



吉利汽车  
GEELY AUTOMOBILE

自由舰

>安全型家庭轿车

# 自由舰1.3L领航上市

自由驰骋 安全护航

>28项立体安全护卫系统



## Management Discussion & Analysis

# MANAGEMENT DISCUSSION & ANALYSIS

## OVERALL PERFORMANCE

Despite a difficult period at the early part of 2005, characterized by rapidly rising steel prices and continued fierce competition in China's sedan market, the Group's two associates – Zhejiang Geely and Shanghai Maple – still managed to achieve respectable results for the full year period of 2005, helped by a strong recovery of the demand for economy sedans in China since early 2005, a more stable raw material prices since the second quarter of 2005, the good market responses to the new products introduced during the year including "Free Cruiser" and 1.0L "Ulion", and a significant improvement in profitability by the company's auto parts subsidiary Zhejiang Fulin during the year. Despite a 23% decline in net profit in the first six months of 2005, the group achieved a much better earnings performance in the second half and managed to record a 36% increase in net profit to HK\$111 m in the full year of 2005. The earnings growth achieved in 2005 was despite an additional HK\$5.5m expenses incurred by the grant of share options to key management team members in August 2005 following the adoption of revised Hong Kong Accounting Standards from 1st January, 2005. The Group's total turnover was up more than 100% to HK101.4m as the absence of turnover from IT businesses, which was disposed of in March 2004, in 2005 was more than offset by the substantial increase in the turnover of 51%-owned Zhejiang Fulin.

## REORGANISATION

During the year, the Group continued its on-going restructuring to transform itself into a company focusing on manufacturing and sales of automobile and automobile parts and to streamline the corporate structures of the Group as well as its two major associates. Key events related to reorganization of the Group and its two major associates in 2005 include:

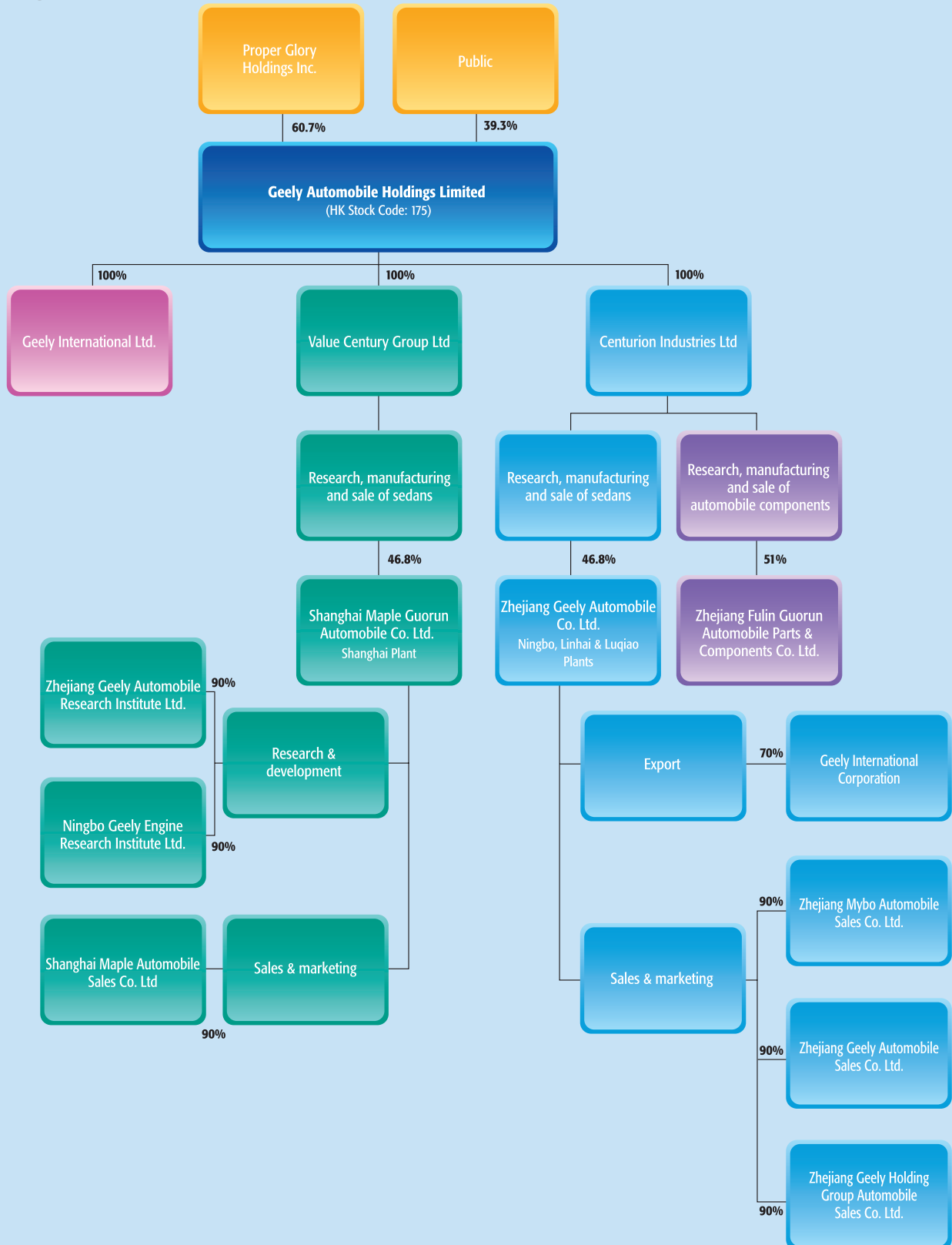
**June 2005:** Mr. Li Shu Fu, the founder and Chairman of Geely Holding Group became the controlling shareholders of the Group after the acquisition of an effective 41.3% stake in the Group, raising his equity stake in the Group to 60.7%;

