

DIRECTORS' REPORT

The Directors present their annual report and the audited financial statements for the year ended 31st December, 2003.

(I) REVIEW OF OPERATIONS

1. Overview of principal activities

The Group is engaged in the design, development, manufacture and sales of machine tools, precision measuring equipment, precision transducers, digital control machine tools, digital scanning machine tools development of Hi-tech products and technology consultation services etc.

2. Review of operation

The PRC economy continues to grow in 2003. The market demand for manufacturing machineries remained strong, thus offering business opportunities for the Group. Under the leadership of the Directors of the Company, the Company had strengthened its internal controls, expanded its external markets and caught up with the development of the economic expansion. During the year, the Group had set up the cost and profit control centres. More efforts and resources are devoted to five operational systems, i.e. design and development, production arrangements, quality control, marketing services as well as assets monitoring. Leveraging on the existing market position, the Group also capitalised on advanced technology and value-added products while the production capacities continued to expand. Simultaneously, the Company actively developed its four technology segments of its four major subsidiaries, and had established "the management system of the subsidiaries" and "the information disclosure system".

With the efforts of all staffs of the Company, in 2003, the Company had attained a turnover of RMB330,613,000 and a net profit for the year of RMB15,063,000; an increase of 84.05% and 147.87%, respectively from last year. The principal operating activities for the boring and turbo machines had attained a turnover of RMB200,027,000 and a net profit of RMB7,509,000; an increase of 54.80% and 673.91% respectively from last year. The remaining four segments had attained a turnover of RMB132,366,000 and a net profit of RMB9,801,000; an increase of 162.57% and 62.24%, respectively from last year. The boring and turbo machines operations and the remaining four major segments' results are detailed as follows:—

(1) Analysis on turnover and its gross profit

| | Turnover RMB'000 | Cost RMB'000 | Gross profit % | Increase in turnover % | Increase in cost % | Increase (decrease) in gross profit % |
|---|---------------------|-----------------|----------------------|---------------------------------|--------------------------|---|
| Turbo machines | 200,027 | 138,533 | 30.74 | 54.80 | 60.69 | (7.63) |
| (Including related party transaction) | 890 | 623 | — | — | — | — |
| Sales, installation and technical services of high efficient compressor | 85,627 | 64,108 | 25.13 | 198.09 | 187.50 | 12.33 |
| Computerized embroidery | 21,817 | 14,696 | 32.64 | 148.33 | 184.03 | (20.60) |
| Intelligence electrical machines | 15,072 | 7,986 | 47.01 | 82.70 | 129.70 | (18.74) |
| Prototyping machines | 9,850 | 5,021 | 49.03 | 111.81 | 73.97 | 29.23 |
| Including eliminations related party transaction | (1,780) | (1,780) | — | — | — | — |
| Total | <u>330,613</u> | <u>228,564</u> | <u>30.87</u> | <u>84.05</u> | <u>90.40</u> | <u>(6.94)</u> |

Basis of related party transactions:

with reference to market price

Details of importance and continuance of related party transactions:

not determinable

(2) Analysis on turnover and market share by

2.1 Products

| | Turnover RMB'000 | Market share % |
|--|---------------------|-------------------|
| Horizontal boring machines | 110,867 | 30 |
| Horizontal machine centres | 30,380 | 2 |
| Floor-type boring machines | 30,003 | 20 |
| Jig boring machines | 4,489 | 70 |
| Table-type boring and milling machines | 3,802 | 10 |
| Vertical machine centres | 1,001 | — |
| Machine Parts | 128 | — |
| Total | 180,670 | — |

2.2 Business

| | Turnover RMB'000 | Proportion % |
|--|---------------------|-----------------|
| Professional equipment | 67,889 | 37.58 |
| Normal equipment production | 51,777 | 28.66 |
| Other production | 39,049 | 21.62 |
| Transportation equipment production | 13,141 | 7.27 |
| Metal production | 3,870 | 2.14 |
| Electrical plant of machinery production | 3,437 | 1.90 |
| Electronics and communication equipment production | 630 | 0.35 |
| Office machine equipment production | 571 | 0.31 |
| Refined metal | 306 | 0.17 |
| Total | 180,670 | 100.00 |

