

# MANAGEMENT DISCUSSION AND ANALYSIS

## Overall Performance

The year of 2006 was again a record year for the Group in terms of both revenues and profitability. The Group's four associates Zhejiang Geely Automobile Company Limited ("Zhejiang Geely"), Shanghai Maple Guorun Automobile Company Limited ("Shanghai Maple"), Zhejiang Kingkong Automobile Company Limited ("Zhejiang Kingkong") and Zhejiang Ruhoo Automobile Company Limited ("Zhejiang Ruhoo") (collectively the "Associates") contracted a record sales of 175,635 units of vehicles in 2006, up 32% from 2005, and achieved encouraging results during the year, despite their significant investments in capacity expansion, technological upgrading, and research and development of core technologies and new products during the period. Of which, the sales of 164,495 units were recognised in the 2006 consolidated financial statements. The remarkable financial performance of the four associates had enabled the Group to report another record profitability with net profit increasing by 88% to around HK\$209 million in 2006, helped by nearly 98% increase in profit contribution from its four associates during the same period. The good results was despite additional charges including net interest expenses and revaluation deficit totaled around HK\$25 million incurred by the issue of a 5-year HK\$741.6 million zero-coupon convertible bonds due 2011 in April 2006.

The Group's turnover, which principally came from its 51%-owned auto parts subsidiary Zhejiang Fulin Guorun Automobile Parts and Components Co. Ltd. ("Zhejiang Fulin"), was up 21% to RMB127 million in 2006, mainly driven by increased sales of auto parts and components by Zhejiang Fulin to the Company's four vehicle manufacturing associates.

## 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 its corporate structure, aiming at further improving its operating efficiency and enhancing the transparency of the Group. Key events related to reorganization of the Group include:

**August 2006:** The Group's 46.8%-owned associate Zhejiang Geely and its 46.8%-owned associate Shanghai Maple proposed to increase their registered capital by way of pro rata subscription by their respective shareholders. As a result, the Group injected US\$91.88 million in cash into the two associates, which was mainly financed by the proceeds of the convertible bonds issued by the Company on 10 April 2006. After the cash injection, the Group's stakes in the two associates were maintained at 46.8%, while the total registered capital of the two associates had been increased from US\$134.5 million to US\$330.77 million to support the two associates' continuous expansion.

**August 2006:** The Group's 51%-owned subsidiary Zhejiang Fulin Guorun Automobile Parts and Components Co. Ltd. ("Zhejiang Fulin") proposed to increase its registered capital by way of pro rata subscription by their respective shareholders to support the construction of new plant and production facilities. As a result, Zhejiang Fulin's total registered capital was increased from RMB10 million to RMB20 million. The Group contributed RMB5.1 million to the fund raising exercise, maintaining its stake in Zhejiang Fulin at 51%. The capital contribution was mainly funded by the convertible bond issued in April 2006.

**December 2006:** To further simplify the structure of the Group, the Group established two new 46.8%-owned joint ventures Zhejiang Kingkong Automobile Company Limited ("Zhejiang Kingkong") and Zhejiang Ruhoo Automobile Company Limited ("Zhejiang Ruhoo") with Zhejiang Geely Holding Group Company Ltd. ("Geely Holding"), which is controlled by the Company's Chairman and major shareholder Mr. Li Shu Fu. The Group's capital contribution to the two new associates was mainly funded by dividend received from its two existing associates Zhejiang Geely and Shanghai Maple, while Geely Holding's capital contribution to the two new associates will be satisfied by the transfer to the two new associates the land, buildings and production facilities in Linhai and Luqiao of Zhejiang province.

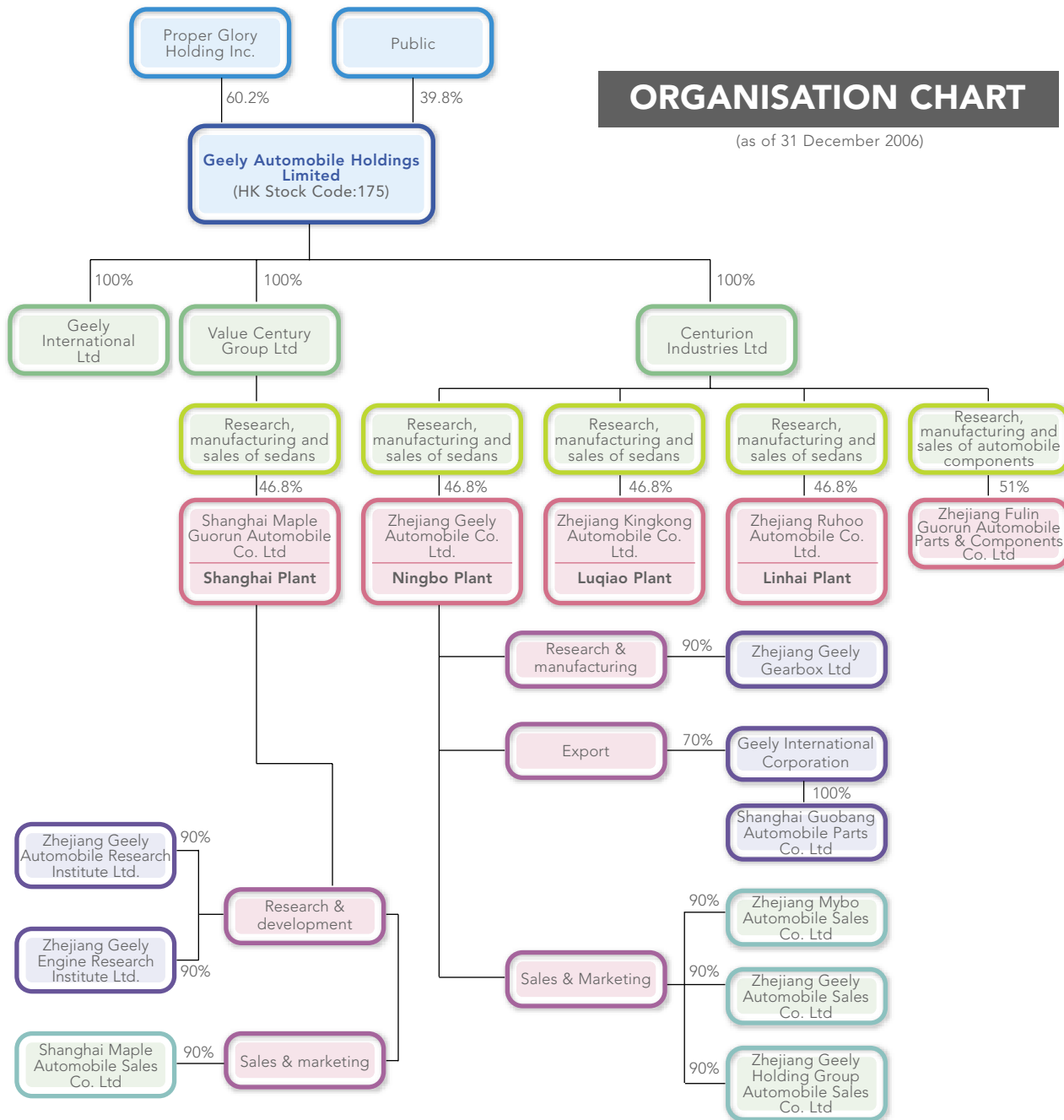
**March 2007:** To further expand the sources of earnings and the product line of the Group, the Group set up a new production joint venture, named Shanghai LTI Automobile Components Company Limited ("Shanghai LTI"), with Manganese Bronze Holdings Plc ("MBH") to manufacture the iconic London Taxies and three high-end saloon car models in Shanghai. The Group invested US\$53.8 million for a 51% stake in Shanghai LTI, plus a