**August 2005:** The Group's 46.8%-owned associate Zhejiang Geely, and its 46.8%-owned associate Shanghai Maple Guorun acquired a combined 85% stake in Geely International Corporation ("Geely International"). Geely International was previously owned by its management team and is the exclusive export agent of Geely brand sedans in overseas markets.

**October 2005:** To simplify the Group structure of the Group's 46.8%-owned associate Zhejiang Geely, Zhejiang Geely transferred all auto-related assets (including the Linhai and Luqiao plants) in its 90%-owned Zhejiang Haoqing Automobile Manufacturing Co. Ltd. ("Zhejiang Haoqing") to two newly established branch companies directly under Zhejiang Geely. Zhejiang Haoqing, together with all its liabilities and other non auto-related assets were subsequently sold back to Geely Holding Group at book costs. The transaction was largely completed by the end of 2005 with the exception of the transfer of the titles for some factory buildings and lands pending completion of some regulatory procedures.

# MANAGEMENT DISCUSSION & ANALYSIS

## Organisation chart



# MANAGEMENT DISCUSSION & ANALYSIS

## MANAGEMENT TEAM

The members of the Group's Board of Directors had also been changed to reflect the new shareholding structure of the company after Mr Li Shu Fu, the founder and Chairman of Geely Holding Group, became the controlling shareholder of the Group in June 2005. Six existing executive directors had resigned and seven new executive directors including Mr. Li Shu Fu, Mr. Xu Gang, Mr. Yang Jian, Mr. Shim Bong Sup, Mr. Yin Da Qing, Richard, Mr. Liu Jin Liang and Mr. Gui Sheng Yue were nominated to join the Board in June 2005. Mr. Li Shu Fu was also appointed as the Chairman of the Group on 9th June, 2005.

Also, Mr. Yeung Sau Hung, Alex was appointed as an independent non-executive director and a member of the Audit Committee and Remuneration Committee of the Group on 6th June, 2005. Mr. Yeung is the Chief Executive Officer of DBS Vickers Hong Kong since 1st September, 2002, bringing with him more than 20 years' experience in the financial services industry to the Board.

Mr. Shim Bong Sup resigned as an executive director with effect from 15th September, 2005 for personal reason. Mr. Shim remains a Vice President of Group's Chinese partner – Geely Holding Group and a senior consultant of the Group's automobile R&D centre under its associate Shanghai Maple. Mr. Shim shall focus on helping the Group to improve its R&D capabilities in sedan manufacturing.

Mr. Zhao Jie was appointed as an executive director of the company with effect from 15th September, 2005. Mr. Zhao is a founder of the Group's export operation called Geely International Corporation. Mr. Zhao's appointment reflected the Group's increasing involvement in Geely Holding Group's export businesses after the acquisition by a combined 85% stake in Geely International by the Group's two associates Zhejiang Geely and Shanghai Maple in August 2005.

Also, Mr. Nan Yang resigned as an executive director of the company with effect from 18th October, 2005 after Nan Yang resigned as the General Manager of Shanghai Maple.

# MANAGEMENT DISCUSSION & ANALYSIS

## FINANCIAL RESOURCES

The Group's cashflow comes from the operational cashflow of its 51%-owned auto parts subsidiary Zhejiang Fulin and dividend distribution from its two associates: Zhejiang Geely and Shanghai Maple. With the commencement of major investment projects including the construction of Phase II of Shanghai Maple plant, the launch of strategic new models: LG-1, FC-1 and Marindo MB, and the expansion and further upgrading of Ningbo and Luqiao plant, the Group's two associates have recently decided to significantly expand their capitals and therefore have called for additional investments from the two associates' two shareholders: Geely Holding Group and the Group. To support the tremendous growth experienced by Zhejiang Geely and Shanghai Maple and to fund the Group's capital commitments to the two associates, the Group appointed Citigroup Global Markets Limited to arrange a HK\$741.6 million five-year zero coupon convertible bond issue in March 2006. The estimated net proceeds of the convertible bond issue are approximately HK\$727 million. The proceeds are intended to be used by the Group for increasing its investments in its two associates and to raise its equity stake in its 51%-owned auto parts subsidiary Zhejiang Fulin. Assuming full conversion of the convertible bonds at the initial conversion price of HK\$0.90, the bonds will be convertible into approximately 824 million ordinary shares subject to adjustments as stipulated by the bonds' offer document, representing about 20% of the existing issued share capital of the Group.

