Superb Products and Business Model

Norstar will continue to develop high value-added products and expand production capacities, identify suitable business opportunities through M&As and invest in new plants, strengthen its customer network and production expertise with an aim of becoming a world leading auto parts manufacturer and system integrator.

On Strong Heritage We Climb

Management Discussion & Analysis

Business and financial review

For the financial year ended 31 March 2006 (the "Period"), the Group recorded a turnover of approximately RMB2,658,993,000, a 20.5% rise from last year's approximately RMB2,206,041,000. Gross profit amounted to approximately RMB493,775,000, representing a 33.9% increase from the approximately RMB368,692,000 last year. Together with the profit of associated company, total profit attributable to shareholders surged 27% from last year's approximately RMB273,487,000 to approximately RMB347,313,000. Excluding the interest on convertible bonds, core profit approximated at RMB367,985,000, representing a 44.2% increase over last year's core profit of RMB255,209,000 after excluding over-provision of PRC corporate income tax and interest on convertible bonds. Earnings per share were RMB35.24 cents, 21.8% higher than in the same period last year.

The Board of Directors recommended the payment of a final dividend of HK 5.7 cents per share for FY2005/06 payable to shareholders whose names appear on the Register of Members of the Company on 14 August 2006. Together with the interim dividend of HK 2 cents per share paid, the annual total dividend per share for the year amounts to HK 7.7 cents.

Subject to the passing of the relevant resolution at the forthcoming annual general meeting, such final dividend will be payable on or before 8 September 2006 to qualified shareholders.

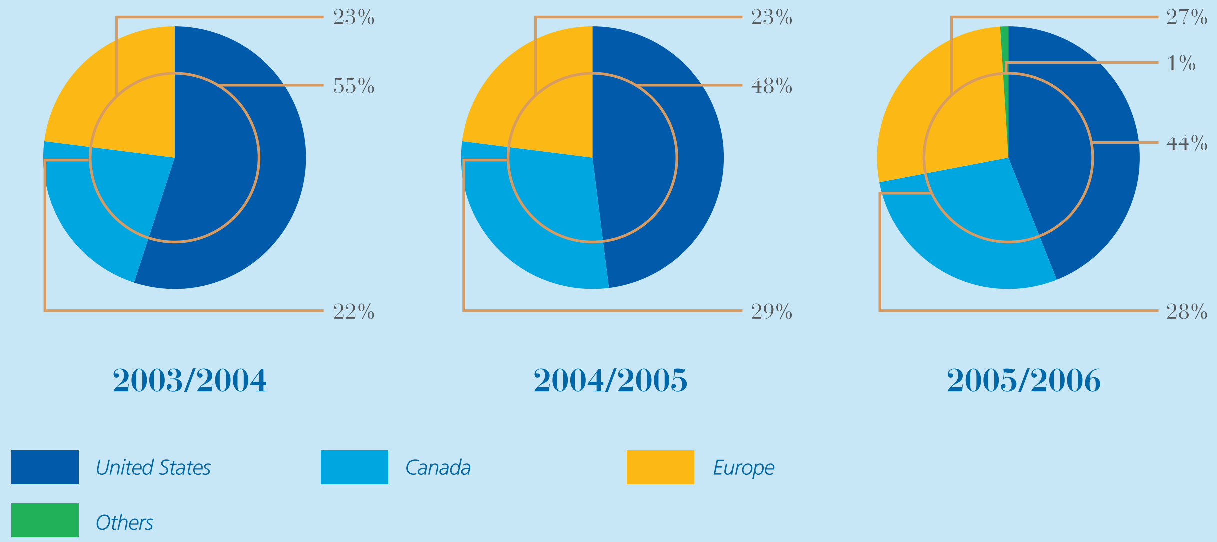
During the Period, increasing competition in the global automobile market, appreciation of the RMB and fluctuating raw material costs all posed challenges to the Group's business. However, boasting products of premium quality, efforts in developing high value-added products, stable after market demand, and benefiting from increased purchase in China from global automobile manufacturers, the Group continued to record stable sales growth. The composite friction material production line, which commenced operation in September 2004, reported increasing utilization rate during the Period and its full year operation also facilitated sales of high value-added products. Regarding production costs, the Group implemented stringent internal cost control measures, allowing it to combat unfavourable market conditions as well as enhance overall gross margin. During the Period, the Group's overall gross profit margin was approximately 18.6%, an encouraging growth compared to 16.7% for the same period last year.

Auto parts

During the Period under review, sale of auto parts continued to be the core business of the Group with turnover amounted to approximately RMB2,297,521,000, representing a 24.6% increase from approximately RMB1,843,883,000 in the last corresponding period. It accounted for approximately 86.4% of the Group's

Friction materials production line

Auto parts turnover by geographical location



total turnover. Gross margin for the auto parts business increased to 19.5% from 17.4% last year. The remarkable growth was attributable to the increased utilization of the composite friction material production line and improved customer recognition of the Group's high value-added products.