23% stake or 5.7 million new shares in MBH, which in turn will own 48% stake in the joint venture. The remaining 1% stake of the joint venture will be owned by Shanghai Maple Automobile Company Limited, which is 90%-owned by Geely Holding. Total investment of Shanghai LTI is estimated to be around US\$99.5 million, which will be funded by shareholders' capital contribution and bank borrowings. The Group financed its total investment of US\$53.8 million by the proceeds from a new equity issue in February 2007.

The Group will continue to seek for ways and opportunities to further rationalize and restructure its structure, aiming at improving the its overall transparency and its effectiveness as the ultimate holding vehicle of Geely Holding's auto related businesses. To achieve that, the Group would actively consider raising its shareholdings in the four associates, which own Geely Holding's four existing sedan manufacturing facilities, to over 50% and consider acquiring the four new production facilities under construction in Xiangtan, Lanzhou, Jinan and Ningbo currently undertaken by Geely Holding, subject to government approval and compliance with relevant regulations.

# ORGANISATION CHART

(as of 31 December 2006)



### Management Team

The Group's four associates have embarked on an aggressive hiring campaign over the past year to strengthen their research and development capability and enhance their technological know-how in preparation for achieving their ambitious target of selling up to 2 million vehicles per annum and exporting two third of their output to overseas markets by 2015. The 2006 marked an outstanding year in terms of the building up of the Associates' R&D expertise with the conclusion of three important new hires of key R&D professionals:

1. Dr. Zhao Fuquan was appointed as an executive director of the Company on 17 November 2006. Dr. Zhao was also appointed as Vice President, Chief Technology Officer and Head of R&D Centre of Geely Holding, in charge of the group's technology development and exports business to mature markets like Northern America and Europe. Prior to joining Geely Holding and the Company, Dr. Zhao was the Research Executive of Technical Affairs Corporation of Daimler Chrysler and Vice President of Shenyang Brilliance Jinbei Automobile Company Limited and General Manager of its Research and Development Centre. Dr. Zhao is a regular contributor to international automobile magazines and journals, publishing 5 English books and over 100 academic dissertation papers on automobile technologies. He was awarded 2 patents in United States of America and had won many prizes and awards. His research focus is on power train technology.

2. Mr. George Chee was appointed as the Head of Shanghai Maple Research and Development Centre. Prior to joining Geely Holding, Mr. Chee was the Deputy Head of Research and Development for Chery Automobile Company Limited, focusing on car body design.
3. Mr. Liang, Henian was appointed as the Head of Research and Development for the Associates' new product line of commercial vehicles. Prior to joining Geely Holding, Mr. Liang was the Chief Engineer and Deputy General Manager of Great Wall Motor Company Limited, in charge of the Research and Development function of the company.

In addition, Mr. Peter Zhang was appointed as Vice President, Internal Control and International Business Development of the Company effective 26 February 2007. Mr. Zhang is responsible for the Group's internal control function and to assist other management team members in the development of the Group's international businesses. Prior to joining the Company, Mr. Zhang was the Group Internal Control Advisor for BP Plc (British Petroleum) in Beijing. Mr. Zhang holds a doctoral degree in Economics.

The management team of the Group's associate Shanghai Maple had also been adjusted to reflect the new focus and the new role of Shanghai Maple, being the key manufacturing arm of Geely Holding in alternate energy vehicles, high-end and specialized vehicles. Mr. Liu Jin Liang, an executive director of the Company and formerly the Head of Sales and Marketing of Geely Holding, was appointed as Chief Executive Officer of Shanghai Maple's operations, including Shanghai Maple plant and the newly set up Shanghai LTI joint venture. Mr. Liu is responsible for the overall management of Geely Holding's manufacturing facilities in Shanghai. Reporting to Mr. Liu, Mr. Yu Wei, formerly the Head of R&D Centres of Geely Holding was appointed as the General Manager of the Group's 46.8%-owned associate Shanghai Maple, assisting Mr. Liu in the overall management of the Shanghai manufacturing operation.

### Financial Resources

During the year, the Group's cashflow mainly came from dividend distribution from its four associates: Zhejiang Geely, Shanghai Maple, Zhejiang Ruhoo and Zhejiang Kingkong.

With the commencement of major investment projects including the construction of Phase II of Shanghai plant, the launch of strategic new models: "Geely Kingkong" and "Vision", and the expansion and further upgrading of Ningbo and Luqiao plants, the Group's two associates Zhejiang Geely and Shanghai Maple decided to expand their capitals in August 2006. The Group funded its capital commitments to the two associates with the proceeds of a HK\$741.6 million five-year zero coupon convertible bond issued in April 2006.

To simplify the Group's structure and to fully utilize the tax benefits offered by the Chinese government to foreign invested enterprises in China, the Group has set up two new 46.8%-owned joint ventures: Zhejiang Ruhoo and Zhejiang Kingkong with a total registered capital of RMB386.7 million to own Geely Holding's manufacturing facilities and land in Linhai and Luqiao areas. The Group's capital contribution to the two new joint-ventures amounted to RMB181 million and was financed by dividend distributed by the Group's two existing associates Zhejiang Geely and Shanghai Maple.