## AUTOMOBILE PARTS MANUFACTURING – ZHEJIANG FULIN GUORUN AUTOMOBILE PARTS & COMPONENTS CO. LTD.

51%-owned Zhejiang Fulin Guorun Automobile Parts and Components Co. Ltd. ("Zhejiang Fulin") is principally engaged in the manufacturing and sales of brake slices and electric power steering for sedans. Zhejiang Fulin recorded a significant improvement in profitability in 2005 due to the full year contribution of the new Electric Power Steering ("EPS") launched in October 2004, and the strong demand for the company's braking system helped by the good sales volume growth enjoyed by Geely and Maple sedans, which utilize the company's braking and steering products. As a result, Zhejiang Fulin's turnover grew significantly by over 200% to around RMB100 m in 2005, helping the company to return to profitability during the year. Net profit amounted to approximately RMB10 m compared with a small loss in 2004. The Board believes that Zhejiang Fulin's earnings performance should continue to improve in 2006, helped by continued strong growth in sales volume projected by Zhejiang Geely and Shanghai Maple in 2006, both are major customers of Zhejiang Fulin's products.

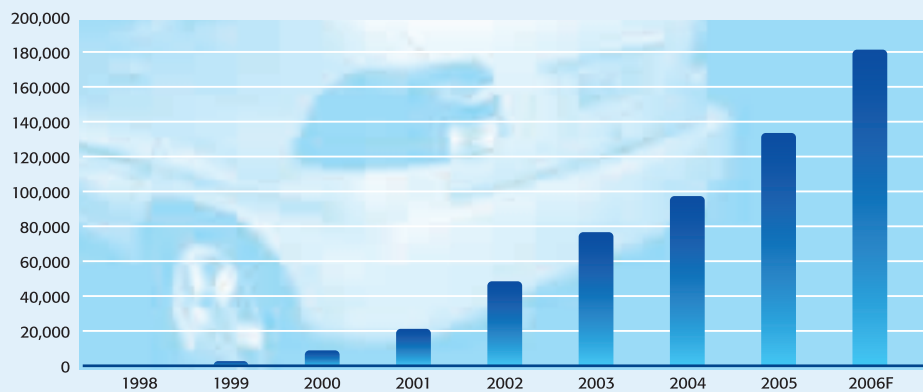


Electric Power Steering developed and made by Fulin

# MANAGEMENT DISCUSSION & ANALYSIS

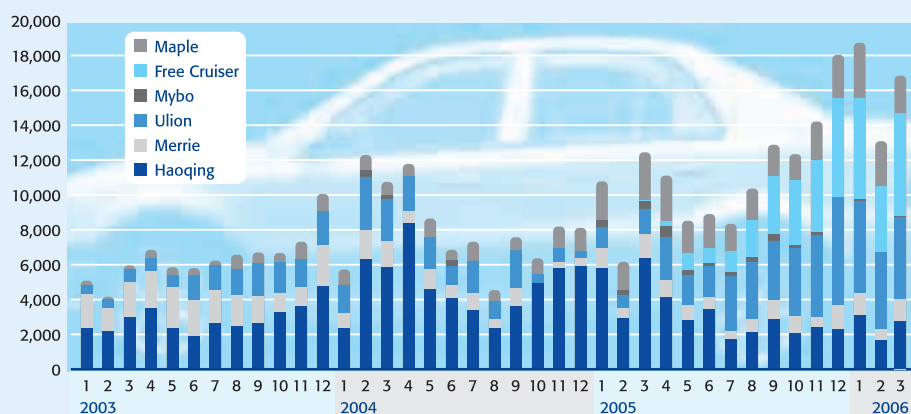
## VEHICLE MANUFACTURING – ZHEJIANG GEELY AND SHANGHAI MAPLE

Annual sales volume of Geely and Maple sedans



Source: Geely Group

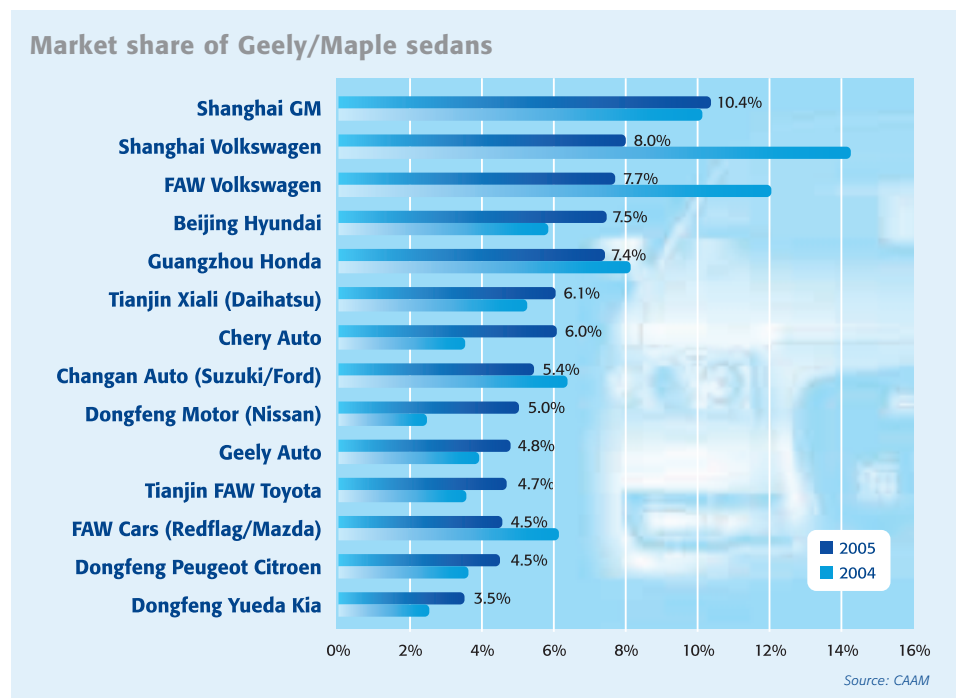
Monthly sales volume of Geely and Maple sedans



