

# Management Discussion and Analysis

## OVERVIEW

Confronting with the challenges brought by the SARS epidemic in the first half of 2003, Zhongda International has taken proactive steps to seize business opportunities, and strengthened its existing customer base and market share, thereby achieving satisfactory results in the year. The encouraging result reflected the success of the Group's direct business relationship with large-scale automobile manufacturers and its focused marketing strategy. Besides, since the sales performance of the Group's automobile business is outstanding and strict cost control measures are implemented, the Group's turnover and profit attributable to shareholders for the year amounted to approximately RMB228,000,000 and RMB11,000,000 respectively, representing an increase of approximately 31% and 144% when compared with last year. The gross margin maintained at the level of approximately 30%, while net profit margin increased by approximately 2.3% over last year. As at 31st December, 2003, the Group had commitments to capital expenditure in respect of the acquisition of land use right and construction property, plant and equipment for production purposes amounted to approximately RMB19,800,000 (2002: RMB54,200,000). It is expected that the amount will be financed by internal funding.

For the year ended 31st December, 2003, the basic earnings per share of the Group are RMB0.029 (2002 (as restated): RMB0.012).

In 2003, the automobile lacquer rooms, wheel aligners for automobiles and specialized automobile modeling equipment of the Group were named as Torch Plan projects of Jiangsu Province and the Group was selected as one of the top 500 companies in the global automobile servicing industry and accredited as an outstanding enterprise in the PRC.

## BUSINESS REVIEW

### Automobile Maintenance Equipment Business

Despite the difficulties brought by the SARS epidemic, the economic growth in the PRC continues and the government encourages investments in the automobile industry, which fuels the rapid growth of the industry in the PRC, and stimulates the demand for the automobile repair, maintenance and inspection equipment. During the year, the sales of automobiles increased by 40% while highway length increased by 26% to 25,000 km, contributing to the favourable sales performance of the Group's automobile maintenance equipment business.

At present, the Chinese automobile maintenance market has been transformed from a free market operation to planned development led by major automobile plants. In response to the market changes, Zhongda International adopts corresponding measures and proactively establishes close partnership with major automobile manufacturers such as Shanghai Volkswagen, 中華車廠, Japan Honda, Benz, General Motors and Ford and provides value-added services like after sales and technical support services. Benefiting from the fad of private car purchase in the PRC, the strategic marketing activities and the implementation of e-commerce, the turnover of the year set another new record.

## Management Discussion and Analysis

### **BUSINESS REVIEW** (continued)

#### **Automobile Maintenance Equipment Business** (continued)

The sales of the Group's major products lacquer rooms, lifters and body repairing machine in 2003 were approximately RMB110,000,000, RMB38,000,000 and RMB15,000,000 respectively, representing an increase of approximately 25%, 40% and 39%. The sales of such products accounted for approximately 49%, 17% and 7% of the Group's turnover respectively. The overall sales performance of all the products are satisfactory and the gross margin is generally maintained at a level between 25% and 35%. In order to meet the increasing market demand, the annual production capacity of lifters increased to 3,000 pieces during the year.

As for the industrial surface treatment production (painting and coating) line, when compared with last year, the turnover significantly increased to RMB56,000,000. This is attributable to the increased marketing efforts, the establishment of a close relationship with its customers, the improvement of the management and production procedures and strict control on cost and expenditure.

The Group's marketing efforts were focused in identifying new clients in UK, Ireland, Canada, Pakistan and Iran. The Group also actively established trading relationship with its overseas agents, and engaged 3 US companies and 1 Australian company as the agents of the products of Zhongda International in US and Australia respectively. This arrangement was crucial for the expansion of Group's export business and enabled the Group to achieve a higher cost efficiency.

Apart from lacquer rooms and lifters, the Group also exports other automobile maintenance equipment such as automatic tyre changer, wheel balancer and paint mixing machine, the Group's lacquer rooms have obtained the CE international certification, which shows that the products of Zhongda International have been accepted and recognized in the international market and that the quality of its products has reached international standard.

As for the new projects, the Group's 3 investment projects in the Yancheng Economic Development Zone of Jiangsu Province in the PRC include the production lines for painting and coating, the production line for car wash system and a line for the production of export-oriented lacquer rooms or automobile lifters. The construction of the related production plants which occupies an area of 60,000m<sup>2</sup> was completed in early 2004, the investment in the construction of the plant amounted to RMB60,000,000. Equipment and fixtures are now installed in the plant and it is anticipated that the plant will commence production in the middle of 2004. The annual production capacity of the production line for car washing system is expected to reach 500 pieces and the Group has already received preliminary bulk orders of about 150 pieces main for business catering for the Beijing Olympic Games. The Board of Directors believe that the new projects can further increase the production capacity and sales of the Group.