2.3 Geographical

| | Quantity (units) | Turnover RMB'000 | Proportion % |
|-------------------|---------------------|---------------------|-----------------|
| Eastern Region | 190 | 92,540 | 51.22 |
| South-West Region | 51 | 36,184 | 20.03 |
| Northern Region | 39 | 30,555 | 16.91 |
| Southern Region | 59 | 21,391 | 11.84 |
| Total | 339 | 180,670 | 100.00 |

DIRECTORS' REPORT

(3) Subsidiaries

| Name | Turnover RMB'000 | Proportion to turnover % | Share of result RMB'000 | Proportion to net profit % | Current year net profit RMB'000 |
|--|---------------------|-----------------------------------|----------------------------------|-------------------------------------|--|
| Xian Ser Turbo Machinery Company Limited | 85,627 | 25.90 | 5,414 | 35.94 | 6,767 |
| Winko Machines Company Limited | 21,817 | 6.60 | 934 | 6.20 | 1,028 |
| Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited | 15,072 | 4.56 | 1,313 | 8.72 | 1,682 |
| Shanxi Hengtong Intelligent Machine Company Limited | 9,850 | 2.98 | (107) | (0.71) | 324 |
| Total | 132,366 | 40.04 | 7,554 | 50.15 | 9,801 |

(II) MAJOR SUPPLIERS AND CUSTOMERS

1. Major suppliers

- (1) In 2003, the aggregate purchases attributable to the Group's five largest suppliers accounted for 32.46% of the Group's total purchases for the year.
- (2) The major supplier in 2003 was German Siemens Company Ltd. which accounted for 15.25% of the Group's total purchases for the year.
- (3) At no time during the year did a Director, an associate of a Director or a shareholder of the Company (which to the knowledge of Directors owns more than 5% of the Company's share capital) have an interest in any of the Group's five largest suppliers.

2. During the year, the aggregate sales attributable to the Group's five largest customers accounted for 12.91% of the Group's total sales for the year.

(III) DIFFICULTIES FACED BY THE GROUP AND ITS RESOLUTIONS

- (1) During 2003, the market demand for boring machines increased significantly, however, due to the restriction on the Company's production capacity, the Company has faced challenges on its logistic system. In order to overcome this challenges, the Company has intensified internal reform and adjusted its operations to the higher standard according to the requirement of the market. Besides, the Company has also acquired some advanced technology machines in order to maximise its production capabilities.
- (2) There was shortage of energy and increase in production cost which affected the Company's operation. In order to overcome the challenges, the Company has improved the operations management and cost control.

(IV) INVESTING ACTIVITIES

1. Use of proceeds from raised funds

There was no new proceeds from raised funds during the reporting period and there was no listing proceeds from previous year being utilised during the reporting period.

2. Principal investments financed by non-raised funds

- (1) In November 2002, the Company invested RMB18,390,000 in Winko Machines Company Limited ("Winko") (the registered share capital is RMB20,230,000), the Company's shareholding in Winko is 90.91%. The principal activities of Winko is the sales of intelligent computerised colored embroidery machines.
- (2) In December 2002, the Company invested RMB27,310,000 in Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited ("Siyuan Intelligent") (the registered share capital is RMB35,000,000), the Company's shareholding in Siyuan Intelligent is 78.03%. During the reporting period, Siyuan Intelligent is engaged in the sales of automatic machines.
- (3) During the reporting period, the Company has authorised to make further investment in Xian Ser Turbo Machinery Equipment Company Limited ("Xian Ser") amounted to RMB21,630,000. During the reporting period, Xian Ser was engaged in the development, design and sales of turbo-machinery.
- (4) In June 2003, the Company made further investment in Shaanxi Hengtong Intelligence Machine Company Limited ("Hengtong") amounted to RMB17,730,000 (the registered share capital is RMB27,960,000). The Company's shareholding in Hengtong was increased to 65.34%. During the reporting period, Hengtong was engaged in the development and sales of rapid prototyping system.