Source: Geely Group

Zhejiang Geely and Shanghai Maple, both are 46.8%-owned by the Group, are the investment holding vehicles for virtually all of Geely Holding Group's businesses in sedan manufacturing and sales in both China and overseas markets. The two companies continued to be the key earnings contributors to the Group in 2005, accounting for the bulk of the Group's earnings in 2005. The market share of Geely and Maple sedans in China's sedan market continued to increase in 2005, rising from 4.2% in 2004 to 4.8% in 2005, ranking number ten in terms of sales volume amongst sedan manufacturers in China.

# MANAGEMENT DISCUSSION & ANALYSIS

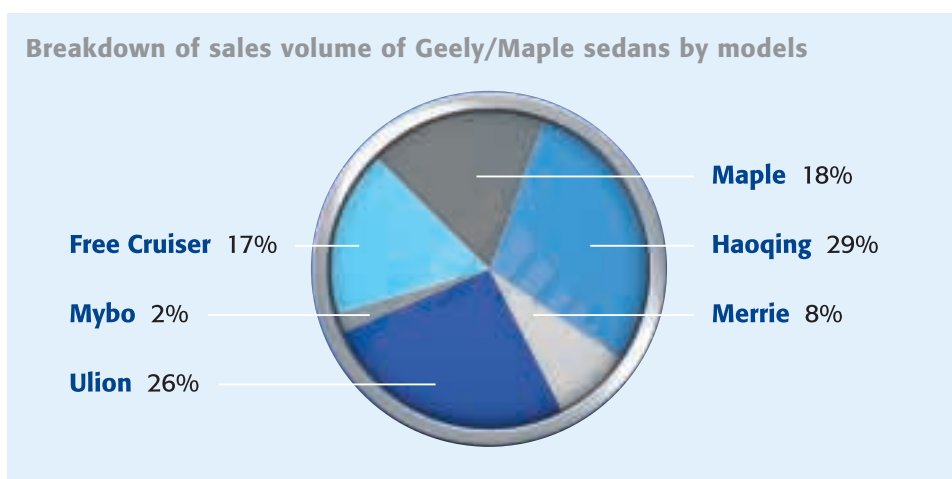


Zhejiang Geely and Shanghai Maple recorded total net profit of HK262m in 2005, up 30% over 2004, on 101% increase in sales volume to 133,041 units and 115% increase in total revenues to HK\$4,971m. Average revenues per car improved 7% to HK\$37,361 per car as increased sales of higher-priced Free Cruiser and Maple models more than offset the inclusion of low price Haoqing models since the second half of 2004.

Net profit per car, however, declined 35% to HK\$1,971 per unit as increased sales of higher profit margin models like Free Cruiser and Maple were not enough to offset the significantly lower margin in the first half of 2005 due to the inclusion of lower price Haoqing models since the second half of 2004, the closure of Ningbo plant in the first quarter 2005 for technological upgrading, the inclusion of expenses incurred by newly completed Luqiao plant, and the rapidly rising steel prices in the first quarter of 2005.

During 2005, the two associates managed to reduce the cost of outsourced automobile parts by around 7%, largely offsetting the average 30% increase in steel prices during the first quarter of 2005 and the 8-10% price cuts by some of the existing models under the Maple brand. The retail prices for other Geely and Maple models, however, remained stable during the year due to the strong recovery of demand for economy cars since early 2005.

# MANAGEMENT DISCUSSION & ANALYSIS



During 2005, the Group's two associates had embarked on a new strategy to improve its product mix to include more higher-priced and higher margin models in a bid to further enhance the two associates' profitability and alleviate the impact of a fluctuating raw material prices. This was partly achieved through the launches of a number of higher priced models including Maple Marindo series (retail prices: RMB60,000-73,000) at the end of 2004, and the Geely Free Cruiser (retail price: RMB51,800-69,800) in the 2nd quarter of 2005. As a result, the Group's dependence on the lowest priced Haoqing models (retail price: RMB33,000-45,000) declined significantly during 2005 with the Haoqing Models accounted for only 29% of the total sales volume of the two associates compared with over 50% in 2004. Despite this, although the sales volume of Haoqing model in 2005 declined 33% from previous year, it remained the best selling model of the two associates in 2005.