The Group's capital commitments to the Shanghai LTI project, which include a 51% stake in the Shanghai LTI joint-venture and a 23% stake in Manganese Bronze Holdings Plc, totaled US\$53.8 million, was funded by a top-up new equity issue in February 2007, involving the issue of 600 million new shares of the Company at HK\$1.06 per share, raising net proceeds of around HK\$609 million for the Company. The new share issue had substantially improved the Group's financial position with its net debt-to-equity ratio improving significantly from nearly 70% at the end of 2006 to around 5% immediately after the issue.

### Automobile Parts Manufacturing – Zhejiang Fulin Guorun Automobile Parts & Components Co. Ltd.

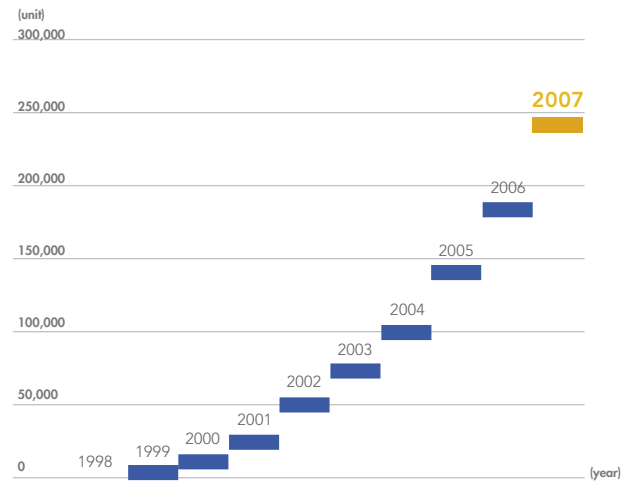
51%-owned Zhejiang Fulin Guorun Automobile Parts and Components Co. Ltd. ("Zhejiang Fulin") is principally engaged in the manufacturing and sales of brake slices and electric power steering for sedans. Zhejiang Fulin recorded a 21% growth in revenues to RMB127 million in 2006 helped by the launch of new models of electric power steering ("EPS") and new braking system

specifically designed for Geely Holding's "Free Cruiser" models. Despite significant improvement in gross margin from around 11% in 2005 to over 13% in 2006, net margin declined slightly from 9.2% in 2005 to 8.7% in 2006 due to significant increase in selling and administrative expenses as a result of the preparation work for the relocation of the plant to new facilities in 2007 and higher taxation expenses following the expiry of income tax exemption in 2006. Despite this, Zhejiang Fulin still managed to record an 14% increase in net profit to RMB11 million.

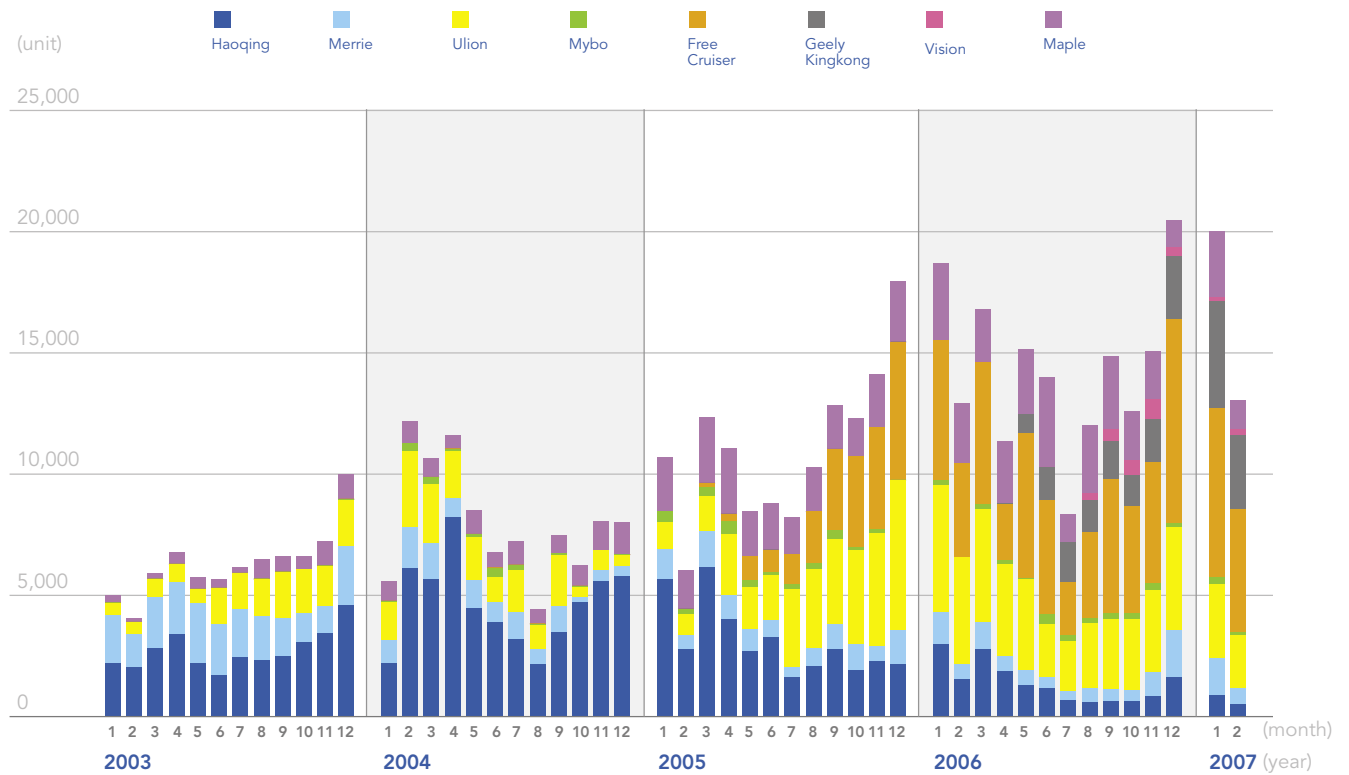
The Board believes that Zhejiang Fulin's earnings performance should improve in 2007, helped by the planned launches of new generation of EPS and braking system, mainly for use on "Geely Kingkong" and "Vision" models, and the continued strong growth in 2007 sales volume projected by the Group's four associates Zhejiang Geely, Shanaghai Maple, Zhejiang Ruhoo and Zhejiang Kingkong, which are the major customers of Zhejiang Fulin's products.

