

## (1) DISCUSSION AND ANALYSIS ON REVIEW OF OPERATIONS

The PRC economy continues to grow in 2004. The market demand for manufacturing machineries remain strong, offering business opportunities for the Group. During the year, under the instruction of the directors, the Group focuses on the development of core business in achieving the production and operation targets. Internally, the Group continues to improve organization structure, management function, and technology. In addition, the Group encourages product design and development and 3 approaches to improving efficiencies of modular design, craftsmanship and scientific. Externally, the Group focuses on reform of distribution channel, the development of new market, implementing the reorganization and internationalization of the industry in order to become a large corporation, and improve competitiveness in the international market.

## (2) 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.

#### (1) Review of operation

With the efforts of all staff of the Company in 2004, the Company maintains its sound financial position. The Company had attained a turnover of RMB469,436,000 and a net loss for the year of RMB17,081,000. The reasons for negative net profit is the impairment loss on deposits placed with securities company of RMB37,480,000.

Ignoring the impairment loss, the net profit for the year is RMB20,399,000, representing an increase of 41.99% and 35.42%, respectively from last year. The operating activities for the boring and turbo machines had attained a turnover of RMB284,113,000 and a net profit of RMB17,570,000; an increase of 42.04% and 133.99% respectively from last year. The remaining four segments had attained a turnover of RMB190,663,000 and a net profit of RMB6,074,000; an increase of 44.04% and 38.03%, respectively from last year. The boring and turbo machines operations and the remaining four major segments' results are detailed as follows:

#### (2) Analysis on turnover and its gross profit

Items	2004				Increase in			
	Turnover RMB'000	% in turnover	Cost RMB'000	Gross profit %	Turnover RMB'000	turnover %	cost %	gross profit %
Turbo machines	284,113	60.52	205,494	27.67	78,619	42.04	48.34	(3.07)
Sales, installation and technical services of high efficient compressor	137,452	29.28	103,572	24.65	33,941	60.52	61.56	(0.48)
Computerized embroidery	27,420	5.84	20,517	25.18	6,848	25.68	39.61	(7.46)
Intelligence electrical machines	12,387	2.64	6,758	45.44	5,501	(17.81)	(15.38)	(1.57)
Prototyping machines	13,404	2.86	8,097	39.59	5,229	36.08	61.26	(9.44)
Including related party transaction	699	0.15	-	-	-	-	-	-
Total	474,776	-	344,438	-	130,138	-	-	-
Internal Elimination	5,340	-	5,340	-	-	-	-	-
Total	469,436	100	339,098	-	130,138	-	-	-

(3) Analysis on turnover and market share by products

Unit: RMB'000

Name of products	This year Turnover	Last year Turnover
Horizontal boring machines	159,896	110,867
Horizontal machine centres	23,639	30,380
Floor-type boring machines	46,161	30,003
Jig boring machines	8,362	4,489
Table-type boring and milling machines	22,223	3,802
Others	1,507	1,129
Total	<u>261,788</u>	<u>180,670</u>

(4) Analysis on turnover and market share by geographical

Unit: RMB'000

Name of region	This year Turnover	Last year Turnover
Eastern Region	98,032	92,540
South-West Region	78,389	36,184
Northern Region	43,372	30,555
Southern Region	35,132	21,391
Other Region	6,864	—
Total	<u>261,788</u>	<u>180,670</u>

(5) Analysis on turnover and market share by Business

Type of business	This year Turnover	Last year Turnover
Normal equipment production	126,841	51,777
Professional equipment	80,219	67,889
Other production	15,333	39,049
Transportation equipment production	13,579	13,141
Metal production	4,493	3,870
Electrical plant of machinery production	15,001	3,437
Electronics and communication equipment production	3,975	630
Office machine equipment production	723	571
Refined metal	1,624	306
Total	<u>261,788</u>	<u>180,670</u>

- (6) Main products comprising 10% or more of the Turnover of Gross profits

Business or products	Turnover	Cost	Gross profit (%)
Turbo machines (RMB'000)	284,113	205,494	27.67
Sales, installation and technical services of high efficient compressor (RMB'000)	137,452	103,572	24.65

## 2. Review of operations for subsidiaries and controlling company

- (1) Subsidiaries

Unit: RMB'000				
Name	Major product or services	Registered share Capital	Total assets	Net profit RMB'000
Winko Machines Company Limited	Computerised embroidery machines	20,230	48,394	(2,810)
Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited	Intelligent electrical appliances	35,000	49,405	(1,590)
Xian Ser Turbo Machinery Company Limited	Turbo machine	4,561	304,715	10,003
Shanxi Hengtong Intelligent Machine Company Limited	Laser phototyping machine	27,960	33,240	440

During the year, Xian Ser Turbo Machinery Company Limited continued to expand and has a net profit of 10,032,000, representing an increase of 48.16%. Shanxi Hengtong Intelligent Machine Company Limited also has profit. Winko Machines Company Limited and Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited has a loss.

