

Management discussion and analysis



R&D centre for moulds

Substantial improvement in the Group's turnover and profit was attributable to the strong demand from the global market for high quality auto parts produced in the PRC.

Business and financial review

For the financial year ended 31 March 2005, the Group recorded a turnover of approximately RMB2,206,041,000, a 28.9% rise from approximately RMB1,711,442,000 last year. Gross profit amounted to approximately RMB368,692,000, representing a 29.6% increase from approximately RMB 284,417,000 for the same period last year. Together with the profit of the associated company this year, total profit attributable to shareholders increased 67.3% from last year's approximately RMB163,521,000 to approximately RMB273,487,000. Excluding the tax write-back and amortisation of convertible bonds redemption premium, core business earnings increased by 63.2% to approximately RMB254,249,000 (2004:RMB155,841,000). Earnings per share were RMB28.94 cents (2004:RMB23.07 cents).

Taking into consideration the satisfactory results achieved during the year, the Board of Directors recommended the payment of a final dividend of HK4.5 cents per share for the

year ended 31 March 2005 (2004: HK2.4 cents) payable to shareholders whose names appear on the Register of Members of the Company on 18 July 2005. Together with the interim dividend of HK2.5 cents per share paid, the annual total dividend per share for the year amounts to HK7.0 cents. Subject to the passing of the relevant resolution at the forthcoming annual general meeting, such final dividend will be payable on or before 28 September 2005.

The substantial improvement in the Group's turnover and profit was attributable to the strong demand from the global market for high quality auto parts produced in the PRC. Coping with the increasingly competitive global automotive market, most international automobile system integrators have shifted their purchasing and production activities to the PRC in a bid to reduce production costs. This has brought in notably more orders for auto parts to the Group. Although the price of steel increased during the year under review, with the help of stringent costs control measures, its sound business foundation and effective marketing strategies, the Group achieved encouraging results with gross profit margin increased to 16.7%.

Auto parts

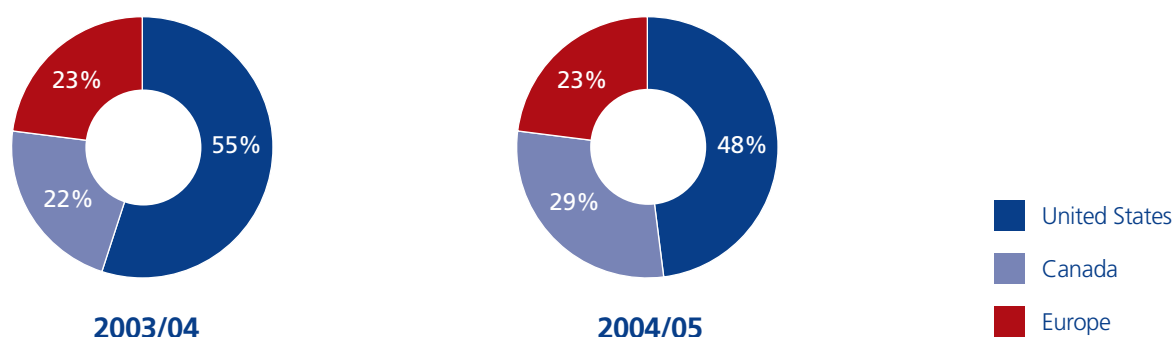
In the year under review, turnover from the sale of auto parts amounted to approximately RMB1,843,883,000, representing an increase of 31.5% from approximately RMB1,401,696,000 last year. Sale of auto parts continued to

be the core business of the Group with turnover constituted approximately 83.6% of the Group's total turnover for the year. During the year, the Group continued to benefit from the production capacity of the brake plates/shoes added in early 2004. Besides, there were strong demands for the Group's product and selling prices also saw considerable increase as a result of rising sales of higher value added products. Such strong demands were mainly from the Group's existing customers, especially those from the Canadian and European markets. The segment's turnover and profit margin also grew along with the increasing demand for traditional products and receipt of sizeable orders for newly developed high value added products. During the year, the Group produced auto parts of over 1,000 models, among which over 280 were newly developed models.