## Vehicle manufacturing – Zhejiang Geely, Shanghai Maple, Zhejiang Kingkong and Zhejiang Ruhoo

### Annual contracted sales volume of Geely and Maple sedans



Monthly contracted sales volume of Geely and Maple sedans



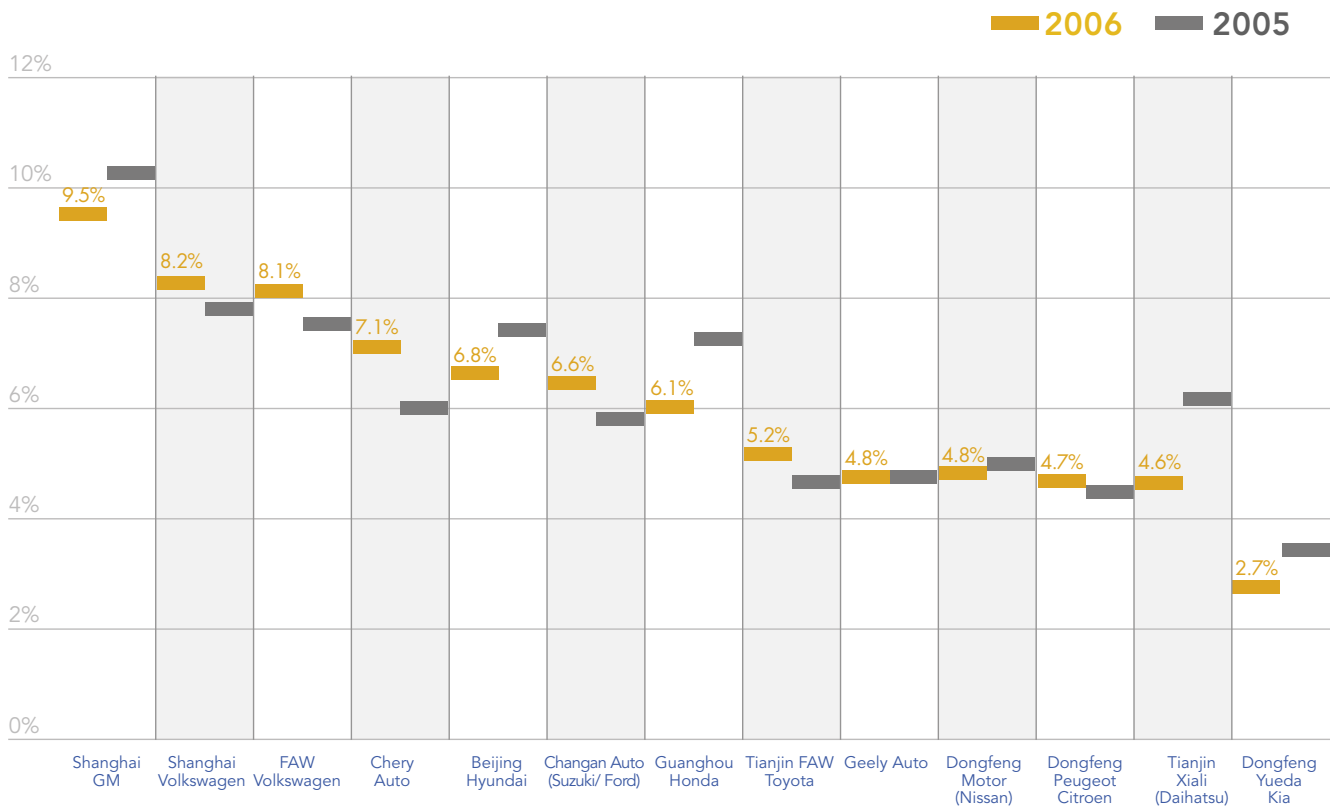
Following a restructuring completed in December 2006, Geely Holdings' auto related businesses were grouped under four associates of the Group: Zhejiang Geely, Shanghai Maple, Zhejiang Ruhoo and Zhejiang Kingkong with each company owning production facilities in

different location, including: Zhejiang Geely in Ningbo, Shanghai Maple in Shanghai, Zhejiang Ruhoo in Linhai and Zhejiang Kingkong in Luqiao. All the four companies are 46.8%-owned by the Group and 53.2%-owned by Geely Holding.

The vehicle manufacturing businesses under the four associates continued to be the key earnings contributors to the Group in 2006, accounting for the bulk of the Group's earnings in the year. The market share of Geely and Maple sedans in China's sedan market reached 4.6% in 2006, ranking number nine in terms of sales volume amongst sedan manufacturers in China.

**Market share of Geely and Maple sedans**

The Group's four sedan manufacturing associates: Zhejiang Geely, Shanghai Maple, Zhejiang Ruhoo and Zhejiang Kingkong recorded total net profit of nearly HK\$520 million in 2006, up 98% over 2005, on 33% increase in total revenues to HK\$6,589 million. Average revenues per car increased 7% to HK\$40,055 per car as improved product mix towards higher priced models during the year more than offset a number of price cuts since 2Q 2006 in response to aggressive price competition from other major sedan manufacturers in China during the period.



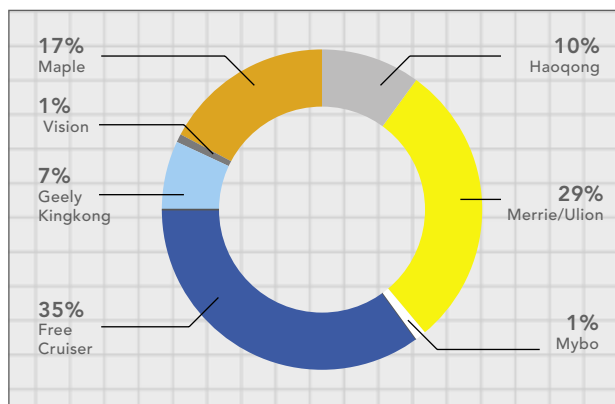
Source: China Association of Automobile Manufacturers



Gross margin, however, increased from 14.2% to 15.6% helped by 5% reduction in the cost of outsourced parts, the reduction of sales tax rates on sedans with engine size ranging from 1.0L to 1.5L and the success in cutting costs. Net profit per car increased significantly by 60% to HK\$3,159 per unit due to the Associates' success in controlling distribution and selling expenses, reduction in finance charges, and lower effective tax rates due to restructuring and better tax planning.