- (2) Review of operations in investing company (profit from investments with 10% or more of total net profit)

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	137,452	29.28	6,336	–	10,032

## 3. Major suppliers and customers

Unit: RMB'000

Aggregate purchase attributable to the Group's five largest suppliers	35,187	Proportion to net profit (%)	33.75
Aggregate purchase attributable to the Group's five largest customers	96,480	Proportion to net profit (%)	20.55

#### **4. Difficulties faced by the group and its resolutions**

Difficulties and problems in operations and its resolutions

- (1) The sales of the holding company's main product, machine centre, did not increase to an extent that would facilitate the digitalization of the Company's product line and hence the profit from operation did not improve much over the years. The problem lies in the incapability of research and development of the Company.
- (2) Due to the scale of production, and the highly accelerated, the sales of particular products of the holding company, the quality of some individual products have been deteriorated and the loss of external quality has increased. The main reason was due to lack of training of customers' services and after-sale services.
- (3) Although the Company continued to improve the technical skills and the production environment, the processing capacity of the existing machines were still highly inadequate. This resulted in a sales-production conflict. The product delivery cycle could not be totally guaranteed. This problem will be partly resolved by improving technical skills in 2005.
- (4) The main problem of the subsidiary - Xian Ser Turbo Machinery Equipment Company Limited ("Xian Ser ") was, the utilisation of current assets increased at an accelerated rate, in particular, inventory levels have exceed the normal threshold. Accounts receivable have also increased. These problems will be solved by a reasonable and organized production and the strengthening of the repatriated capital.
- (5) There was a need for the holding company to strengthen its management over the operations of the subsidiaries, especially in investment, financing, guarantee and the establishment of branches.

### **(3) INVESTING ACTIVITIES**

1. During the year, total investment of the Company is RMB144,230,000, representing an increase in investment for RMB55,960,000 (63.40%).

- (1) During the year, the Company invested RMB1,000,000 in Ju Tian Fund.
- (2) The Company appointed the China Fortune to invest 50 million in State Bonds on 23rd February, 2004.
- (3) The share of the Company in Xian Ser was diluted to 45% after. In August 2004, Xian Ser increased its registered capital and the Company increased its investment by RMB4,960,000 in Xian Ser. After the injection, the shareholding of the Company in Xian Ser was diluted to 45%.

#### **2. 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.

#### **3. Principal investments financed by non-raised funds**

There is no principal investments in non-raised funds during the year.

#### (4) FINANCIAL HIGHLIGHTS OF THE GROUP

Items	2003 RMB'000	2002 RMB'000	Difference	Increase (decrease) %
Total assets	1,125,840	965,803	160,037	16.57
Principal operating profit	130,138	101,119	29,019	28.70
Net (Loss) profit	(17,081)	15,063	(32,144)	–
Increase in cash and cash equivalents	21,118	2,883	18,235	632.50
Shareholders' equity	504,771	521,841	(17,070)	–

- (1) The increase in total assets is due to expansion of the Company business.
- (2) The increase in principal operating profit is due to increase in sales.
- (3) The change in net profit is due to the impairment loss on deposits placed with securities company.
- (4) The increase in cash and cash equivalents is due to the expansion of the Company business.
- (5) The change in shareholders' equity is due to the impairment loss on deposits placed with securities company.

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

In 2005, the Group will focus on achieving the production and operation targets, improving the internal control between the holding and subsidiaries companies, accelerating the rate of product development, developing new markets, and improving technology, production routes and mechanism. In addition, the Group continues to encourage product design and development, and 3 approaches to improving efficiencies of modular design, craftsmanship and scientific, implement the reorganization and internationalization of the industry. The Group will also improve asset management, human resource and corporate culture in order to upgrade the management and meet market demand.