Sales volumes of Ulion and Mybo increased significantly during 2005 by 86% and 88% YoY respectively due to the encouraging response to their upgraded models like Ulion 1.0L sedans and newly-launched economy version of Mybo sport cars. Sales volume of Maple sedans was also boosted by the good response to 1.5L Marindo launched at the end of 2004. Despite these, the most successful model for the two associates in 2005 is undoubtedly the "Free Cruiser" – a new series of economy sedans jointly developed by Zhejiang Geely and Daewoo International of Korea. Although Free Cruiser only started mass production in mid-2005, total sales volume of the model amounted to 22,668 units in 2005. Its monthly sales volume approached 6,000 units towards the end of 2005, making it one of the best selling sedan models in China in the 4th quarter of 2005.

## PRODUCTION PLANTS

The Group's two associate companies – Zhejiang Geely and Shanghai Maple – own four production facilities in Shanghai, Ningbo, Linhai and Luqiao. The four production plants' combined annual production capacity amounted to 250,000 units of sedans, 300,000 units of engines and 200,000 units of gearboxes by the end of 2005. The four production plants are fully-integrated plants, comprising stamping, welding, painting and assembly facilities and supporting production and testing lines for engines and gearboxes.

The Group's strategy is to continue the expansion and upgrading of its four production plants to further improve quality and reduce costs. In addition, the Group also plans to build new



# MANAGEMENT DISCUSSION & ANALYSIS

production facilities at less developed provinces in China for the benefit of proximity to new demand, lower costs and access to additional financial and other resources available in other provinces. To minimize the financial burdens and the investment risks for the two associates and in order to allow the new plants to become eligible for more investment incentives offered by the respective local governments, the construction of the new plants in new locations will be initially undertaken by the Group's parent Geely Holding Group, which has agreed to transfer its interests in these new plants to the two associates at costs once mass production has started.

The Group's plan is to expand the combined annual production capacity of the four plants to over 300,000 units by end of 2006 and further to 1 million units by end of 2010. In addition to the expansion of existing plants, the capacity expansion target would be achieved through the planned acquisitions of satellite plants currently constructed by the Geely Holding Group in China's less developed areas including Lanzhou of Gansu province and Xiangtan of Hunan province. Details about the Group's four existing production plants are summarized below:

## Geely Automobile Holdings – Production Plants

名稱 Name	權益 interests	年生產能力 Annual capacity (單班) (single shift)	型號 Models
臨海廠房 (經濟型轎車) Linhai Plant (economy cars)	46.8%	100,000	優利歐Ulion JL7100X(1.0L) 美日之星Merrie HQ6360B(1.3L) 優利歐Ulion 303JL7130X3(1.3L) 豪情Haoqing HQ6360E(1.0) 豹風Leopard GT1.3L 美人豹Mybo 1.5L 美人豹Mybo AT版1.5L
路橋廠房 (特別型號) Luqiao Plant (specialized models)	46.8%	50,000	豪情Haoqing SRV(1.0-1.3L) 豪情Haoqing SRV-AT版1.5L 豪情Haoqing 303A1.0L 豪情Haoqing 3031.3L
寧波廠房 (經濟型家庭轎車) Ningbo Plant (economy family cars)	46.8%	50,000	自由艦Free Cruiser 1.3L 自由艦Free Cruiser 1.6L 自由艦Free Cruiser AT版1.5L MR479Q1.3L發動機Engines MR479QA1.5L發動機Engines JL4G18(1.8L)發動機Engines S-90手動變速器Manual Gearboxes S-110手動變速器Manual Gearboxes S-160手動變速器Manual Gearboxes S-160A手動變速器Manual Gearboxes Z130自動變速器Automatic Gearboxes
上海華普廠房 (中檔轎車) Shanghai Maple Plant (mid-end cars)	46.8%	50,000	海域Marindo MA(1.5L) 海域Marindo AA(1.3L) 海迅Hisoon AA(1.5L) 海尚Hysoul MA(1.8L) MR479Q1.3L發動機Engines MR479QA1.5L發動機Engines JL16 1.6L、JL18 1.8L發動機Engines

## MANAGEMENT DISCUSSION & ANALYSIS

Total capital expenditures by the Group's two associates amounted to approximately RMB600 million in 2005, mainly for the funding of the expansion and upgrading of Linhai and Ningbo plants, construction of new plant in Luqiao and the development of new products like "Free Cruiser". Major investment projects completed in 2005 included:

