

# DIRECTORS' REPORT

The Directors present their annual report together with the audited financial statements for the year ended 31st December, 2005.

## PRINCIPAL ACTIVITIES

The Company is an investment holding company. The principal activities of the Company's subsidiaries are set out in note 35 to the financial statements.

## RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31st December, 2005 are set out in the consolidated income statement on page 49.

The directors now recommend the payment of a final dividend of HK\$0.01 per share to the shareholders on the register of members on 19th May, 2006, amounting to HK\$41,203,000.

## PROPERTY, PLANT AND EQUIPMENT

Details of movements during the year in the property, plant and equipment of the Group are set out in note 14 to the financial statements.

## SHARE CAPITAL

Details of the Company's share capital are set out in note 26 to the financial statements.

## DISTRIBUTABLE RESERVES OF THE COMPANY

The amount of the Company's reserves available for distribution as at 31st December, 2005 representing the share premium, share option reserve and accumulated losses with an aggregate amount of HK\$347,660,000.

# DIRECTORS' REPORT

## DIRECTORS

The directors of the Company during the year and up to the date of this report were:

### Executive directors:

Mr. Li Shu Fu ( <i>Chairman</i> )	(appointed on 9th June, 2005)
Mr. Gui Sheng Yue ( <i>Chief Executive Officer</i> )	(appointed on 9th June, 2005)
Mr. Ang Siu Lun, Lawrence	
Mr. Xu Gang	(appointed on 9th June, 2005)
Mr. Yang Jian	(appointed on 9th June, 2005)
Mr. Yin Da Qing, Richard	(appointed on 9th June, 2005)
Mr. Liu Jin Liang	(appointed on 9th June, 2005)
Mr. Zhao Jie	(appointed on 15th September, 2005)
Mr. Shim Bong Sup	(appointed on 9th June, 2005 and resigned on 15th September, 2005)
Mr. He Xue Chu	(resigned on 21st June, 2005)
Mr. Ku Wai Kwan	(resigned on 21st June, 2005)
Mr. Zhou Teng	(resigned on 21st June, 2005)
Mr. Wong Hing Kwok	(resigned on 21st June, 2005)
Mr. Xu Xing Yao	(resigned on 21st June, 2005)
Mr. Zhang Zhe	(resigned on 21st June, 2005)
Mr. Nan Yang	(resigned on 18th October, 2005)

### Independent non-executive directors:

Mr. Lee Cheuk Yin, Dannis	
Mr. Song Lin	
Mr. Yeung Sau Hung, Alex	(appointed on 6th June, 2005)
Mr. Liu Ming Hui	(resigned on 7th March, 2005)

In accordance with Articles 99 and 116 of the Company's Articles of Association, Messrs. Ang Siu Lun, Lawrence, Zhao Jie and Yeung Sau Hung, Alex shall retire from office at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

The independent non-executive directors have no fixed term of office and will be subject to retirement by rotation and re-election at the annual general meeting of the Company in accordance with the Company's Articles of Association.

## DIRECTORS' SERVICE CONTRACTS

None of the directors, being proposed for re-election at the forthcoming annual general meeting, has a service contract with the Company or its subsidiaries which is not determinable by the Group within one year without payment of compensation, other than statutory compensation.

# DIRECTORS' REPORT

## DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN THE SECURITIES OF THE COMPANY AND ITS ASSOCIATED CORPORATIONS

As at 31st December, 2005, the interests and short positions of the directors in the securities of the Company and its associated corporations, within the meaning of Part XV of the Securities and Futures Ordinance (the "SFO"), which were required to be notified to the Company and The Stock Exchange of Hong Kong Limited (the "Stock Exchange") pursuant to Part XV of the SFO, including interests and short positions which they were deemed or taken to have under such provisions of the SFO, or which are required, pursuant to Section 352 of the SFO, to be entered in the register referred to therein, or which are required, pursuant to the Model Code for Securities Transactions by Directors of Listed Companies contained in the Rules Governing the Listing of Securities on the Stock Exchange (the "Listing Rules") to be notified to the Company and the Stock Exchange are as follows:

### (1) Long position

#### (a) Ordinary shares of HK\$0.02 each of the Company

Name of director	Capacity	Number of shares in the Company	Shareholding percentage (%)
<b>Shares</b>			
Mr. Li Shu Fu ( <i>Note 1</i> )	Corporate	2,500,087,000	60.68%
Mr. Ang Siu Lun, Lawrence	Personal	2,270,000	0.06%
<b>Share options (<i>Note 2</i>)</b>			
Mr. Ang Siu Lun, Lawrence	Personal	45,000,000	1.09%
Mr. Gui Sheng Yue	Personal	23,000,000	0.56%
Mr. Xu Gang	Personal	23,000,000	0.56%
Mr. Yang Jian	Personal	23,000,000	0.56%
Mr. Liu Jin Liang	Personal	18,000,000	0.44%
Mr. Zhao Jie	Personal	18,000,000	0.44%
Mr. Yin Da Qing, Richard	Personal	16,000,000	0.39%