Market analysis

In 2004/05, the U.S market continued to be the major market of the Group. Sales from this market increased by approximately 14.1% over that of last year, accounting for approximately 47.7% of the total turnover of auto parts. As a result of this surging demand for the Group's products during the year, the Group adjusted its marketing strategies accordingly. The Group delegated its effort in deepening relationship with its key customers, and on the other hand, smaller customers were gradually transferred to its distributing agents which handle those orders on behalf of the Group. This helped to reduce administrative expenses and settlement risks.

Auto parts turnover by geographical location



Having established a solid base in the U.S., the Group focused on developing the Canadian and European markets during the year. Sales of auto parts to these two markets grew by approximately 72.0% and 34.3% respectively when compared with the same period last year, accounting for approximately 28.8% and 23.4% respectively of the Group's total auto parts turnover. The increase in sales was attributable to the Group's efforts over the past two years to gain in-depth understanding of demands in Canada and Europe and developing products meeting those demands, resulting in both customer and order gains.

Product analysis

Existing products

During the year under review, the Group reported sustainable increase in both sales volume and selling price of its existing products. Brake shoes continued to be the core auto parts product sold by the Group, accounting for approximately 60.6% of its total turnover of auto parts and registered a 33.5% growth compared to the previous year.

In 2004/05, the Group embarked on more advanced development of the brake shoes. It focused mainly on developing high value added products with high returns. Among all the products, heavy duty brake shoes and medium duty brake shoes received the most enthusiastic customer response and achieved the most outstanding

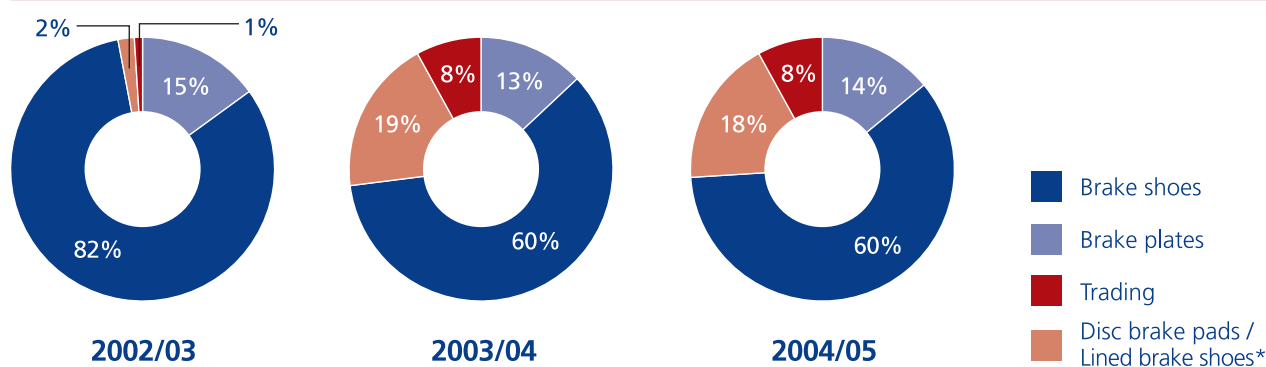
results. The manufacturing process of these products is more complex and requires more advanced technology, thus are sold at higher market prices. These new additions boosted the average selling prices of brake shoes products.

As at 31 March 2005, sales of brake plates jumped 39.3%. This was mainly attributable to the increase in annual production capacity of brake plates to approximately 83,000,000 pieces in early 2004. The Group also stepped up the development of products for the American and European markets and in doing so substantially enhanced the overall utilization rate of its production facilities. Advances were also made in the development of fine blanking technology, leading to quick surge in customer orders.