During 2006, the four associates managed to reduce the cost of outsourced automobile parts by around 5%, partly offsetting the average 5-10% cut in the retail prices of their products. The retail prices for most Geely and Maple sedan models, experienced relatively large pressure during the year due to aggressive price competition from other car manufacturers in China.

**Breakdown of 2006 contracted sales volume of Geely and Maple sedans by models**



During 2006, the Group's four associates continued to expand their product lines towards higher-priced and higher margin models in a bid to further enhance the four associates' profitability and to alleviate the impact of a fluctuating raw material prices. Longer-term, the strategy should also help to further reduce the associates' technology gap with major international automobile companies and to enhance Geely's brand image in both the domestic and export markets. The objective was partly achieved in 2006 through the launches of a number of higher priced models including "Geely Kingkong" sedans in mid 2006, and "Vision" mid-end sedans towards the end of 2006. As a result, the associates' dependence on the lower priced models declined further during 2006 with higher-priced models now accounting for nearly 40% of total contracted sales volume compared with less than 20% in 2005. "Free Cruiser", which was first launched in 2005, had overtook "Haoqing" model as the best selling models of the four associates in 2006, accounting for over one third of the total contracted sales volume of the four associates during the year.

During the year, contracted sales volumes of "Ulion" and "Maple" sedan also recorded healthy growth with their sales volume increasing by 23% and 18% YoY respectively despite fierce competition in the economy sedan market in China. Despite this, the most successful model for the four associates in 2006 remained the "Free Cruiser", a new series of economy sedans jointly developed by Zhejiang Geely and Daewoo International of Korea, first launched in mid 2005. Although "Free Cruiser" only started mass production in mid-2005, total contracted sales volume of the model amounted to 22,668 units in 2005 and further increased to 60,663 units in 2006,

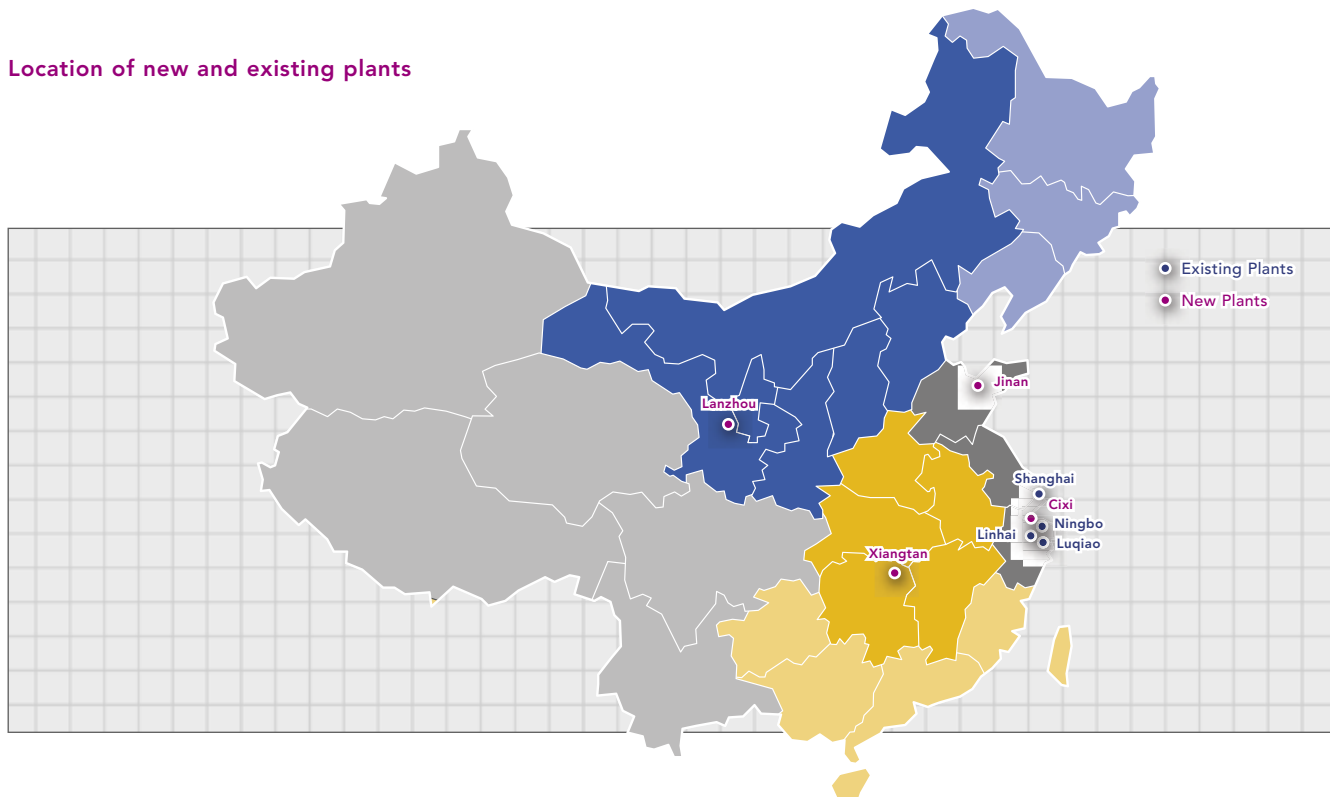
surpassing the low-end Haoqing model to become the best selling models of the four associates in 2006. Its monthly contracted sales volume reached 8,403 units in December 2006, making it one of the best selling economy sedan models in China in 2006.

### Production Plants

The Group's four associates Zhejiang Geely, Shanghai Maple, Zhejiang Ruhoo and Zhejiang Kingkong own four production facilities in Shanghai, Ningbo, Linhai and Luqiao. The four production plants' combined annual production capacity amounted to 200,000 units of sedans, 200,000 units of engines and 200,000 units of gearboxes based on a single shift basis by the end of 2006. The four production plants are fully-integrated plants, comprising stamping, welding, painting and assembly facilities, and supporting production lines for engines and gearboxes.