In the Period, sales of high value-added products, including disc brake pads and lined brake shoes, enjoyed notable growth. Together with the Group starting to sell suspension systems/axle modules and shock absorbers to local automobile manufacturers led to an increase in total turnover of the Group's auto parts manufacturing business.

Market analysis

While the Group started to sell suspension systems/axle modules and shock absorbers to local automobile manufacturers during the reporting Period, its primary focus has remained on export, which accounted for approximately 99% of the auto parts turnover in the Period. The U.S., Canada and Europe remained as its principle markets.

The U.S., Canada and Europe markets accounted for 43.8%, 28.1% and 27.1% respectively of the Group's total auto parts sales, against last year's 48%, 29% and 23%. Sales to Europe recorded the highest growth, attributable mainly to the Group's proactive marketing strategies to heed the characteristics and demand of the European automobile market, and its added efforts in product development and boosting supply capacity. These endeavors brought in more sales orders for the Group.

The Group expects sales for the U.S., Canada and Europe markets in the coming year to remain steadfast. The Group will focus its effort on exploring market opportunities for chassis system integration and auto parts business, such as suspension systems/axle modules and shock absorbers in China, so as to enter into the OE system in mainstream automobile manufacturing.

Manufacturing business

During the Period under review, turnover of the auto parts manufacturing business grew a substantial 26.1% over that in the corresponding period last year to approximately RMB2,143,332,000, and accounted for approximately 93.3% of the total auto parts sales.

The Group reported continual increase in sales of disc brake pads and lined brake shoes. The sales of brake plates/shoes, however, decreased by 27.1% when compared with the same period last year, the main reason being the bulk of the output was used to produce higher-margin disc brake pads and lined brake shoes by adding to them composite friction material. Lined brake shoes' contribution to total turnover of auto parts manufacturing business climbed notably from last year's 11.9% to approximately 39%, and sales also surged 313%. Sale of disc brake pads also surged 132% accounting for 13% of total turnover of auto parts manufacturing business.

Currently, disc brake pads and lined brake shoes coming in over 700 models together accounted for around 52.1% of total auto parts manufacturing sales (2005: 19%). The management believes that increasing sales of high value-added products would enhance the Group's overall sales and gross profit margin, at the same time alleviate any impacts of unfavourable conditions, such as the RMB appreciation.

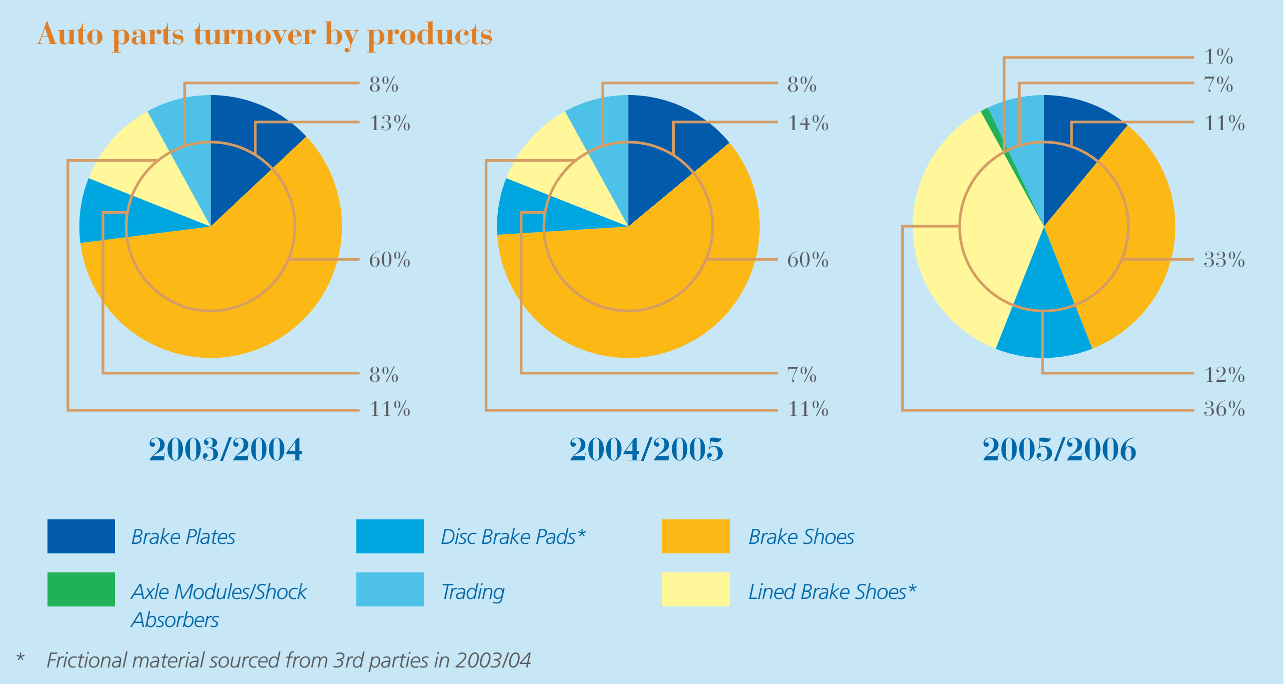
In October 2005, the Group's subsidiary, Norstar Auto Suspension Manufacturing (Bejing) Inc. (北泰汽車懸架製造（北京）有限公司), located in the Beijing Economic-Technology Development Area commenced operation with assembly capacities of 60,000 sets of suspension systems/axle modules and 750,000 pieces of shock absorbers a year. During the Period, the utilization rate of the Group's suspension system/axle module and shock absorber production facilities only approximated at 10-20%, and related outputs accounted for less than 2% of the Group's total auto parts sales. The Group continued to sign new supply agreements with domestic customers. During early FY2006/2007, the Group landed a major order from Beijing Benz-Daimler Chrysler Automotive Co., Ltd, symbolizing the Group's dominant position in the mainstream auto parts manufacturers in the country. It also called for the need to expand the Group's production capacity as total new supply contracts signed have exceeded the plant's current production capacity.