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### **BUSINESS REVIEW** (continued)

#### **Diversification of Business – Automobile Manufacturing Business**

After the end of the year, the Group has agreed to establish a joint-venture with Jiangsu Jinling Transportation Group Limited to manufacture and sell buses for running in major cities in the PRC. This helps develop the high-potential automobile market and reinforce the Group's leading position in the automobile maintenance equipment market in the PRC. Supported by the recovery of the passenger transportation market and the formation of an urban public transportation market, and capturing the business opportunities brought by the World Expo in Shanghai and the Olympic Games in Beijing, it is expected that the sales of passenger cars will grow rapidly.

### **LIQUIDITY AND FINANCIAL RESOURCES**

As at 31st December, 2003, the Group's total assets amounted to RMB317,491,000, represented an increase of RMB55,906,000 (2002 restated: RMB261,585,000). As at 31st December, 2003, the Group had bank balances and cash of RMB45,803,000 (2002: RMB47,795,000) and bank loans amounted to RMB65,900,000 (2002: RMB48,391,000). The Group's bank borrowings were mainly secured by corporate guarantee given by subsidiaries of the Company, or by charges on certain of the Group's land use right and buildings with a net book value of RMB30,623,000 (2002: RMB32,614,000).

There is no significant changes to the bad debt provision and inventory provision except in the case of Zhongda Group (U.S.A.) Inc. where the debtors and inventory level have significantly decreased. As a result, there was a reduction of bad debts provision by RMB1,648,000 (2002: increase by RMB5,980,000) and a reduction of stock provision by RMB806,000 (2002: increase of RMB2,198,000). The income of the Group is mainly denominated in RMB and USD, while the borrowings are mainly denominated in RMB. The Directors believe that the exchange rate of RMB and USD are quite stable, and accordingly, there is no significant exposure to foreign exchange rate fluctuation. The bank borrowings were at interest rates ranging from 3.98% to 7.13% per annum (2002: 5.625% to 7.13% per annum). As at 31st December, 2003, the debt to equity ratio of the Group was 42.7% (2002 restated: 33.8%). The debt to equity ratio is computed on the basis of total bank borrowings divided by the shareholders' fund of the Group.

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### **DIVIDEND**

The Board of Directors do not recommend the payment of a dividend for the year ended 31st December, 2003 (2002: Nil).

### **PROSPECT**

In 2004, automobile market will continue to grow steadily. Meanwhile, Zhongda International will develop its automobile maintenance equipment business and automobile manufacturing business at the same time. While strengthening our leading position in the automobile maintenance business to further increase sales, the Group will actively develop its automobile manufacturing business.

Regarding the automobile maintenance equipment business, the Group will continue to strengthen its cooperation with automobile manufacturers, selling our products directly to the automobile manufacturers in order to be the designated accessories supplier of the large-scale automobile manufacturers in the PRC. Meanwhile, the Group will work with foreign enterprises to develop potential projects, to introduce international advanced technology and to diversify its product portfolio. As for the marketing strategy, the Group will assign excellent salesmen and engage local distributors in target regions which are selected for their market and economic development in order to increase our market share.

As for the automobile manufacturing business, the Group will closely monitor the construction progress of the production lines of passenger and business automobiles as a preparation for entering the automobile market. Adopting the “Diversified products with low cost” strategy, the Group manufactures quality products with low cost. To implement our sales strategy which includes both direct sales and indirect sales through agents, the Group will continue to participate in automobile exhibitions and invite well established distributors and professional sales companies to join the Group’s sales network in order to actively explore the market. Moreover, the Group will be engaged in mature and profitable automobile related business through equity investment so as to create synergy with its existing business.

To further increase our market share and enhance our competitiveness in the automobile industry, the Group provides its customers with one-stop comprehensive services, developing a four-in-one service which includes automobile sales, after sales service, accessories supply and information supply. The Group also standardizes its after sales services to provide quality services. Currently, after sales services contribute about 50% of the profits of automobile retailers. Therefore, the Group believes that expanding after sales services can help broaden its profit base and sources of revenue.

## Management Discussion and Analysis

### **PROSPECT** (continued)

In future, the Group will continue to implement the following development strategies and measures:

- Speed up the research and development of new products to diversify our product mix;
- Upgrade production technology and improve product design, optimize production procedures in order to reduce production cost effectively and increase competitiveness;
- Implement e-commerce and establish “Zhongda International” as a quality brand name;
- Provide one-stop service to cater for the various needs of the customers;
- Establish an international trading company to focus on overseas market and launch new products in overseas market to increase sales;
- Explore development opportunities, capitalize on the strength of the capital market to carry out acquisitions, mergers, restructurings, in order to speed up the development of the business;
- Continue to implement the staff reward system to motivate the staff, enhance service quality and operating efficiency;
- Build up an excellent team and strengthen information management.