*Notes:*

- (1) Proper Glory Holdings Inc. ("Proper Glory") is a private company incorporated in the British Virgin Islands and is wholly owned by Geely Group Limited ("Geely Group"). Geely Group is a private company incorporated in the British Virgin Islands and is wholly-owned by Mr. Li Shu Fu. 2,500,000,000 shares in the Company are directly held by Proper Glory and the remaining 87,000 shares in the Company are directly held by Geely Group.
- (2) These share option interests are also referred to in the section headed "Share Options" below. The percentage of holding is calculated on the basis (i) that the options are fully exercised; and (ii) the number of issued share capital of the Company when the options are exercised is the same as that at 31st December, 2005.

Save as disclosed above, as at 31st December, 2005, none of the directors or their associates had any personal, family, corporate or other interests in the shares or underlying shares of the Company or any of its associated corporations as defined in the SFO.

# DIRECTORS' REPORT

## DIRECTORS' AND CHIEF EXECUTIVES' INTERESTS AND SHORT POSITIONS IN THE SECURITIES OF THE COMPANY AND ITS ASSOCIATED CORPORATIONS *(continued)*

### (2) Short position

None of the directors, chief executives nor their associates had any interest in the short position in any shares or underlying shares of the Company or any of its associated corporations as at 31st December, 2005.

## SUBSTANTIAL SHAREHOLDERS

As at 31st December, 2005, the following persons (other than the directors or the chief executive of the Company) had interests in the shares of the Company as recorded in the register required to be kept under Section 336 of the SFO:

### Substantial Shareholders

*(as defined in the Listing Rules)*

Name	Capacity	Number of shares held		Shareholding Percentage (%)
		Long position	Short position	
Proper Glory	Beneficial owner	2,500,000,000	–	60.68
Geely Group Limited	Beneficial owner	87,000	–	0.00
	Corporate	2,500,000,000	–	60.68
Deutsche Bank Aktiengesellschaft	Corporate	230,019,000	–	5.58

Save as disclosed above, the Company had not been notified of any other person (other than the directors or the chief executive of the Company) who had an interest or a short position in the shares and underlying shares of the Company as at 31st December, 2005 as required to be recorded in the register of the Company pursuant to Section 336 of the SFO.

# DIRECTORS' REPORT

## SHARE OPTIONS

Particulars of the Company's share option scheme are set out in note 31 to the financial statements.

The following table discloses movements in the Company's share options during the year.

Name	Exercisable period	Exercise price per share <i>HK\$</i>	Outstanding at 1.1.2005	Granted during the year	Cancelled during the year	Outstanding at 31.12.2005
<b>Directors</b>						
Mr. Ang Siu Lun,	23.2.2004-22.2.2009	0.95	35,000,000	–	–	35,000,000
Lawrence	5.8.2005-4.8.2010	0.70	–	10,000,000	–	10,000,000
Mr. Gui Sheng Yue	5.8.2005-4.8.2010	0.70	–	23,000,000	–	23,000,000
Mr. Xu Gang	5.8.2005-4.8.2010	0.70	–	23,000,000	–	23,000,000
Mr. Yang Jian	5.8.2005-4.8.2010	0.70	–	23,000,000	–	23,000,000
Mr. Liu Jin Liang	5.8.2005-4.8.2010	0.70	–	18,000,000	–	18,000,000
Mr. Yin Da Qing, Richard	5.8.2005-4.8.2010	0.70	–	16,000,000	–	16,000,000
Mr. Nan Yang (resigned as director on 18th October, 2005)	5.8.2005-4.8.2010	0.70	–	15,000,000	(15,000,000)	–
Mr. Zhao Jie	5.8.2005-4.8.2010	0.70	–	18,000,000	–	18,000,000
			35,000,000	146,000,000	(15,000,000)	166,000,000
<b>Employees</b>	5.8.2005-4.8.2010	0.70	–	93,500,000	(5,000,000)	88,500,000
			35,000,000	239,500,000	(20,000,000)	254,500,000

## ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES

Other than the share options disclosed above, at no time during the year was the Company, its holding companies 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 in, or debentures of, the Company or any other body corporate.

## DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

Details of transactions between the Group and other companies under the control of Mr. Li Shu Fu during the year are set out in note 32 to the financial statements.

Save as disclosed above, no contracts of significance to which the Company, its holding companies 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 year or at any time during the year.

# DIRECTORS' REPORT

## CONNECTED TRANSACTIONS

During the year, the Group entered into certain related party transactions which also constitute connected transactions under the Listing Rules. The following is an ongoing transaction which certain connected parties and the Group has entered into and for which relevant announcement had been made by the Company in accordance with the requirements of the Listing Rules.