#### (6) DAY TO DAY OPERATIONS OF THE BOARD OF DIRECTORS

##### 1. The Board of Directors' Meeting and Resolution

- (1) On 5th February 2004, the fourteenth and fifteenth resolutions of the Fourth Board of Directors' Meeting (written resolution) - the Company provided a bank loan guarantee of HK\$30 million in favor of its subsidiary – Xian Jiaotong University Siyuan Intelligent Electric Apparatus Company Limited in respect of the investment in National High-Tech Industrization Project (not yet executed in the reporting period) and the respective office in Hong Kong proposed to open a bank account in Bank of East Asia Limited, and authorized the Company Executive Director, Mr. Zhang Hanrong, and its representative, Ms Qu Xinye (the principal of the Hong Kong representative office), being the authorized signatory of the bank account of Bank of East Asia Limited.
- (2) On 17th-18th April 2004, the sixteenth resolution of the Fourth Board of Directors' Meeting – For approval of the Annual Report for the year ended 2003, to reappoint Xian Xigema Certifying Public Accounts and Messrs. Deloitte Touche Tohmatsu as auditors of the Group and passed to hold a Shareholders' Meeting of the Company and other matters.
- (3) On 11th April 2004, the seventeenth resolution of the Fourth Board of Directors's Meeting (written resolution) – For approval of First Quarterly Report for the year 2004.
- (4) On 30th August, the eighteenth resolution of the Fourth Board of Directors's Meeting (written resolution) – For approval of Half-year Report for the year 2004 and the establishment of Joint Venture Company with Tos Varnsdorf, A.S. and other matters.
- (5) On 11th October 2004, the nineteenth resolution of the Fourth Board of Directors' Meeting (written resolution). To discuss the agreement on the capital injection with Xian Ser Turbo Machinery Equipment Company Limited, and such relevant matters.
- (6) On 14th October 2004, the twentieth resolution of the Fourth Board of Directors' Meeting (written resolution) – For approval of Third Quarterly Report for the year 2004.

## 2. Implement of Resolutions of General Shareholders' Meeting

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

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

In accordance to the PRC Accounting Standards, net loss for the year of RMB17,081,000. In accordance with the HK Accounting Standard, the Group has attained a net loss for the year of RMB17,586,000. 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.

## (8) STATEMENT REGARDING THE USE OF FUNDS BY THE COMPANY'S CONTROLLING SHAREHOLDER AND OTHER RELATED PARTIES

Xi Hui Shen Zi (2005) 0483

Statement on the details of the use of funds by the company's controlling shareholder and other related parties.

To all shareholders of the Company:

We have accepted the appointment and audited the financial statements of Jiaoda Kunji High-Tech Company Limited ("the Company") for the year ended 31 December 2004 and have issued the Xi Hui Shen Zi (2005) 0482 (Audited Report). We have performed audit procedures in the course of our audit of the financial statement for the year 2004 on the use of funds by the Company's Controlling shareholder and other related parties. According to the requirements under "Notice concerning the regulation on the flow of funds between listed companies and other related parties and the provision of guarantees by listed companies to external parties" (Zheng Jian Fa [2003] No. 56). The summary is as followings:

Name of related party	Opening balance	Increase during the year	Decrease during the year	Balance as at year end	Nature of the use of funds	Means of Repayment	Relationship with the Company
Xian Jiaotong University Industrial (Group) Incorporation	77,987	7,000,000	8,517,987	(1,440,000)	Business operation	Cash	Controlling shareholder
Jiaoda Hong Fan High-Tech Company Limited	417,144	2,168,362	2,336,775	248,731	Settlement of account payable	Cash	Subsidiary of the controlling shareholder
<b>Total</b>	<b>495,131</b>	<b>9,168,262</b>	<b>10,854,762</b>	<b>(1,191,269)</b>			

We find the company did not provide the fund to the other parties save as mentioned above. We were not aware of any circumstances stated in "Notice concerning the regulation on the flow of funds between listed companies and other related parties and the provision of guarantees by listed companies to external parties" (Zheng Jian Fa [2003] No. 56) shown below:

1. The Company's controlling shareholder and other related parties require the company to pay for their salaries, staff welfare, insurance expenses, advertising expenses and share the production cost and other expenses;
2. Guarantee for the loan borrowed from financial institutions and non-financial institutions;
3. Appointment of the Company's controlling shareholder and other related parties to engage in security trading;
4. Issuance of bank note for fraudulent business transactions;
5. Settlement of loans for the Company's controlling shareholder and other related parties.