The Associate'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 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 of the four 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 Associates' parent Geely Holding, which has agreed to transfer its interests in these new plants to the Group when mass production started.

### Location of new and existing plants



The Associate's plan is to expand their combined annual production capacity to over 300,000 units by end of 2007 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 construction of satellite plants in China's less

developed areas including Lanzhou of Gansu province and Xiangtan of Hunan province, and the setting up of SKD/CKD assembly arrangements with local partners in overseas countries. Details about the Associates' existing production plants are summarized below:

#### Existing Production Plants of the Associates

Name	Interests	Annual capacity (single shift)	Models
Linhai Plant	46.8%	50,000	Haoqing (1.0L, 1.05L, 1.3L) Ulion (1.0L, 1.05L, 1.3L) Merrie (1.0L, 1.05L, 1.3L) GT (1.3L) Mybo (1.5L, 1.8L)
Luqiao Plant	46.8%	50,000	Geely Kingkong (1.5L, 1.6L)
Ningbo Plant	46.8%	50,000	Free Cruiser (1.3L, 1.5L, 1.6L) Vision (1.8L) Engines (1.5L, 1.6L, 1.8L) Manual gearboxes Automatic gearboxes
Shanghai Plant	46.8%	50,000	Shanghai Maple: Marindo (1.3L, 1.5L, 1.8L) Hysoul (1.5L, 1.8L) Hysoon (1.5L, 1.8L) Hyshire (1.5L) Engines (1.5L, 1.8L) Planned-Shanghai LTI: London Taxi TX4 Limousines and saloon cars



Total capital expenditures by the Group's four associates amounted to over RMB500 million in 2006, mainly for the funding of the expansion and upgrading of Shanghai and Ningbo plants, and the development of new products like "Geely Kingkong" and "Vision". The capital expenditures were mainly funded by the capital increase at Zhejiang Geely and Shanghai Maple in 2006, bank borrowings by the two associates during the year and the associates' operational cashflow. Major investment projects completed in 2006 included:

1. Upgrading of Ningbo plant to facilitate the large scale production of "Vision" mid-end sedan model was completed in mid-2006.
2. The construction of factory buildings of Shanghai plant Phase II. The construction was completed in mid 2006 to expand the annual production capacity of the Shanghai plant from 50,000 units

to 150,000 units. After installation of equipment, the Phase II plant could start production within 2007.

3. The technological upgrading and expansion of Shanghai Maple engine plant to increase production capacity to 100,000 units per annum.

Total capital expenditures at the Group level in 2006 amounted to HK\$6 million, being the capital expenditure by the Group's 51%-owned subsidiary Zhejiang Fulin for the construction of a new plant to house its production facilities which will be relocated from the existing plant rented from a connected party to a new plant in mid 2007. To fund the construction of the new plant, Zhejiang Fulin expanded its registered capital from RMB10 million to RMB 20 million in 2006. The Group had made its capital contribution of HK\$5.1 million using part of the proceeds from the convertible bond issued in April 2006.

Total budgeted capital expenditures for the four associates in 2007 amounted to approximately RMB500 million, which will mainly be financed by the capital expansion by Zhejiang Geely and Shanghai Maple in 2006. Major investment projects planned for 2007 include:

1. The final phase of construction of the Phase II of Shanghai Plant. The construction of Shanghai Plant's Phase II facilities started in November 2005 and was completed in mid 2006. Total annual production capacity would be 60,000 units, expandable to 100,000 units. Test production is scheduled to start in March 2007. Total investment is estimated to be around RMB350 million.
2. The construction of ECVT transmission plant in Luqiao is scheduled to be completed by end of 2007.

On the Group front, major capital investment in 2007 should be the construction of the production facilities for the Group's planned 51%-owned joint venture Shanghai LTI in Shanghai. Total investment at Shanghai LTI is estimated to be HK\$774.8 million. The initial construction of the facilities will be funded by the initial capital contribution by its shareholders totaled HK\$422.81 million. The remaining investment will be funded by either bank borrowings or operational cashflow generated by the joint-venture.

To reduce the amount of the initial investment and thus investment risk of Shanghai LTI and to allow Shanghai LTI to start production as quickly as possible, Shanghai LTI plans to lease existing plant and facilities from Shanghai Maple. To facilitate the production at Shanghai LTI and to utilize its production capacity more efficiently, Shanghai Maple plans to gradually relocate its production of the Maple sedans to Phase II of the Shanghai Plant and make available the existing Phase I plant for lease to Shanghai LTI before the end of 2007.

In an undertaking agreed between Geely Holding, which is ultimately controlled by the Company's Chairman Mr. Li Shu Fu, and the Company, Geely Holding has undertaken to sell to the Company all its interests in the four new production plants to avoid engaging in competing businesses with the Company, subject to compliance with applicable requirements of the Listing Rules and applicable laws and regulations upon terms to be mutually agreed as fair and reasonable, and at time determined and agreed by the majority of the Company's independent non-executive Directors. The four plants are currently constructed by Geely Holding for the manufacturing and distribution of Geely sedans in four locations.

Two of the four new plants under construction by Geely Holding

Name	% owned by Geely Holding	Models	Production Capacity (units per annum)	Status
Xiangtan Plant, Hunan	100%	Geely Kingkong	50,000 (Phase I) 50,000 (Phase II) Total: 100,000	Trial production: Dec 2006 Mass production: Mid 2007
Lanzhou Plant, Gansu	100%	Free Cruiser	50,000 (Phase I) 50,000 (Phase II) Total: 100,000	Trial production: Feb 2007 Mass production: 2H 2007

Quality Control

The Group’s four associates have set up a quality control system satisfying the ISO9000 quality certifications. The key focus of the Group’s four associates in the area of quality control in 2007 is to prepare for the certification of their major production facilities in accordance with the requirements of ISO/TS16949:2002 standards. In addition, to prepare for large scale exports in the coming years, the Group’s four associates have started the certifications of their products to satisfy different standards around the World including ECE of Europe, DOT and EPA in the United States.

The Group’s four associates currently produce and sell over 30 models of sedans, equipped with 8 series of engines and gearboxes. All their products have passed the Chinese Government’s “3C” (China Compulsory Certifications) certifications and the Euro III emission standards, which are now required in most of the areas in China.