1. Upgrading of Ningbo plant to facilitate the large scale production of "Free Cruiser" model was completed in 2005. Further upgrading of production facilities at Ningbo plant had started during 2005 to prepare for the production of higher-end model "FC-1" in 2006. Major upgrading of the engine and gearbox production facilities was completed in 2005, including the completion of engine processing centre, testing lines, assembly lines for automatic gearboxes, and the completion of new engine production plants for bigger size engines.
2. The construction of the first part of Shanghai Maple plant Phase II was started in November 2005 to expand the annual production capacity from 50,000 units to 110,000 units by early 2007.
3. Trial production at the Luqiao plant was started in 2005. The Group's newest production plant is located in Luqiao of Taizhou, Zhejiang province, comprising land area of 484,533 square metres, a plant of 46,996 square meters and a second plant of 68,314 square metres, housing the production lines for stamping, welding, painting and final assembly with a designed annual production capacity of 50,000 units. The plant's initial focus was specialized models such as Haoqing's new sport recreation vehicle ("SRV") models, followed by an upgraded model of Haoqing 300 sedans called Haoqing 303. The plant will start the production of "Geely King Kong" a brand new 1.6L sedan in mid-2006.
4. The relocation of the production of Merrie and Ulion models from Ningbo plant to Linhai plant was completed in 2005, thus allowing the Group to concentrate the production of most of its sedan models under the Haoqing platform in a single plant. A small scale expansion at Linhai plant was completed by the end of 2005, lifting the annual production capacity at Linhai plant from 80,000 units to 100,000 units.
5. New R&D Centre Building in Linhai was completed and was officially put into operations on 17th June, 2005. The new R&D facilities and the R&D building in Hangzhou was completed in August 2005.



Shanghai Engine Factory



# MANAGEMENT DISCUSSION & ANALYSIS

Total budgeted capital expenditures for the two associates in 2006 amounted to approximately RMB770 million. Major investment projects planned for 2006 included:

1. Construction of Phase II of Shanghai Maple Plant. The construction of the first part of Shanghai Plant's Phase II facilities started in November 2005 and is scheduled to be completed by early 2007. Total annual production capacity would be expanded to 60,000 units. Test production is scheduled to start in March 2007. Total investment is estimated to be around RMB350 million. The overall Phase II expansion of the Shanghai plant would add a total of 200,000 unit production capacity to the Shanghai plant.
2. Expansion of Ningbo plant. Annual production capacity should be expanded from 50,000 units to 100,000 units. Engine production capacity to reach 150,000 units.
3. Expansion of Luqiao plant. Annual production capacity should be expanded from 50,000 units to 100,000 units. Engine production capacity to reach 50,000 units.
4. Upgrading of existing production facilities in Luqiao plant and Ningbo plant and the procurement of necessary equipment, machinery and moulds to prepare for the launches of Geely King Kong and Geely Tiger.

## QUALITY CONTROL

The Group's two associates have set up a quality control system in accordance with the requirements of ISO9001:2000 standards. The key focus of the Group's two associates in the area of quality control in 2006 is to prepare for the certification of the Group's major production facilities in accordance with the requirements of ISO/TS16949:2002 standards.



(from left to right)

Maple Hisoon AA 1.5L

Geely Free Cruiser

Launch ceremony of Geely Free Cruiser

# MANAGEMENT DISCUSSION & ANALYSIS



(from left to right)

LG -1

FC -1

China Dragon

## NEW PRODUCTS

Major new product launches in 2005 are summarized below:

1. Geely "Free Cruiser" 1.6L family sedans;
2. Geely "Free Cruiser" 1.3L family sedans;
3. Geely "Haoqing" SRV 1.0-1.3L Sport Recreation Vehicles;
4. Geely "Ulion" 1.0L family sedans;
5. Geely "Merrie Star" 1.3L-1.5L hatchback sedans
6. Maple "Hisoon AA" 1.5L hatchback sedans;
7. Maple "Marindo AA" 1.3L hatchback sedans;
8. Maole "Hysoul MA" 1.8L family sedans;
9. Geely JL481Q 1.8L petroleum engines;
10. Geely MR481QA 1.6L petroleum engines.

In 2006, the Group's two associates plan to launch at least ten new models, Details of the planned new product launched in 2006 follow:

1. Geely "Haoqing" 303 1.0-1.3L economy sedans;
2. Geely "Merrie" 303 family sedans;
3. Geely "Free Cruiser" 1.5L family sedans with automatic transmissions;
4. Geely "Mybo 2" 1.5L-1.8L sport cars;
5. Geely "LG-1 or Geely King Kong" 1.6L family sedans;
6. Geely "FC-1 or Geely Tiger" 1.8L mid-end sedans;
7. Maple "Hisoon AB" 1.8L hatchback sedans;
8. Maple "HuaYau Lady's Cars" 1.3L or 1.5L hatchback sedans;
9. Maple "Marindo MB" 1.5L or 1.8L mid-end sedans;
10. Geely JL-ZA series of automatic gearboxes for 1.3L-1.6L engines;
11. Geely JL4G18 all aluminium petroleum engines with VVT Technologies.

The Group also plans to start to offer right-hand drive version for some of its existing models in a bid to facilitate the sales of these vehicles to more overseas markets.

# MANAGEMENT DISCUSSION & ANALYSIS

## EXPORTS

In 2005, the company's two associates exported around 7,000 units of Geely and Maple sedans, up from 5,000 units in 2004, accounted for over 5% of the two associates' combined sales volume, to over 30 countries and regions, most of which are located in Middle East, Africa and Central America. The Group expects total exports sales volume of the two associates amount to 10,000 units in 2006.