(V) FINANCIAL HIGHLIGHTS OF THE GROUP

In accordance to the PRC GAAP, the major change of the financial indicator is as follows:

| Items | 2003 RMB'000 | 2002 RMB'000 | Increase (decrease) % | Major reason |
|---------------------------------------|-----------------|-----------------|-----------------------------|--|
| Total assets | 965,803 | 839,469 | 15.05 | Increase in production scale |
| Shareholders' equity | 521,841 | 506,778 | 2.97 | Increase in net profit for the year |
| Principal operating profit | 101,119 | 59,345 | 70.39 | Increase in turnover |
| Net profit | 15,063 | 6,077 | 147.87 | Increase in turnover |
| Increase in cash and cash equivalents | 2,883 | 47,805 | (93.97) | Repayment of bank borrowings in amount of RMB44,500,000 |

(VI) THE BOARD OF DIRECTORS' PROPOSAL ON 2004 BUSINESS PLAN

In 2004, the Group continues its mission "market leadership, economic feasibility", whilst exploring "co-operation and progress". Capitalising on the market opportunities and the Group's strengthening management, the Group will accelerate its competitiveness through the following measures:

1. Rely on high technology and management innovation, and continues on corporate reform. To maintain better management system and reinforce the internal control in order to improve the corporate governance of the Group.
2. Following China's entry into World Trade Organisation ("WTO"), the Group will devote great efforts in the development of machine tools and digital products and to make the scales of our production and sales to match our capital. Our Company hopes to contribute more to the national economy, create high economic return for our stockholders. Our Hong Kong office has been set up, providing a window to the Group.

DIRECTORS' REPORT

3. With the benefit of the high reputation of "Xi' An Jiatong University" and "Kunji", the Group has intensified its corporate reform. To grasp the golden reforming opportunity in Yunnan Province and render greater contribution to the national economy. To strengthen the resources allocation process to enhance the operational efficiency and to reduce overhead costs, while at the same time, to expand the product base.
4. To put emphasis on personnel management. Efforts are made on three areas of staff coaching, utilisation and work allocation. The Group has developed its human resources policies and procedures based on the performance and merits. The staff quality is upgraded through job training to its employees, thus enhancing the corporate profitability.
5. The Group reinforced trade debt collection from credit period, amount and different categories of customer so as to reduce bad and doubtful debts. By capitalising on the debt credit rating and follow-up procedures, the Group will target to maintain the quality and collection of the trade debts, thus adding values to the Group.

(VII) DAY TO DAY OPERATIONS OF THE BOARD OF DIRECTORS

1. Resolutions of the Board of Directors' Meetings

During the reporting period, the Board of Directors of the Company held 11 meetings. The purpose of these meetings were to approve the 2002 Annual Report, to approve the 2003 first quarter report, to approve the 2003 Interim Report, to approve the 2003 third quarter report, to approve the re-appointment of Xian Xigema Certified Public Accountants as auditors of the Company in the PRC and Messrs. Deloitte Touche Tohmatsu as auditors of the Company in Hong Kong, to approve the RMB100,000,000 short term investment in 2004 and to approve the set-up of the Hong Kong branch office, etc.

2. During the reporting period, the Board of Directors had acted their statutory power and duties carefully as provided in the Shareholder's Meeting.

(VIII) THE BOARD OF DIRECTORS' PROPOSAL ON THE PROFIT APPROPRIATION OR TRANSFER OF CAPITAL RESERVE FUND

In accordance to the PRC Accounting Standards, the Group has a profit from principal operation for the year of RMB101,119,000 and net profit for the year of RMB15,063,000. In accordance with the HK Accounting Standard, the Group has attained a net profit for the year of RMB15,324,000. In accordance with the Company's Articles of Association, the profit for the year will be used to set off losses brought forward from previous years. Thus no appropriation and no transfer were made to the statutory surplus reserve and the statutory public welfare fund.

On behalf of the Board

Yue Huafeng
Chairman

18th April, 2004