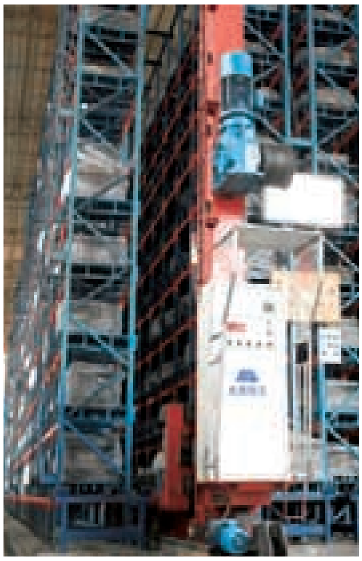
During the Period, the utilization rate of the Group's brake plates/shoes production facilities exceeded 80%. To meet increasing sales orders, the Group completed expansion of its production capacity in February 2006. The Group's annual production capacities for brake plates/shoes have increased 17.8%, equipping the Group with capability to meet the rising demand of brake plates and shoes.

During the Period under review, the annual utilization rate of the Group's composite friction material production facilities increased to approximately 75%. The management is currently looking into whether to raise production capacity for composite friction materials in the next financial year.

Trading business

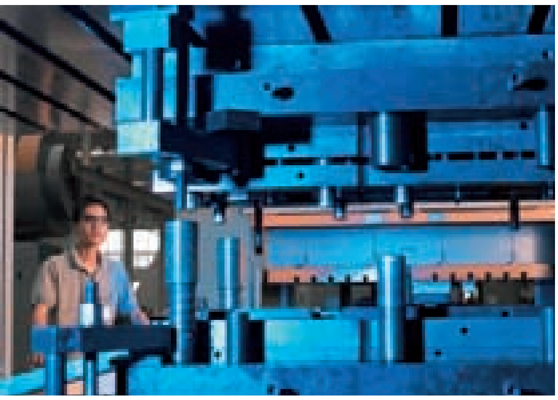
Compared with the same period last year, income from trading of auto parts increased slightly by 6.8% to RMB154,188,000, accounting for





Mould library located in Anhui plant with over 1000 moulds.

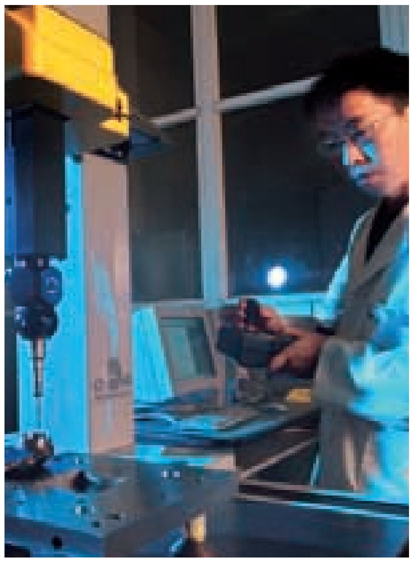
Differential parts



Stamping machine for multi-process moulds

approximately 6.7% of the year's total auto parts sales. During the Period, universal joints and transmission shafts were the major auto part products sourced for customers. Compared with the corresponding period last year, the sales of transmission shafts increased by over 23%, and the sales of universal joints more than doubled because of a substantial increase in customer orders.

Looking forward, as the Group generates closer relationship with customers and rides on its extensive procurement network in China, it will continue to source high quality products from domestic suppliers with relevant technological capability according to customers' needs. This will ensure stable growth for the Group's auto parts trading business.