Given the critical importance of the quality of outsourced parts to the final quality and reliability of the sedans manufactured by the Group’s associates, the four associates have implemented a new parts procurement and supplier policy in 2007, calling for significant bigger R&D investments by their suppliers so that the parts suppliers could catch up with the increasingly more stringent quality requirements adopted by the four associates. The associates have also implemented a new pricing policy, adopting variable prices for auto parts depending on the historic quality standards achieved by each supplier, largely determined by the historical claim rates of their products. An exit mechanism has been set up to eliminate unqualified suppliers from the list of designated suppliers of the four associates.

**New Products**

Major new product launches by the Associates in 2006 are summarized below:

1. Geely JL-ZA series of automatic gearboxes for 1.5L engines;
2. Geely JL4G18 1.8L all aluminium petroleum engines with VVT technologies;
3. Geely "Free Cruiser" 1.5L family sedans with AT transmission;
4. "Geely Kingkong" 1.5L and 1.6L sedans;
5. Geely "Vision" 1.8L mid-end sedans;
6. Geely "Mybo II Leading" 1.8L sport sedans;
7. Maple "Hyshine AA" 1.5L family sedans;
8. Maple "Hysoon AB" 1.5L, 1.8L sport sedans.

The Group's four associates also started to manufacture right-hand drive version for both "Free Cruiser" and "Geely Kingkong" in 2006, for exports. A small number of Geely right hand sedans were exported to a number

of Asian countries, including Singapore, Pakistan and Bangladesh in 2006.

In 2007, the Group's four associates plan to launch eight new models, Details of the planned new product launches in 2007 follow:

1. Geely "Haoqing", "Haoqing SRV" 2007 facelift;
2. Geely "Merrie Star", "Ulion" 2007 facelift;
3. Geely "Free Cruiser II" economy sedans;
4. Geely "Mybo III" (China Dragon) sport sedans;
5. "Geely Kingkong" Hatchback sedans;
6. Maple "Marindo MB" 1.5L, 1.8L mid-end family sedans;
7. Maple "Hysoon MA" 1.5L, 1.8L sport sedans;
8. A new platform of Maple mid-end sedans.





Longer-terms, the Associates' product development focus called for the development of fifteen brand new models, eight new engines, six types of new manual transmission, six types of new automatic transmission, three types of ECVT (Electronically controlled Continuously Variable Transmission) and one hybrid project by 2010.

### Exports

In 2006, the Group's four associates exported about 10,000 units of Geely and Maple sedans, up from 7,000 units in 2005, accounted for over 5% of the four associates' combined contracted sales volume and over 10% of China's total sedan export volume during the year. The four associates' products were sold to over 40 countries and regions, most of which are located in Middle East, Africa and Central America. By the end of 2006, the four associates have set up 26 sales agents and 128 sales and maintenance spots in overseas markets. The Group expects total exports sales volume of the four associates to double to 20,000 units in 2007.

The Group and the Associates consider exports a very important part of their businesses and has set an ambitious target of exporting two third of their output to overseas countries by 2015. To achieve this, the Associates have allocated substantial resources to explore the export markets, including:

1. Development of brand new models tailored to major overseas markets' regulatory requirements and consumer needs;
2. Application for product certifications in the United States and Europe;



3. Construction of dedicated manufacturing plants for export models;
4. Participation in major international car shows to promote "Geely" and "Maple" sedans;
5. Investigation and negotiation with local partners to set up SKD/CKD manufacturing arrangement outside China.

In 2006, the Associates were amongst the first to be awarded the status of "State Designated Automobile and Auto Parts Export Base Enterprises" by the Ministry of Commerce, reflecting the Associates' leading position in motor vehicle exports.

**SKD/CKD Manufacturing in Overseas Countries.** 2007 will be a ground-breaking year for the Associates' export businesses, when their cooperations with local partners to assembly Geely sedans in Indonesia and Russia are scheduled to commence operation during the year. Both arrangements will call for the eventual assembly of 30,000 units of Geely sedans in each location. The SKD manufacturing arrangement in Indonesia is scheduled to start before mid-2007 and should mainly supply to the South East Asian market as well as other right-hand drive vehicle markets. The Associates' local partners in the Indonesia project include Information Gateway Corporation Sdn Bhd ("IGC") of Malaysia and Astra Automotive Group of Indonesia. While the Associates' partner in Russia is Ural Automobiles & Motors ("AMUR"). The SKD manufacturing arrangement in Russia calls for the assembly of up to 30,000 units of Geely sedans in Ural Automobiles' plant in Russia. The project is scheduled to start in 2H 2007 and shall mainly supply to the Eastern Europe markets such as Russia and Ukraine.

Similar SKD manufacturing arrangements are under the Associates' negotiations with local partners in several countries in Europe, Northern America and Africa to facilitate the sales of Geely sedans to these markets in the future.

### Marketing and Promotions

To promote the "Geely" and "Maple" brands and enhance market recognition of the Associates' engine and car design and manufacturing technologies, the Group's four associates participated and sponsored a number of promotional events during 2006, including:

- First appearance in 2006 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 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 2006 China National Sports Car/Racetrack Championship ("CCC"). It has also become the key sponsor and sole engine supplier of the first Asia Geely Formula Racing ("AGF") started in October 2006. Two AGF races were held in 2006 in Beijing and Zhuhai with a total of 9 sponsored teams comprising 18 cars participating in the races.
- The Group's four associates attracted significant attention and gained enormous publicity in the 2006 Beijing Auto Show by taking an innovative approach of setting up a permanent display hall in the Beijing Geely University for the display of Geely sedans exclusively.



In October 2006, Geely brand and trademark logo was awarded the status of "Famous Brand in China" by the State Industry and Commerce Bureau. Despite this, the Associates decided to adopt a new trademark logo for Geely sedans to reflect the rapid development of the Group and the Associates over the past few years and the significant changes in the Associates' targeted market and product lineups. The Associates launched a worldwide campaign, seeking for a new design for Geely sedans' trademark logo in January 2007.



### Sales and Distribution

By the end of 2006, the Group's four associates had established a comprehensive distribution and service networks in China and foreign countries, comprising 400 4S independent franchisee stores and 600 independent service stations in China, and 26 agents and 128 sales and service spots in 40 foreign countries.