New products

Composite friction material was the first new high value added product launched by the Group during the year. Many international auto parts system integrators who have auto parts supply arrangements with the Group placed orders for the Group's disc brake pads/lined brake shoes (with the composite friction material attached) in the past year. This move represented a major step in the Group's development into a one-stop automobile chassis system products and services provider. The current annual production capacity of composite friction material reached approximately 36,000,000 pieces. Since production

Auto parts turnover by products



* Friction material sourced from third parties in 2002/03 and 2003/04



Friction material production line - lined brake shoes



Friction material production line - disc brake pads

commenced in second half of 2004, the Group produced over 200 models of disc brake pads/lined brake shoes, which contributed approximately 17.5% of the turnover of the auto parts business. Norstar's composite friction material passed the European ECER90 and AMECA test in the U.S., and the Group is the first and only PRC enterprise to have passed the Brake Effectiveness Evaluation Procedure ("BEEP") as certified by the LINK National Laboratory in the U.S. The Group also accelerated the development of fine blanking thus rapidly increased the product's added value. With different new product models planned for launch in the coming years, the Group expects the utilization rate of its production facilities for composite friction materials to reach 75% by 2005/06. The products' contribution to the Group will increase notably in the coming years.

Outstanding research and development

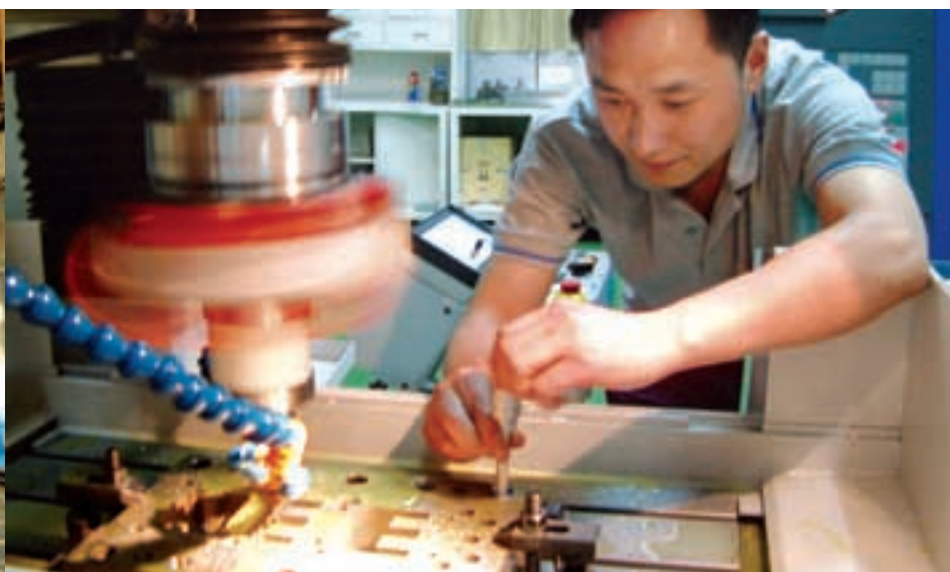
During the year, the Group invested approximately RMB76,531,000 (2004: RMB 44,887,000) in R&D of products. This amount accounted for approximately 3.5% of the Group's total turnover (2004: 2.6%). During the year,

the Group successfully developed products of over 280 specifications, bringing the total number of auto parts models it offers to over 1,000. To enhance production efficiency and extend the life cycle of its moulds, the Group invented the multi-cavity continuous module. Advancement was also made in expanding the scope of chassis system parts and improving the manufacturing processes.

In 2004/05, the Group also committed more resources in exploring more complex manufacturing technologies and processes. At such relentless efforts, the Group successfully developed many high value added products such as heavy duty brake shoes and medium duty brake shoes. On the brake plate front, the Group made a big step forward in the R&D of the manufacturing process of fine blanking. Since the production of fine blanking has stringent requirement on raw material quality, mechanical measurement deviation and luminance, and involves a complex manufacturing process, few manufacturers in the PRC are able to meet the quality requirement and produce it in bulk. Armed with extensive experience accumulated over the years, the Group has the capabilities to develop, produce and test fine blanking.