The Group considers exports a very important part of our businesses and is allocating substantial resources to explore the export markets, including the application for product certifications in the United States and Middle East, participation in major international car shows to promote "Geely" and "Maple" sedans, and investigation for CKD manufacturing and product development outside China.

### CKD manufacturing in Malaysia.

The Group's associates Shanghai Maple entered into an agreement with Information Gateway Corporation Sdn Bhd ("IGC") on 30th May, 2005 to export Geely sedans and CKD parts and components for the CK-1, FC-1 and LG-1 models of right-hand drive sedans to IGC for sales and assembly of Geely sedans in Malaysia. Shanghai Maple will provide the technical assistance at a fee and authorize the rights to use Geely's logo and intellectual property and know-how at cost to IGC. The move marked Geely's first strategic attempt to assembly Geely sedans in overseas locations in an attempt to further expand the sales of Geely sedans in overseas markets.

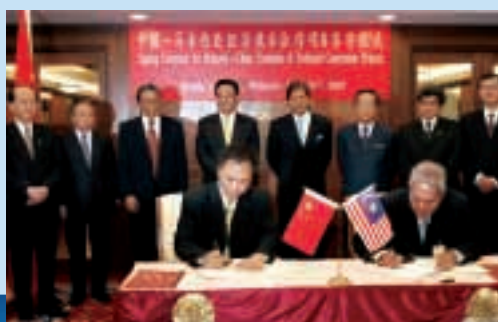
## MARKETING AND PROMOTION

To promote the "Geely" and "Maple" brands and enhance market recognition of the Group's engine and car design and manufacturing technologies, the Group's two associates participated and sponsored a number of promotional events during 2005, including:

First appearance in Frankfurt Motor Show: The Group's two associates displayed five models including: "Free Cruiser", "Haoqing 203A", "China Dragon", "FC-1" and Maple "Marindo MA" in the 2005 International Motor Show in Frankfurt in mid September 2005.



Geely sedan dealers in Syria



Signing ceremony of Malaysian CKD contracts



Geely stand in Frankfurt Motor Show

# MANAGEMENT DISCUSSION & ANALYSIS



Geely stand in Detroit Auto Show



Launch Ceremony of Asia Geely Formula Racing

First appearance in North American International Auto Show (NAIAS) in Detroit: Zhejiang Geely displayed one model – Geely 7151 CK (called “Free Cruiser” in China market) – in the most important auto show in North America in January 2006. The committee of the motor show awarded Zhejiang Geely Holding Group with a “Silver Diamond Award” for being the first Chinese auto company attending the motor show.

The Group’s associate Zhejiang Geely participated in the 2005 and 2006 China National Sports Car/Racetrack Championship. It has also become the key sponsor and sole engine supplier of First Asia Geely Formula Racing (AGF) to be started in June 2006.

The 55th Miss World 2005 final campaign in Sanya of Hainan Island: Shanghai Maple was one of the sponsors of the event held in Sanya in December 2005.

## SALES AND DISTRIBUTION

By the end of 2005, the Group’s two associates had established a comprehensive distribution and service networks in China as well as over 30 foreign countries, comprising 286 4S stores and 489 exclusive dealers for sales of Geely and Maple sedans in China and 18 distributors and 108 service centres in overseas countries. In addition, there are 569 service and maintenance spots in China for Geely and Maple sedans in China.

To cope with a much boarder product range now offered by the Group’s two associates with the retail prices of their products now spanning from RMB33,000 to close to RMB100,000, the Group and its two associates have started to pursue a more flexible distribution strategy through a more detailed segmentation of its distribution channel. The two associates’ over 800 domestic dealers are now grouped under four major brands, namely (1) Geely (including Haoqing, Merrie and Ulion), (2) Free Cruiser, (3) Mybo and (4) Maple. The dealers under each brand are tailored structured and trained to serve particular segment of customers with a specific range of models and different levels of services.

# MANAGEMENT DISCUSSION & ANALYSIS



Geely's new R&D centre in Linhai



Signing ceremony of Maple's hybrid car project



Geely's automatic gearboxes

## RESEARCH AND DEVELOPMENT

The major focus of the Group's Research and Development function includes new car model design, development of engine, gearbox, car electronic and electric components. A new R&D centre in Linhai of Zhejiang province, costing around RMB350 million, was completed in 2005. In addition to four major laboratories (Basic, Electrical, Street-Test and Multi-function), the new R&D centre also includes a high speed body design and formation workshop, which could significantly shorten the time required for new model development by up to 90%, thus allowing the Group to release new models much faster and in a more cost effective manner.