Mould testing equipment from Italy

Construction decorative hardware

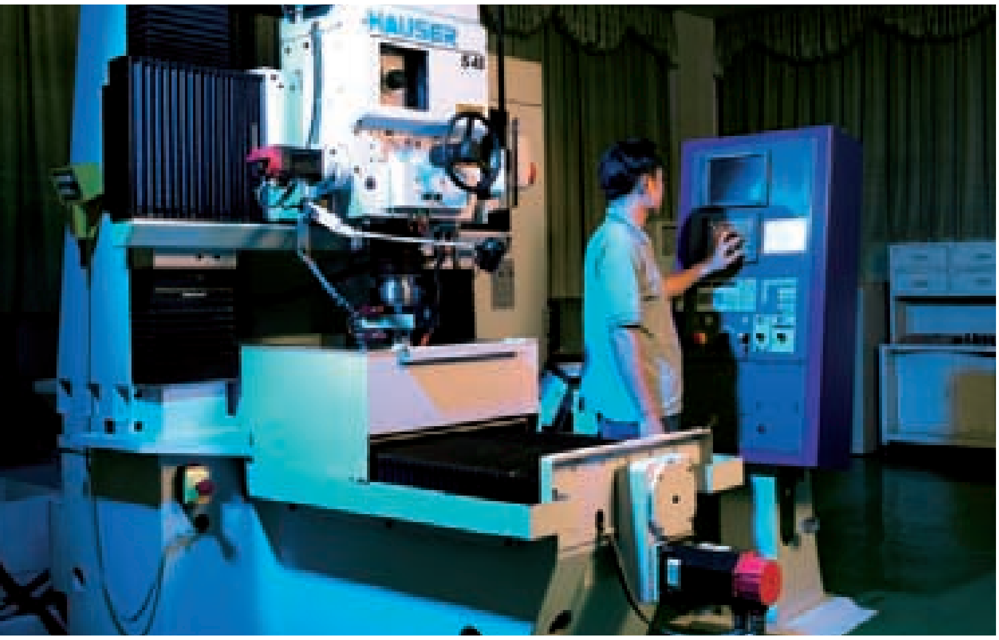
In the Period under review, construction decorative hardware products generated a turnover of approximately RMB361,472,000 which was similar to that of last year. Its contribution to total sales of the Group dropped 16.4% to 13.6%. During the Period, the Group continued to focus on selling self-manufactured construction decorative hardware products, which accounted for approximately 82% of total turnover from construction decorative hardware products. The gross profit margin of construction decorative hardware products declined from last year's 15% to 13.3% during the Period mainly due to the RMB appreciation.

Construction decorative hardware products continue to generate stable earnings to the Group. Since the long-term mission of the Group is to focus on developing its auto parts business, the Group expects contribution from the segment to its total turnover to continue to fall by the year.

Raw material costs

During the Period, the cost structure of the Group's manufacturing business has changed due to alteration of product mix. The cost of steel continued to make up the largest share of the Group's production cost, while its percentage dropped from around 58% to around 46% this year, mainly owing to the increased usage of composite friction material for producing disc brake pads and lined brake shoes. The total cost of friction material accounted for approximately 20% of the total cost of production, compared to 7% in the last financial year.

Even though the market prices of steel have come down gradually after peaking in April and May 2005, the Group's



R&D centre for moulds - grinding machine from Switzerland

average cost of steel per tonne increased by approximately 2% compared with the previous financial year.

During the year, the prices of major raw materials used in producing friction materials remained generally stable except for the sudden surge in August 2005 due to temporary supply shortage in China. All in all, the price of major raw materials used in manufacturing friction materials increased less than 4% during the Period.

Although certain raw material costs increased during the Period, increased production utilization of friction materials enabled economies of scale. Together with the Group's stringent cost control measures and commitment to increasing sales of high value-added products saw overall increase in product prices beat rise in production costs. Hence, despite facing different unfavourable factors including increasing raw material costs and RMB appreciation, the Group's auto parts production business still managed to deliver notable growth in margin from last year's 18.3% to 19.8% for the first six month of this year, or 20.4% for the entire year.

Looking into the coming financial year, although three major overseas iron ore suppliers raised price by 19%, the Chinese Government's macroeconomic control on the steel industry is still expected to see steel supply in surplus of demand in the next one to two years. Thus the Group does not expect overall steel price to surge significantly. As for the major raw materials of friction materials and chemical materials, according to the latest supply agreements, prices have remained stable in the first quarter of the next financial year. In the medium to long run, the Group will gradually increase the proportion of high value-added product output and control costs vigilantly. The Group also aims at raising its gross profit margin by producing more key parts internally.

Outstanding product research and development

During the year, the Group invested approximately RMB95,537,000 (2005: RMB76,531,000) in research and development ("R&D") of products. The amount accounted for approximately 3.6% of the Group's total turnover (2005: 3.5%). The Group also successfully developed over 500 product items, including brake plates/shoes, disc brake pads/lined brake shoes, suspension systems/axle modules and shock absorbers, etc., bringing the total number of products it offers to over 1,500 types.