To cope with an increasingly competitive market in China, characterized by fierce price competition and flurry of new sedan models, the Group's four associates



have adopted a more pro-active approach towards the management and supervision of their distribution and service networks in China, aiming at further improving customer satisfactions, rationalization of distribution network and improving market coverage. In August 2006, a 24-hour national customer call centre was set up to enhance the communications with the customers. Continuous restructuring of the dealers' network has significantly improved the image of Geely brand and provided much better incentives for the Geely dealers. As a result, Geely sedans were awarded the best improving sedan brand in terms of customers' satisfaction based on a J. D. Power survey in 2006.

In 2007, the Group's four associates will devote additional resources to further improve service quality with particular focus on achieving even better customers' satisfaction. Key measures to be implemented in 2007 include: the setting up of additional spare parts distribution centres in different parts of China to enhance the supply of spare parts to customers, and the addition of more spare parts distribution and supply channels.

On the distribution front, more effort will be devoted to the development of second and third tier cities in China



in order to achieve better market coverage and thus higher market shares for Geely sedans.

### Research and Development

The major focus of the Associates' Research and Development function includes new car model design, development of engine, gearbox, electronic and electric components. With its extensive investment in research and development, the Associates' R&D team is capable of launching two to three brand new models every year, reflecting their leading position in R&D and technology innovation capabilities in China's automobile sector.

In 2006, the Associates initiated and started a record number of new research and development projects, thus paving way for sustained growth and further improvement in the Group and the Associates' competitiveness over the coming years. In addition to the development of new vehicle models, the Associates' R&D focus also include emission control, quality certifications, collision test, automobile electronics, vibration control, noise reduction, weight reduction, and alternate power like hybrid and ethanol.

To further improve the Associates' technological advantages, a restructuring of their R&D function was implemented in early 2007, aiming to further streamline the Associates' R&D organizations through centralization of management, resources allocation and project planning, and through division of responsibilities and assignment of focuses amongst different R&D organizations. Dr. Zhao Fuquan was appointed to take up the post of Chief Technology Officer to look after the overall planning and management of the Associates' R&D capability.

In addition to the R&D centre in Linhai of Zhejiang province, which is the key location for new model design and the Associates' major testing centre, the Associates have set up several R&D centres in different locations: including a R&D centre in Shanghai focusing on new energy, green and clean fuels, hybrid and electric power and the design and development of classic vehicles, and a R&D centre in Ningbo emphasizing on power train development and research. A new R&D centre in Luqiao has started construction and will house the Associates' R&D capability in the development of automobile electronic and electrical components. In addition, the Associates have set up a new internet-based portal for



attracting auto-related innovation achievements from individuals and independent research institutes and engineering companies all over the world.

In 2006, the Associates' most important R&D achievements included the "JL4G18 VVT engines" and "JL-ZA series of automatic gearboxes". The JL4G18 VVT engines have been installed in the Zhejiang Geely's newest model "Vision" and have become the only engines used in the formula racing cars used by Asian Geely Formula Racing Champion. The JL-ZA series of automatic gearboxes was awarded the only Class 1 Prize in Technology Advancement in the auto industry by the Ministry of Science and Technology in 2006.

In addition to building up the Associates' own R&D capability, the Associates have also actively explored opportunities to cooperate with foreign technology partners to shorten development cycle and reduce development costs. In November 2006, the Company signed a Joint-Venture and Technology Transfer agreement with Manganese Bronze Holdings Plc of the United Kingdom to jointly develop a new taxi vehicle and high-end limousine saloons for both domestic and overseas markets. To prepare for the Group's imminent entry into the high-end and larger vehicle market, the Group's associate Zhejiang Geely signed a production licensing agreement with Antonov Plc, an independent engineering company focusing on transmission technology and design, to develop, manufacture and sell "TX-6" six-speed automatic transmission in China.

By the end of 2006, the number of the Associates' R&D staff exceeded 1,500 peoples, representing around 16% of the total number of staff of the Group and the Associates, reflecting the Associates' emphasis on R&D capabilities.

**Outlook**

We believe there are substantial growth potential for car demand in China in the coming decade, due to China's consistent economy growth, its rising household incomes, and its still low car ownership with only 1% of the population owning a sedan at present.

The Group and the Associates will continue to focus on the operation and expansion of their automobile business, to actively seek for ways and opportunities to expand their 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 37% to 3.8 million units in 2006, surpassing most market expectations. 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.

With the successful launches of the "Geely Kingkong" and "Vision" sedans, JL-ZA series of automatic gearboxes, and JL4G18 VVT engines - considered the Associates' most strategically important new product launches in their history - in 2006, and the significant efforts spent in the exploration of export markets, the Group's associates are well positioned to further increase their combined market shares from 4.6% to 5% in 2007, thus translating into total contracted sales volume of 240,000 units, representing an YoY growth of 37%.



In the short to medium term, the Group will continue to actively seek for ways and opportunities to further rationalize and restructure the Group's structure, aiming at improving the Group's overall transparency and its effectiveness as the ultimate holding vehicle of Geely Holding's auto related businesses. To achieve that, the Group would actively consider raising its shareholdings in the Associates to over 50% subject to government approval and compliance with relevant regulations.

With the significant investment and effort spent by the Associates in production development and capacity expansion over the past few years, the improved production facilities and more comprehensive product lines, the Board believes that the Group's profitability and its shareholders' returns should continue to improve in the coming years.

### 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 proceeds of the convertible bonds issued by the Company on 10 April 2006. As at 31 December 2006, the Group's equity holders fund amounted to HK\$1,030 million (As at 31 December 2005: HK\$798 million). Apart from the shares issued upon conversion of convertible bonds, 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 31 December 2006, the Group's current ratio (current assets/current liabilities) was 1.24 (As at 31 December 2005: 1.23) and the gearing ratio of the Group was 69.5% (As at 31 December 2005: 2.4%) which was calculated on the Group's total borrowings to total shareholders' equity. Total borrowings (excluding the embedded derivatives of the Company's convertible bonds and trade and other payables) as at 31 December 2006 amounted to approximately HK\$716 million (As at 31 December 2005: approximately HK\$19 million) were mainly the Company's convertible bonds, bank borrowings and the amount due to immediate holding company. For the Company's convertible bonds, they were unsecured, interest-bearing and repaid on maturity. For the bank borrowings, they were secured by notes receivables, interest-bearing and repaid on maturity. While for the amount due to immediate holding company, it was 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 31 December 2006, the total number of employees of the Group including associates was about 9,498 (As at 31 December 2005: 7,714). 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.