Mould library



Mould processing centre

Looking ahead, the Group will gradually accelerate its product development and focus on the development of brake system, suspension system, transmission system and steering system for the top 30 most popular European, U.S. and Japanese automobile models in accordance with the demand of our customers. The Group also plans to increase its product development budget and at the same time seeks to enhance cooperation in R&D on new technology and new technique with existing customers, which will enable the Group to provide tailored-made products to the customers and continually boost its own competitiveness. The Group expects its product R&D budget to account for approximately 4% to 5% of its total annual sales.

New production facility

To accommodate the rising demand of the markets, the Group has built a new plant in the Beijing Economic and Technological Development Zone. The new production plant will focus primarily on suspension system components and shock absorbers. Currently, production facilities are being installed and tested, and trial operation is expected to begin between July and August this year. From primarily producing brake system products to including assembly of suspension

systems in its product offers, the Group has successfully diversified its product portfolio, as well as marking the Group's active effort to enter the lucrative PRC market.

Trading business

The Group's income from trading of auto parts increased by 23.4% to approximately RMB144,367,000, accounting for approximately 7.8% of its total auto parts turnover this year. The increase in turnover was a result of the increase in orders for trading, and the addition of new suppliers in its distribution network in the PRC. Having long standing relationship with its customers and promising low procurement cost and stringent quality control, the Group saw surge in both the quantity and types of products ordered by customers. Looking ahead, the Group expects its auto parts trading business to continue to grow, riding on the increasing number of trading partners it has in the PRC and the closer cooperation between the Group and its customers.

Raw material costs

The market price of steel in the PRC climbed substantially during the year. Albeit so, through implementing stringent



Beijing production plant



Construction decorative hardware production line

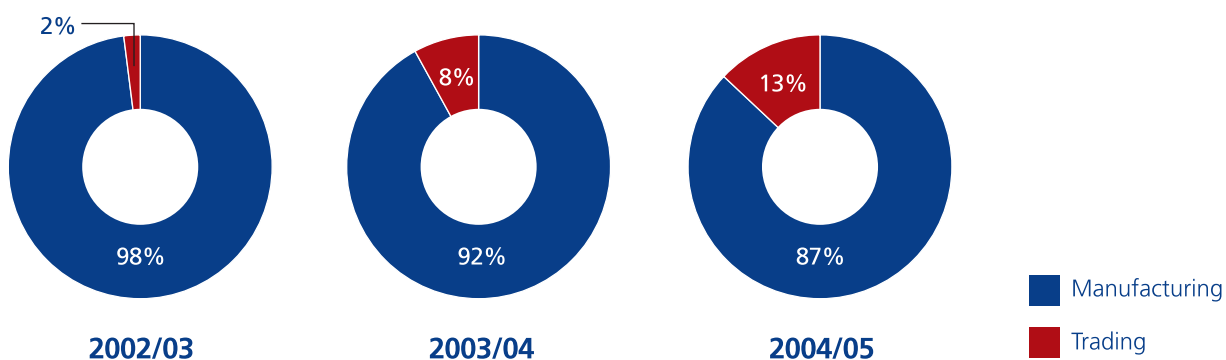
cost and price control measures and with the price of steel used in producing auto parts relatively stable, the rising steel price did not have much impact on the Group's profit. During the year under review, the average unit cost of steel, which accounted for approximately 58.3% of the Group's total production costs, increased by 10.3% compared with that of last year. Nevertheless, the gross profit margin of auto parts still saw a notable increase from 16.9% last year to 18.2% this year. The management believes with steel price stabilizing, if not deteriorating, and the Group focusing

on developing more products of higher profit margins and implementing strict cost control, the Group's profit margin will continue to improve.

Construction decorative hardware

During the year under review, construction decorative hardware generated a turnover of approximately RMB362,158,000 (2004: RMB309,746,000), representing about 16.4% of the overall turnover of the Group.