Looking ahead, the Group will focus on developing independent suspension systems assembly, front and rear axle

A variety of shock absorbers manufactured by Norstar and front and rear shock absorbers in Beijing to meet the specific requirements of domestic customers. The Anhui plant will focus on developing brake systems, shock absorber parts and components such as ball joints for different automotive models to suffice demand of the new production lines to be completed by the end of the coming financial year. To extend customer coverage, the Group will also be developing more than 200 new models of brake plates/shoes, disc brake pads and lines brake shoes.

Suspension systems/axle modules

Prospects

Market

Looking ahead, the full operation of new production lines of brake shoes/ plates will enhance the Group's production capacities for satisfying rising demands of existing customers in the U.S., Canada and Europe. These markets are expected to bring in considerable profit contributions to the Group in FY2006/07. The Group expects the markets to mature and enter a stage of steady and balanced growth in the coming year.

The Group started to supply suspension systems/axle modules and shock absorbers produced in Beijing to domestic automobile makers producing light vehicles, SUVs and MPVs. Utilization rate of production lines are set to increase substantially in FY2006/07.

In FY2006/07, the Group landed a major order from BBDC, marking its entry into the OE system of Beijing Automotive Industry Holdings Company Limited (北京汽車工業控股有限責任公司) ("BAIC"), one of the five largest automobile manufacturing groups in the PRC, symbolizing the Group's dominant position in mainstream auto parts manufacture and system integration in the country. Orders from BBDC cover models including Jeep 2500, Mitsubishi Outlander, Mitsubishi Pajero Sport, Grand Cherokee, Military Truck (1st & 2nd generation), police vehicles etc.

Jeep 2500

Mitsubishi Pajero

Mitsubishi Outlander

Cherokee

In the coming year, the Group will focus on expanding the sales of suspension systems/axle modules within China, aiming at increasing the proportion of domestic sales to over 10% of the Group's total turnover in FY2006/07, and to over 30% in the coming 3 to 5 years.

The Group will continue to strive to become a world-class system integrator and manufacturer of auto parts in the global market.

Long-term strategy

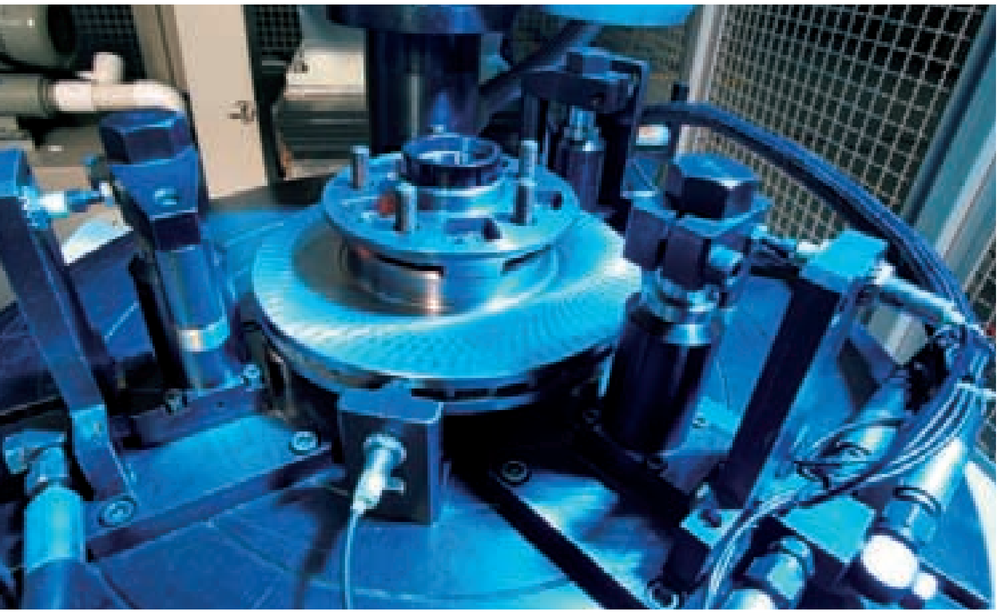
The market is of the general view that automobile sales in Europe, the US and Japan have limited growth potential, and the main drives of the global automobile industry in the future will come from emerging markets in the Asia Pacific, Eastern Europe and South America. Globalization of the worldwide auto parts industry is going to accelerate. Facing intensifying market competition and cost pressure, major automotive enterprises have resorted to purchasing auto parts globally. Many automotive enterprises in Europe and the US have reduced domestic production and shifted operations to countries with cost advantage. Between 2006 and 2010, a large number of automotive manufacturers is expected to relocate production to China, and that will see China become the production base of auto parts for the world.

According to the State Information Centre, China sold approximately 5,900,000 automobiles in 2005, which became the world's second largest automotive market. Assuming growing importance in the international arena, China has become an integral part of the global automotive market.

