number of share options granted	Number of Shares to be acquired under a call option agreement
		Long Position	Short Position			
Wu Xiao An (also known as Ng Siu On)	Personal	—	—	—	2,800,000	92,911,266
Hong Xing	Personal	—	—	—	2,338,000	84,464,788
Su Qiang (also known as So Keung)	Personal	42,000	—	0.00	2,338,000	84,464,788
He Tao (also known as Ho To)	Personal	45,000	—	0.00	2,338,000	84,464,788

*Note:* Pursuant to four call option agreements all dated 18th December, 2002, Huachen has granted to each of Mr. Wu Xiao An (also known as Mr. Ng Siu On), Mr. Hong Xing, Mr. Su Qiang (also known as Mr. So Keung) and Mr. He Tao (also known as Mr. Ho To) a call option to acquire up to 92,911,266 Shares, 84,464,788 Shares, 84,464,788 Shares and 84,464,788 Shares, respectively, representing approximately 2.533%, 2.303%, 2.303% and 2.303%, respectively, of the existing issued share capital of the Company, at HK\$0.95 per Share, exercisable in whole or in part at any time during a period of three years commencing from the date falling six months after 6th February, 2003. During the year ended 31st December, 2004, none of the call options had been exercised by the above directors.

Save as disclosed above, as at 31st December, 2004, none of the directors, chief executives of the Company or their respective associates had any interests and short positions in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of Part XV of the SFO) which were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests and short positions which he was taken or deemed to have under such provisions of the SFO); or were required pursuant to Section 352 of the SFO to be entered in the register referred to therein; or were required pursuant to the Model Code for Securities Transactions by Directors of Listed Companies to be notified to the Company and the Stock Exchange.

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## **DIRECTORS' RIGHT TO ACQUIRE SHARES OR DEBENTURES**

At no time during the year ended 31st December, 2004 was the Company or any of its subsidiaries a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares or debentures of the Company or any other body corporate; and none of the directors, or their spouses or children under the age of 18, had any right to subscribe for securities of the Company, or had exercised any such right during the year.

## **DIRECTORS' INTERESTS IN CONTRACTS**

No contracts of significance in relation to the Group's business to which the Company or any of its subsidiaries or associates was a party and in which any director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

## **DIRECTORS' SERVICE CONTRACTS**

Each of Mr. Wu Xiao An (also known as Mr. Ng Siu On), Mr. Hong Xing and Mr. Su Qiang (also known as Mr. So Keung), all of whom are executive directors as at the date of this annual report, has entered into a service agreement with the Company dated 21st August, 2000 for a term of five years commencing from 1st October, 2000. All of these service contracts with the directors are exempted from the shareholders' approval requirement pursuant to Rule 13.69 of the Listing Rules.

Save as disclosed herein, no director proposed for re-election at the forthcoming annual general meeting has a service contract with members of the Group that is not determinable by the employer within one year without payment of compensation, other than statutory compensation.

## **PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES**

Neither the Company nor any of its subsidiaries had purchased, sold or redeemed any of the Company's securities during the year.

## **ANALYSIS OF INTEREST CAPITALISED**

Details of interest capitalised are set out in note 6 to the financial statements.

## **PRE-EMPTIVE RIGHTS**

There are no provisions for pre-emptive rights under the Company's bye-laws or the laws of Bermuda which oblige the Company to offer new shares on a pro-rata basis to existing shareholders. Such obligations are provided for in the Listing Rules.

# Report of Directors (Cont'd)

## MAJOR CUSTOMERS AND SUPPLIERS

During 2004, the aggregate sales attributable to the Group's five largest customers, excluding the Group's associates and jointly controlled entities, represented approximately 38.65% of the Group's turnover while the sales attributable to the Group's largest customer was approximately 28.87% of the Group's turnover. The aggregate purchases attributable to the Group's five largest suppliers, excluding the Group's associates and jointly controlled entities, during the year represented approximately 12.78% of the Group's total purchases and the purchases attributable to the Group's largest supplier represented approximately 3.14% of the Group's total purchases.

None of the directors, their associates or any shareholders that, to the knowledge of the directors, own more than 5% of the Company's issued share capital, has any interest in the share capital of any of the five largest customers or suppliers of the Group.

## CONNECTED TRANSACTIONS

On 26th February, 2003, waivers were granted by the Stock Exchange (the "Waiver") from strict compliance with the requirements as stipulated in Chapter 14 of the then Listing Rules in respect of the on-going connected transactions (the "On-going Connected Transactions") for a period of three financial years ending 31st December, 2005, subject to certain conditions.