In addition to the new R&D centre in Linhai, the Group's two associates also set up a smaller R&D centre in Hangzhou, an engine and transmission system research and development centre in Ningbo, an electronic and electric R&D centre in Luqiao, and an independent research and design centre supporting new product development for Maple brand in Shanghai. In order to fully utilize the substantial R&D resources and achievements available in China's academic and semi-governmental sector, Shanghai Maple has collaborated with Shanghai Jiaotong University to set up a joint R&D centre for automobile, which is located within the plant area of Shanghai Maple plant. Shanghai Maple also cooperated with Jiaotong University and Tongji University in Shanghai on the development of hybrid technology for use on sedans. With the comprehensive R&D capabilities set up over the past few years, the Group's two associates are able to develop a minimum of 3 brand new models every year, plus conducting upgrade and facelift of their existing models on a regular basis.

The Group's two associates were invited to participate in the first "China National Exhibition of Major Achievements in Technology Innovation" in January 2006 hosted by Ministry of Science and Technology and Ministry of Finance, signifying the first official recognition by the Central Government of the Group's R&D effort and achievements in the past few years. The two associates displayed three products in the Exhibition including its Electric Power Steering ("EPS"), its JL4G18 1.8L engine and the JL automatic gearboxes.

### **Collaboration with Hong Kong Productivity Council to develop new models of high-end sedans in Hong Kong.**

In a bid to utilize more external R&D resources to support the group's longer-term development, the Group signed a Memorandum of Understanding with the Hong Kong Productivity Council ("HKPC"), an organization set up by the Hong Kong Government to promote increased productivity in Hong Kong's industry, on 21st June, 2005 to collaborate in the development of a high-end sedan and related components in Hong Kong. The new project, if successfully implemented, would provide the Group an effective way to enter into the high-end sedan market. It would also facilitate a competitive combination of Hong Kong's strength in consumer product design and development, marketing, logistics, brand management and financial market operations and Geely's competitive advantages in low cost production, manufacturing know-how in automobile and parts and valuable knowledge in distribution and marketing in China's sedan market.

# MANAGEMENT DISCUSSION & ANALYSIS

## OUTLOOK

We believe the strong growth in the demand for fuel-efficient and easy-to-maintain economy sedans in China should be sustainable in the coming decade. This is due to China's consistent economy growth and rising household incomes, and its still low car ownership with less than 1% of the population owning a car at present.

The Group and the Group's two associates will continue to focus on the operation and expansion of its automobile business, to actively seek for ways and opportunities to expand the Group's revenues and to further reduce costs, thereby to enhance the returns to the Group's shareholders.

According to the figures released by the China Association of Automobile Manufacturers, total sales volume of passenger cars in China increased by 25% to 2.9 million units in 2005. Although fierce competition in China's sedan market should remain, we expect growth of China's sedan sales volume to be maintained at around 20% in the coming few years. However, sales of lower end economy sedans should continue to grow faster than other types of vehicles in the foreseeable future due to the continued migration of demand from corporations to individuals.

With the commencement of mass production of new facilities in Luqiao in 2006, the full year contribution from "Free Cruiser" model first offered in 2nd quarter of 2005 and the scheduled launches of a number of strategically important new models in 2006, the Group's two associates expect to further increase their combined market shares from 4.8% to 5% in 2006, thus translating into total sales volume of 180,000 units, representing an YoY growth of 35%.

Looking forwards, 2006 appears to be a better year for car manufacturing industry due to a more stable raw material prices and oil prices, less pressure on prices of economy sedans, and continued strong growth in household incomes in China. Major efforts and management resources will be allocated to control the production costs of the Group's two associates and parts subsidiary Zhejiang Fulin, aiming at maintaining the Group's cost competitiveness and thus its profitability at last year's levels.

## CAPITAL STRUCTURE AND TREASURY POLICIES

The business activities of the Group are mainly financed by the share capital, dividend received from the Group's two major associates and cash generated from the operating activities. As at 31st December, 2005, the Group's shareholders' fund amounted to HK\$798 million (As at 31st December, 2004: HK\$653 million). No additional share was issued during the year.

## EXPOSURE TO FOREIGN EXCHANGE RISK

The Group considers that fluctuations in exchange rate do not impose a significant risk to the Group since the Group's operations are principally in the Mainland China and Hong Kong and all assets and liabilities are denominated either in Renminbi or Hong Kong dollars.

## LIQUIDITY AND FINANCIAL RESOURCES

As at 31st December, 2005, the Group's current ratio (current assets/current liabilities) was 1.23 (As at 31st December, 2004: 1.17) and the gearing ratio of the Group was 2.4% (As at 31st December, 2004: 1.5%) which was calculated on the Group's total borrowings to total shareholders' equity. Total borrowings as at 31st December, 2005 amounted to HK\$19 million (As at 31st December, 2004: HK\$10 million) were mainly advance from immediate holding company and amount due to a minority shareholder and they were unsecured, interest-free and repayable on demand. Should other opportunities arise requiring additional funding, the Directors believe the Group is in a good position to obtain such financing.

## EMPLOYEES' REMUNERATION POLICY

As at 31st December, 2005, the total number of employees of the Group including associates was about 7,714 (As at 31st December, 2004: 6,941). Employees' remuneration packages are based on individual experience and work profile. The packages are reviewed annually by the management who takes into account the overall performance of the working staff and market conditions. The Group also participates in the Mandatory Provident Fund Scheme in Hong Kong and state-managed retirement benefit scheme in the PRC.