China does not only own rich raw material resources, but also stands out among developing countries in having strong production capability, an automotive market laden with immense potential and unmatched labour cost advantage. These strengths are conducive to it becoming a world auto parts manufacturing centre. According to China Automotive Industry Association information, turnover from the sale of auto parts in China amounted to RMB550 billion in 2005 and is expected to reach RMB1,400 billion in 2010, translating into an annual average growth rate of 20%. As for export of auto parts, the country sold RMB100 billion worth in 2005 and expects it to reach RMB400 billion in 2010, growing on average over 34% a year.

Major European and US automobile makers establishing purchasing and R&D centres and production plants in China are presenting auto parts manufacturers in the country with ample opportunities as well as competitive pressure. To exploit the tremendous opportunities and at the same time cope with the competition, Chinese auto parts enterprises have to equip themselves as quickly as possible. A leader in the auto parts industry in China, Norstar's long-term competitive strategy is to become an international auto system integration provider. Within the next two to three years, the Group will seek to develop its business via investing in new plants and capitalizing on mergers and acquisitions that can speed up its evolution into an automobile chassis system integrator. New plants will be built to focus on producing auto parts products like brake

Shock absorbers testing line



An advanced machine used to test balancing on front wheel shafts systems, suspension systems, steering systems and transmission systems. As for mergers and acquisitions, the Group will emphasize on deals that can facilitate its penetration into major automakers' OE systems. It will also actively seek merger, acquisition and restructuring opportunities that can facilitate chassis module, wheeling system and energy system integration, to hasten its entry into the OE system in mainstream automobile manufacturing.

The Group will set up an R&D centre for auto parts and moulds and dies in Anhui. This will help standardise the Group's R&D and mould production capabilities, and enable it to develop new technologies, new production processes and new facilities for supporting the Group's chassis system development. The Group also plans to establish a chassis system research centre in Beijing for the development of mid-to-high end automobile chassis systems. The Beijing site will serve as the Group's R&D headquarter, aim at facilitating Norstar's evolution from a manufacturing-focused enterprise into one that is technology and R&D focused. By developing new chassis systems and products, the centre can ensure the Group has the technological support which it requires to grow its business and compete globally in the future. The Group will be able to keep up with the hastening of new product launch in the international market, offering to it a more diverse product mix.

The Group's planned projects and their latest progress are as follows:

Suspension system assembly

With designed capacities of 60,000 sets of suspension systems/axle modules and 750,000 shock absorbers, the Group's assembly plant in the Beijing Economic-Technology Development Area commenced operation in October last year. As the suspension system/axle module supply contracts signed for the coming year have already exceeded the plant's current production capacity, the Group will seek to increase related capacity to 120,000 sets in the short run to meet customer demand.

Brake systems

Ball joints

In the medium to long run, the Group will construct a new plant with total site area of over 200,000 square metres in the Beijing Economic-Technology Development Area to boost suspension system/axle module production capacity, including that for certain critical components, to 200,000 sets in FY2007/08 and 400,000 sets in FY2008/09.

Suspension system parts

The Group currently purchases parts from external manufacturers for the assembly of suspension systems/axle modules and shock absorbers. The management plans to manufacture some of the parts internally at its Anhui plant, which will not only ensure the Group has a stable supply of quality components, but will also effectively raise the overall profit margin of the Group's suspension system/shock absorber business. Besides being used as parts for assembly in the Beijing plant, the components also possess a huge market of export demand. Currently, the Group has started purchasing equipments from local and overseas suppliers. Production of the facility is expected to formally commence in FY2007/08. The initial designed production capacities are 1.5 million sets of shock absorber parts and 6 million pieces of ball joints.

Brake system assembly

The Group's existing disc brake pad/lined brake shoe products are major components of brake systems. The management plans to commence brake system assembly in the Anhui Plant in FY2007/08 to effect better vertical integration, which will in turn strengthen the Group's position in the supply chain. The initial designed production capacities are 1.2 million sets of disc brake/drum brake assemblies.

With various high value-added products in the pipeline, the management believes the coming few years will see

Assembly line for differentials

the Group achieve stable growth. In the first quarter of FY2006/07, the sales orders from the Group's existing business amounted to RMB730 million (exchange rate: USD1=RMB8.1), representing an increase of 19% when compared with same period of last year.

Operating cost

Distribution and selling expenses

The Group's total distribution and selling expenses surged 34.1% during the year. Sea freight charges incurred in association with CIF sales accounted for most of the distribution and selling expenses. Freight rate increased by approximately 8% during the year, and CIF sales surged 89%. Total distribution and selling expenses expressed as a percentage to total CIF sales decreased from 10.4% in 2005 to 8.9% this year, due to the increased sales of higher-value products (i.e. lined brake shoes and disc brake pads).