On 6th May, 2005, Zhejiang Fulin Guorun Automobile Parts & Components Company Limited ("Zhejiang Fulin Guorun"), a subsidiary of the Company, has entered into a supply agreement with Zhejiang Geely Automobile Company Limited ("Zhejiang Geely JV"), an associate of the Company. Prior to the entering into the supply agreement, Zhejiang Fulin Guorun has been in its usual and ordinary course of business, selling automobile parts and components on normal commercial terms to an associated company of the Company, Zhejiang Geely JV and its subsidiaries since December 2003. Mr. Li Shu Fu is the ultimate controlling shareholder of Zhejiang Geely Automobile Company Limited. Also, he has become the ultimate controlling shareholder of the Company since 19th May, 2005 and was appointed as the Chairman of the Company on 9th June, 2005. Therefore, the transactions between Zhejiang Fulin Guorun and Zhejiang Geely JV under the supply agreement would automatically constitute continuing connected transactions for the Company since 19th May, 2005. The consideration payable under the transactions pursuant to the supply agreement will be determined at arm's length negotiations between the relevant parties with reference to prevailing market price or on no more favorable terms to Zhejiang Geely JV and its subsidiaries than those offered by Zhejiang Fulin Guorun to other independent third parties.

The aforesaid continuing connected transactions have been reviewed by independent non-executive directors of the Company. The independent non-executive directors confirmed that the aforesaid connected transactions were entered into (a) in the ordinary and usual course of business of the Group; (b) either on normal commercial terms or on terms no less favourable to the Group than terms available to or from independent third parties; (c) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole; (d) had been determined to be approximately HK\$101 million which, exceeded the Annual Cap of approximately HK\$60 million for the year ended 31st December, 2005 as approved by the Stock Exchange and the Independent Shareholders.

## PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the year ended 31st December, 2005.

## PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Articles of Association, or the laws of Cayman Islands, which would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

# DIRECTORS' REPORT

## MAJOR CUSTOMERS AND SUPPLIERS

The percentage of purchases attributable to the Group's five largest suppliers and the largest supplier are 34% and 8%, respectively, of the Group's total purchases for the year.

The percentage of sales attributable to the Group's five largest customers and the largest customer are 100% and 73%, respectively, of the Group's total sales for the year. Zhejiang Haoqing Automobile Manufacturing Company Limited, a related company of Zhejiang Geely Automobile Company Limited, an associate of the Company, is the Company's largest customer.

Save as disclosed above, at no time during the year did the directors, their associates, or shareholders of the Company, which to the knowledge of the directors owns more than 5% of the Company's share capital, have an interest in any of the Group's five largest customers or suppliers.

## CORPORATE GOVERNANCE REPORT

Details of the Corporate Governance Report are set out on pages 33 to 39 of the annual report.

## EMOLUMENT POLICY

The emolument policy of the employees of the Group is set up by the human resources department of the Group on the basis of their merits, qualifications and competence.

The emolument policy of the directors of the Company are decided by the Remuneration Committee, having regard to the Company's operating results, individual duties and performance and comparable market statistics.

The Company has adopted a share option scheme as an incentive to directors and eligible employees, details of the scheme is set out in note 31 to the financial statements.

## SUFFICIENCY OF PUBLIC FLOAT

Rule 8.08 of the Listing Rules requires at least 25% of the issued share capital of the Company to be held in public hands. Based on the information available and within the knowledge of the directors as at 20th April, 2006 (the latest practicable date prior to the issue of the annual report), such obligation has been complied with.

# DIRECTORS' REPORT

## COMPETING BUSINESSES

The Group is principally engaged in the research, production, marketing and sales of sedans and related automobile components in the PRC.

During the year, Zhejiang Geely Holding Group Company Limited, which is ultimately owned by Mr. Li Shu Fu ("Mr. Li"), the Company's Chairman, and his associates, has signed agreements or been in negotiations with local governments in the PRC to set up production plants for the manufacturing and distribution of Geely sedans in four locations, namely Lanzhou, Xiangtan, Ningbo and Jinan. The potential production and distribution of Geely sedans in these four locations by Zhejiang Geely Holding Group Company Limited will constitute competing businesses (the "Competing Businesses") to those currently engaged by the Company's two associates. Mr. Li has undertaken to the Company (the "Undertaking") that upon being notified of any decision by the Company pursuant to a resolution approved by a majority of the independent non-executive Directors, he will, and will procure his associates (other than the Group) to sell to the Group all of the Competing Businesses and related assets, subject to compliance with applicable requirements of the Listing Rules and other applicable laws and regulations upon terms to be mutually agreed as fair and reasonable.

## POST BALANCE SHEET EVENT

Details of the significant event occurring after the balance sheet date are set out in note 33 to the financial statements.

## AUDITORS

A resolution will be submitted to the annual general meeting to re-appoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company.

On behalf of the Board

**Li Shu Fu**

*Chairman*

21st April, 2006