Xian Xigema Certified Public Accountants Firm Limited  
Xian PRC

Chinese CPA  
Wang Xia  
Chinese CPA  
Fan Min Hun

27th April, 2005

## (9) THE INDEPENDENT DIRECTORS EXPRESSED INDEPENDENT OPINION OF THE COMPANY'S ACCUMULATED AND CURRENT EXTERNAL GUARANTEE FOR THE YEAR 2004

Deloitte have investigated the issue in accordance with the requirements under "Notice concerning the regulation on the flow of funds between listed companies and other related parties and the provision of guarantees by listed companies to external parties" (Zheng Jian Fa [2003] No. 56). The result of the investigation is as follows:

The Independent Directors find the Company provided the guarantee to its subsidiary, Kunming Winko Machines Company Limited, with the amount of RMB10,000,000 and provide RMB9,091,000 according to the proportionate shareholding in the subsidiary. The company does not have other guarantee to the third party as at the end of the reported period.

Independent Directors

**Yu Chengting**

**Tong Yunhuan**

**Dong Juan**

27th April, 2005

## (10) DESCRIPTION AND OPINION TO THE QUALIFIED OPINION OF THE AUDITORS

### 1. Directors' statement:

On 27th April 2005, local auditors – Xian Xigema Certified Public Accountants Firm Limited gave the company an unqualified opinion, but external auditors – Deloitte Touche Tohmatsu, Certified Public Accountants issued a qualified opinion against the Company. The reason for such discrepancy in opinion being the realizable value of fund account with China Fortune Securities as at 31st December 2004 of RMB7,960,000 gave a limitation on scope.

On 3rd June 2004, as approved by China Securities Regulatory Commission – Shanghai Commission, the Highest People's Court of Shanghai pursuant to decide to freeze all assets owned by China Fortune Securities ("China Fortune"). Henceforth, the directors concluded that the balance in the account was only susceptible to the risk of the fluctuation of market prices, no recognition problems were noted. The balance of the stock investments which China Fortune had invested in for the Company with a market capitalization of approximately RMB7,960,000 and the balance in cash of the Entrusted Fund of approximately RMB31,000 are recoverable. With the prepared investment income on Entrusted Fund of RMB4,250,000 which had been received during the year, an impairment loss of RMB37,480,000 on the Entrusted Fund has been recognised.

Local auditors also agreed to the above directors' statement.

On behalf of  
**Board of Directors**

27th April, 2005

**2. Independent directors Yu Cheng Ting Tong Yunhuan Dong Juan represented independent opinion of on the Company's audited financial statements for the year ended 31st December 2004.**

On 27th April, 2005, a statement made by Board of Directors in relation to the qualified opinion issued by the external auditor on the Company's audited financial statements for the year ended 31st December 2004. We believed that on 3rd June 2004, Shanghai Branch of China Securities Regulatory Commission made an application to the Highest Peoples Court of China. Pursuant to (2004) 滬高人民保字第四號〈上海市高級人民法院民事裁定書〉made by the court, the assets of China Fortune has frozen and before the judgment made on the China Fortune, the reason for diminution of market value of the stock of RMB7,960,000 at 31 December 2004 suggested by the external auditor is inadequate. The Audit Committee believed that Board of Director will made a proper judgment.

Independent Directors  
**Yu Chengting**  
**Tong Yunhuan**  
**Dong Juan**

27th April, 2005

**3. Supervisory committee represented independent opinion of on the Company's audited financial statements for the year ended 31st December 2004**

On 27th April, 2005, a statement made by Board of Directors in relation to the qualified opinion issued by the external auditor on the Company's audited financial statements for the year ended 31st December 2004. We believed that on 3rd June 2004, Shanghai Branch of China Securities Regulatory Commission made an application to the Highest Peoples Court of China. Pursuant to (2004) 滬高人民保字第四號〈上海市高級人民法院民事裁定書〉made by the court, the assets of China Fortune has frozen and before the judgment made on the China Fortune, the reason for diminution of market value of the stock of RMB7,960,000 at 31 December 2004 suggested by the external auditor is inadequate. The Audit Committee believed that Board of Director will make a proper judgment.

On behalf of  
**Supervisory Committee**

27th April, 2005