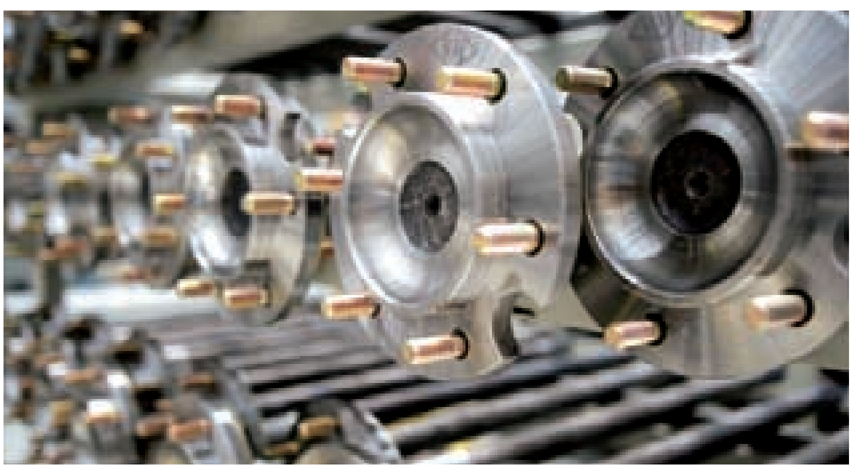
Administrative expenses

Administrative expenses rose 56.1% during the year. Rising salary and payroll for the Group's management and staff accounted for approximately 30% of the increase. The increase was attributed to a rising management headcount to facilitate the Group's rapid expansion and new hires to support the Group's Beijing production facility that began operation during the year. Basic payroll for existing management and directors were also revised, with reference to prevailing market rates, to reflect their contribution to the Group's performance.

Also included in administrative expenses was an exchange loss of RMB8,024,000 (31 March 2005: exchange gain of RMB825,000) (Please refer to the section "Impact from RMB appreciation" for details). Other areas of increase included higher traveling expenses as a result of rising business activities, additional administrative expenses associated with operation of the Group's Beijing production facility, and rising shipment costs for machineries imported from overseas.

Other revenues

Other revenues surged 88% during the year. Sales of scrap metals and waste materials accounted for 54.8% of the total (31 March 2005: 27.9%). Income from sales of scrap metals and waste materials increased 2.7 times. However, after a cut-off adjustment, the growth for the year was actually around 86%. This was attributable to higher prices of scrap metals and higher volume of scrap metals produced resulting from product models with low steel utilization. Rising interest income, as a result of the significant growth in cash balances this year, also contributed to the increase in other revenues.



Half axles

Finance costs

During the year under review, total finance costs surged by 97.1% to RMB66,389,000 approximately. Rising interest expenses on long term loans accounted for over 60% of the increase. To finance the Group's long term project development and prepare for further RMB appreciation, the Group has drawn down a US-dollar denominated syndicated loan totaling USD94.6 million in November 2005. Part of it was used to repay the Group's existing HK-dollar denominated syndicated loan, and the rest would go into future expansion projects. While the terms of the new syndicated loan are more favorable to the Group, an overall increase in outstanding long-term borrowings, coupled with interest rate hikes during the year, resulted in increased interest costs.

Furthermore, the Group's USD40m-convertible bonds, issued in December 2004, saw a full year interest on convertible bonds this year. Besides, as 80% of convertible bonds were already converted into equity this year, there was a significant growth in amortization of related arrangement fee this year.

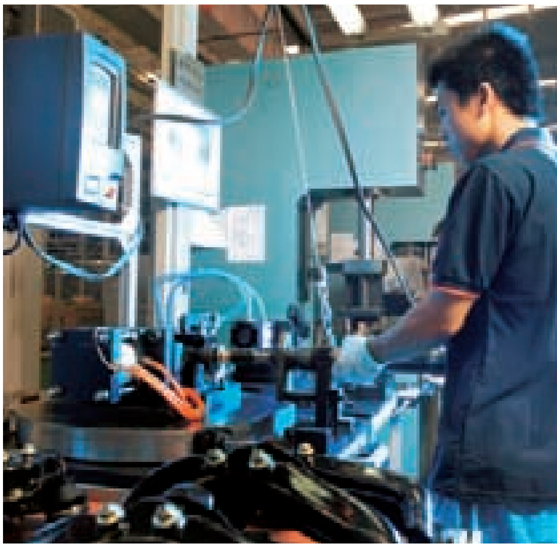
Share of profits of an associate

The Group completed the acquisition of 40% stake in Profound Global Group on 24 December 2004, and has since then shared its profits using the equity accounting method. Profound Global Group recorded an audited net profit of RMB108,200,000 for the year ended 31 December 2005, representing a flat growth from 2004. Stripping out a one-off profit of RMB14,152,000 from discount on acquisition of additional interest in a subsidiary in 2004, its net profit actually grew 15% in 2005. The net profit also exceeded RMB100,000,000 guaranteed by the controlling shareholder of Profound Global Group for 2005. The unaudited net profit was RMB106,888,000 for the period from 1 April 2005 to 31 March 2006. Profound Global Group declared a dividend of RMB8,280,000 to Norstar, representing a pay-out of around 20% of its net profit.