Details of the On-going Connected Transactions entered into by the Group in the year 2004 are as follows:

	<b>RMB'000</b>
Purchases of materials and component parts by Shenyang Automotive from subsidiaries and associates of JinBei	345,590
Purchases of materials and component parts by Xing Yuan Dong from subsidiaries and associates of JinBei	379,755
Purchases of materials and component parts by Dongxing Automotive from subsidiaries and associates of JinBei	5,058
Sale of automobiles and automotive component parts by Shenyang Automotive to subsidiaries and associates of JinBei	38,108
Sales of automotive component parts by Dongxing Automotive to a subsidiary of JinBei	6

The independent non-executive directors of the Company have reviewed and confirmed that each of the On-going Connected Transactions in 2004 to which any member of the Group was a party:

1. had been entered into by the Group in the ordinary and usual course of its business;

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2. had been entered into either (a) on normal commercial terms, (b) on terms not less favourable than those available to or from (as the case may be) independent third parties, or (c) where there is no available comparison for the purpose of determining whether (a) or (b) is satisfied, on terms that are fair and reasonable so far as the shareholders of the Company are concerned; and
3. had not exceeded the relevant annual caps as approved by the Stock Exchange.

The auditors of the Company have reviewed the On-going Connected Transactions and confirmed to the directors that:

1. the directors had approved the On-going Connected Transactions;
2. the On-going Connected Transactions had been entered into in accordance with the terms of the related agreements governing such transactions; and
3. the On-going Connected Transactions had not exceeded the relevant annual caps as approved by the Stock Exchange.

On 19th October, 2004, Beston Asia Investment Limited (“Beston”), a wholly owned subsidiary of the Company, entered into a share transfer agreement with Madam Chen Qiuling (“Madam Chen”) in relation to the transfer of a 49% interest in Ningbo Yuming from Madam Chen to Beston for a consideration of RMB10 million (the “Transfer”). Madam Chen, being the holder prior to the completion of the Transfer of a 49% interest in Ningbo Yuming, a subsidiary of the Company, is a connected person of the Company within the meaning of the Listing Rules. Approvals for the Transfer were obtained from the relevant government authorities in the PRC on 25th November, 2004. As a result, Ningbo Yuming became a wholly owned subsidiary of the Company. The transaction constitutes a connected transaction for the Company under Chapter 14A of the Listing Rules, which came into effect on 31st March, 2004.

Save as disclosed above, in the opinion of the directors, the transactions disclosed as related party transactions in note 36 to the financial statements do not constitute connected transactions as defined under the Listing Rules in force at the timing of the entering into of the relevant transactions.

## **CODE OF BEST PRACTICE AND AUDIT COMMITTEE**

In the opinion of the directors, throughout the year, the Company has complied with the Code of Best Practice as set out in Appendix 14 to the Listing Rules in force prior to 1st January, 2005, except that the independent non-executive directors of the Company are not appointed for specific terms but are subject to retirement by rotation and re-election at the annual general meeting in accordance with the Company’s bye-laws.

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The Audit Committee of the Company comprises Mr. Xu Bingjin, Mr. Song Jian and Mr. Jiang Bo, all of whom are independent non-executive directors. Mr. Xu Bingjin is the chairman of the Audit Committee. The Audit Committee has reviewed with management the accounting principles and practices adopted by the Group and discussed auditing, internal control and financial report matters, including the audited consolidated financial statements for the year ended 31st December, 2004.

## **COMPLIANCE WITH THE MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS OF LISTED ISSUERS**

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers as set out in Appendix 10 to the Listing Rules (the "Model Code"). The Company has made specific enquiry of all directors as to compliance with the Model Code during the year ended 31st December, 2004 and they all confirmed that they have fully complied with the required standards set out in the Model Code.

## **INDEPENDENCE OF INDEPENDENT NON-EXECUTIVE DIRECTORS**

The Company has received from each of the independent non-executive directors an annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Board has assessed the independence of all the independent non-executive directors and is satisfied of their independence.

## **PROPOSED AMENDMENTS TO THE BYE-LAWS**

On 19th November, 2004, the Stock Exchange announced certain amendments to the Listing Rules relating to the Code on Corporate Governance Practices and Rules on the Corporate Governance Report. Subject to certain transitional arrangements, the amendments took effect on 1st January, 2005.

Following a review of the bye-laws of the Company with reference to the Code on Corporate Governance Practices, the Board proposed to make certain amendments to the bye-laws to comply with the code requirements of the Code on Corporate Governance Practices. A resolution to give effect to the amendments to the bye-laws will be proposed at the forthcoming annual general meeting of the Company. Particulars of the proposed amendments are set out in the notice of the annual general meeting and the accompanying circular dated 29th April, 2005 to be despatched to shareholders together with this annual report.

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## AUDITORS

Arthur Andersen & Co was the auditors in 2001 and PricewaterhouseCoopers was the auditors in 2002 and 2003. The financial statements have been audited by Moores Rowland Mazars (having been appointed by the Board on 20th December, 2004 to fill the casual vacancy arising from the resignation of PricewaterhouseCoopers) who will retire and be eligible to offer themselves for appointment. A resolution will be submitted to the forthcoming annual general meeting to authorise the Board to appoint auditors and to fix their remuneration.

By order of the Board

**Wu Xiao An**

(also known as Ng Siu On)

*Chairman*

Hong Kong,

25th April, 2005