Construction decorative hardware turnover by products



Manufactured product accounted for 86.6% (2004: 92.3%) of total turnover of construction decorative hardware business. Affected by the surge in steel price, the gross profit margin of the manufacturing business dropped from last year's 18.5% to 15.0% this year. Since the long-term mission of the Group is to focus on developing its auto parts business, the Group's strategic focus for this business segment will be to meet the demands of existing customers.

Acquisitions

To facilitate the development of its operation in the PRC, Norstar acquired the remaining 10% interest of Norstar Automotive in June 2004. Norstar Automotive, now being the Group's wholly owned subsidiary, provides more flexibility to the Group's business operation.

The Group also completed the acquisition of 40% interest in Profound Global, an associated company, on 24 December 2004. Boasting stable sales and a solid customer network in the PRC, Profound Global will facilitate and smoothen the Group's expansion in the PRC auto parts market. The acquisition will also enhance Norstar's competitiveness as synergies and economies of scale will be achieved through the sharing of resources such as technological know-how, machinery, and the marketing and sales networks of the two companies. Moreover, the Group expects to reap improved cost effectiveness from the access to Profound Global's advanced electroplating facilities. In the long term, the integration of Profound Global's upstream auto parts and production technology and the Norstar's own stamping technology will bring the Group's auto parts production business into a more promising stage of development.

At 31 December 2004, the audited profit of Profound Global increased approximately 55.7% over that of the previous year to approximately RMB 102,297,000. The amount exceeded the guaranteed profit of RMB 83,000,000 in 2004.

At 31 December 2004, the non-current assets (comprised mainly fixed assets) of Profound Global totaled approximately

RMB370,612,000. Total current assets amounted to RMB 578,029,000 approximately and the net book value and net cash balance were approximately RMB877,286,000 and RMB155,727,000 respectively. According to its unaudited financial statements at 31 March 2005, its net cash balance was approximately RMB 217,000,000 and net book value was RMB 905,500,000 approximately.

Operating cost

The Group's total distribution and selling expenses decreased 34.1% during the year. Shipment costs accounted for 94.5% of the total distribution and selling expenses (2004: 95.7%). During the year, sales to FOB shipment customers recorded robust growth, while sales to CIF shipment customers dropped 38.4%, accounting for 13.2% of the Group's total turnover (2004: 27.6%). The Group believes that its focus on selling high value added products such as disc brake pads/lined brake shoes was the major contributing factor to the percentage drop of the distribution and selling expenses against total turnover.

Administrative expenses increased by 31.0% this year, mainly due to management salary adjustments and the increase in legal and professional service charges, traveling costs and a full year impact of costs incurred in relation to the Group's listing.

Other income

Other income dropped this year as last year's figure included a reversal of the provision for staff benefit of approximately RMB7,680,000. Sales of waste materials also declined this year.

China auto forum 2004

In September 2004, Norstar and The Hong Kong and Shanghai Banking Corporation Limited ("HSBC") jointly held the China Auto Forum 2004 in Hong Kong. The aim of the Forum was to enhance the understanding of Hong Kong



Part of Auhui production plant



Mould processing centre

and the worldwide community on PRC's automotive and auto parts industry. Many international automotive industry experts at the forum shared the view that the automotive industry in the PRC will continue to grow in strides in the next 30 to 40 years. As the PRC develops into a global auto parts procurement and production hub, industry suppliers who can deliver quality products and services will enjoy great advantages. The Forum attracted professionals from various international financial and equity research institutions, investment fund houses, and the financial media. The success of the Forum mirrored the confidence and high expectation that the international community, in particular the investment community, has on the future development of the PRC automotive and auto parts industry.

Prospects

Looking ahead, the auto parts industry in the PRC sees enormous opportunities. The competitive global operating environment will drive the demand for high quality and price competitive auto parts manufactured in the PRC. Government policies to encourage the development of technologies by domestic auto parts manufacturers to help

reduce in the long run the country's reliance on imported auto parts has also provided the Group with abundant business opportunities. With its Beijing plant scheduled to commence operation in second half of 2005, the Group will be able to fully explore the PRC market, which is expected to become another major market of the Group after North America and Europe. The PRC market is expected to contribute approximately 20% of the Group's total turnover in 3 to 5 years.