Impact from RMB appreciation

The People's Bank of China adjusted on 21 July 2005 the exchange rate of the US dollar against the RMB to 8.11, translating into a 2% appreciation of the RMB. Income derived by the Group is mainly denominated in US dollars while most of its purchases are denominated in RMB except for certain capital expenditures settled in US dollars.

The Group adjusted its book exchange rate from 8.27 to 8.10 with effect from 1 July 2005 to reflect the RMB appreciation. The change resulted in the following: 1) exchange losses with respect to the settlement of accounts receivables remained outstanding as at 1 July 2005, 2) a reduction in the RMB equivalent of revenue amounting to approximately RMB41 million subsequent to the change in book exchange rate. As the RMB continues to appreciate gradually subsequent to its 2% appreciation in July 2005 (8.03 as at 31 March 2006), additional exchange losses were incurred by the Group with respect to settlement and revaluation of



Assembly line for control arms

accounts receivable balances recorded during the period between 1 July 2005 and 31 March 2006, due to differences between book and actual exchange rate at the points of settlement or revaluation.

All in all, the Group recorded a net exchange loss of approximately RMB8,024,000 for the year ended 31 March 2006.

The Group's financial position, liquidity and capital structure

As at 31 March 2006, the Group had total net assets of RMB2,030,230,000 and net current assets of RMB1,490,154,000 approximately, as compared to approximately RMB1,311,981,000 (restated) and RMB964,925,000 respectively as at 31 March 2005.

The average receivable turnover for the year was 56 days, compared to 45 days last year and 48 days in 2004. While the Group has in general maintained its credit terms of 30-90 days, a few customers stretched their payment towards the end of corresponding credit term. The proportion of exports to overseas customers through the Group's agent which usually maintains a settlement period of 0-30 days, was reduced to 17.2% this year from 28.2% in 2005.

The average payable turnover for the year increased slightly to 16 days from 13 days, while average inventory turnover declined to 7 days from last year's 9 days. The average inventory turnover days measured at year-end are usually exceptionally low due to the Group's policy to slow down raw materials in-take and speed up finished goods delivery prior to year-ends to facilitate smoother physical stock-take at year-ends. Inventory turnover days averaged at 2-3 weeks throughout the rest of the year.

During the year under review, the Group financed its operations principally from internally generated cashflow, while certain expansion projects were financed by bank loans and finance leases. Total cashflow from operations amounted to RMB179,778,000 compared to RMB146,972,000 (restated) approximately last year. The cash portion of capital expenditure for the year amounted to RMB76,490,000, resulting in a positive cashflow even before financing activities.

Total bank borrowings, which also included the unconverted portion of US dollar-denominated convertible bonds issued in December 2004, amounted to RMB1,047,296,000 approximately (31 March 2005: RMB958,542,000 approximately). Cash and bank balances, however, stood at RMB1,079,833,000 approximately (31 March 2005: RMB754,918,000), resulting in a net cash position of around RMB32,537,000 (31 March 2005: net debt of around RMB203,624,000).

As at 31 March 2006, approximately 96.5% of the Group's cash and bank balances was denominated in RMB, while 85.7% of its bank borrowings was denominated in US dollars and HK dollars. The Group's cash and bank balances will be principally used to finance the Group's operations and capital expenditures in coming years, while US and HK dollar-denominated loan portfolio could cushion the potential impact of further RMB appreciation on the Group's earnings. As at 31 March 2006, approximately 97% of the total bank borrowings bears floating interest rates at prevailing market rates, with the remaining at fixed rates. Looking ahead, the Group is actively assessing various hedging mechanisms for providing effective hedges against the Group's interest rate exposure.

Charge on assets

As at 31 March 2006, bank deposits of approximately RMB16,670,000 (31 March 2005: RMB16,631,000) were pledged as security for certain banking facilities of the Group.

Capital commitments and contingent liabilities

As at 31 March 2006, the Group's total capital commitments amounted to RMB138,022,000 compared to RMB122,915,000 as at 31 March 2005. There were no material contingent liabilities as at 31 March 2006 (31 March 2005: Nil).

Employees and remuneration policies

As at 31 March 2006, the Group had a total of 2,157 employees. Total staff costs amounted to RMB49,553,000 during the year. Remuneration packages are determined by considering the qualifications and experience of the staff members concerned and reviewed annually by the management with reference to market conditions and staff performance. The Group also participates in Mandatory Provident Fund Scheme in Hong Kong and State-managed retirement benefit schemes in the PRC. Looking ahead, the Group is considering granting share options to eligible staff to reward them for their contribution to the Group.