The Group has signed a cooperation agreement with one of the largest trading conglomerates of Japan to establish an auto parts procurement center in the PRC. The Group will strengthen its collaboration with the conglomerate in the coming year and targets to supply high quality brake system products and other products to the latter. At the same time, with an extensive global sales network and abundant resources, the conglomerate will collaborate with Norstar in developing business in Japan.

The existing customers of the Group have accelerated the pace of global procurement to cope with the intense competition in the international automotive market. Looking



Brake system parts and components

ahead, the Group will develop more product models and increase production efficiency so as to maximize the utilization rate of its existing production capacities for meeting surging market demand.

Besides existing products, the Group has been actively developing new products of higher profit margins. Following the production of composite friction material in September 2004, the Group will gradually launch other high value added products. Details are as follows:

- Suspension system components / shock absorbers assembly: trial production to commence between July and August 2005
- Suspension system parts: production to commence in first half of financial year 2006/07
- Brake system components assembly: production to commence in first half of financial year 2006/07

The management believes the coming few years will see the Group achieve stable growth with various high value added

products in the pipeline in the coming years. At the Group's relentless effort, it has moved another step closer to becoming a leading supplier and manufacturer of automobile chassis system parts in the international market.

The group's financial position, liquidity, and capital structure

The Group raised total net proceeds of approximately HK\$229,000,000 through the placing of 100,000,000 ordinary shares on 29 April 2004. On 21 May 2004, the Group obtained a syndicated bank loan facility of HK\$380,000,000. The proceeds were applied in the capital expenditures (approximately RMB389,900,000) of new projects, as partial consideration for acquisition of the remaining 10% interest in Norstar Automotive (HK\$19,000,000), as partial repayment of the Renminbi loans in the PRC and for the purpose of working capital. The capital expenditures of the new projects included construction of new plants in Beijing and Anhui and its ancillary equipment as well as the machinery and equipment for the new projects. In addition, on 16 December 2004, the Group issued Zero Coupon Convertible Bonds due 2007 in



Suspension system parts and components

an aggregate principal amount of US\$40,000,000, which were mainly used for the acquisition of 40% interests in Profound Global at a consideration of HK\$181,660,377. At 31 March 2005, the Group had cash and bank balances of approximately RMB754,918,000, while the total bank loans (including Convertible Bonds) were approximately RMB961,721,000. The Group's current ratio increased significantly from 2.3 times at 31 March 2004 to 3.1 times as at 31 March 2005.

At 31 March 2005, the Group's average debtors' turnover was 45 days (2004: 48 days). The proportion of exports to overseas customers through Shanghai Industrial Investment (Group) Co. Ltd. reduced from 36.7% in the previous year to 27.3%. Credit period for overseas customers generally range from 30 to 90 days. At 31 March 2005, the Group's average inventory turnover was 9 days (2004: 22 days).

Foreign exchange risks

Income derived by the Group is denominated in US dollars, RMB and Euro. Most of the purchases of the Group are

denominated in RMB, while certain of its capital expenditures are denominated in US dollars, and dividends are denominated in HK dollars. The Group did not experience any material difficulties or effects on its operations or liquidation as a result of fluctuations in currency exchange rates during the 12 months ended 31 March 2005. The Board believes that the Group has sufficient foreign exchange to meet its foreign exchange requirements.

Employees and the remuneration policy

At 31 March 2005, the Group had a total of more than 2,000 employees. Remuneration packages are determined by reference to the qualifications and experience of the staff concerned and are reviewed annually by the management with reference to market conditions and performance of the staff. The Group also participates in Mandatory Provident Fund Scheme in Hong Kong and State-managed retirement benefit scheme in the PRC.