

## **INDUSTRY OVERVIEW**

The information provided in this section as well as the historical and projected statistics and data provided elsewhere in this prospectus relating to the motor vehicle industry and car rental business in the PRC are based on various government, industry and private publications. Such information, statistics and data have not been independently verified by the Company. The Company and the Directors make no representation as to the accuracy of such information, statistics and data, which may not be consistent with other information compiled within or outside the PRC.

### **THE PRC MOTOR VEHICLE MARKET**

The PRC motor vehicle market is characterised by both domestically manufactured motor vehicles and imported motor vehicles. The domestic motor vehicle industry was developed in 1950s, with the initial focus on production of trucks and good vehicles. Although the domestic motor vehicle industry developed rapidly after the PRC adopted the Open Door Policy in 1979, aided by the improved technology and designs from foreign partners, the industry is still under various controls such as product types, output and production capacity, designs and purchase of raw materials.

The PRC motor vehicle market is dominated by domestic manufacturers. This is, in part, attributable to the price difference between locally manufactured motor vehicles and imported motor vehicles. Such price difference is primarily due to the imposition by the PRC government of import tariffs, ranging from 43.8% to 50.7% for passenger vehicles and an average of 23.4% for auto parts and components, and the quota restrictions on the import of foreign manufactured passenger vehicles. According to the Protocol on the Accession of the PRC published on 10th November, 2001, the import tariffs on passenger vehicles will be further reduced every year after China's entry to the WTO. In the case of imports from European Union, such import tariffs are expected to be reduced over a number of years to 25%. It is also expected that import tariffs on auto parts and components will be gradually reduced to 10% over 5 years.

### **DEMAND FOR IMPORTED MOTOR VEHICLES IN THE PRC**

A country's demand for motor vehicles correlates with the performance of its economy. From 1990 to 2000, the GDP of the PRC has grown from approximately RMB1,770 billion to approximately RMB8,940 billion, representing a compounded annual growth rate of approximately 18%. The annual individual disposable income of urban household in the PRC also recorded a growth rate of approximately 30% from 1996 to 2000 reaching RMB6,280 in 2000. The enhanced purchasing power of profitable private enterprises and individuals has stimulated demand for both locally manufactured and imported motor vehicles in the PRC. The number of sedans imported into the PRC in the first half of 2001 amounted to 30,465 units, representing an increase of approximately 138% comparing to that in the first half of 2000. Total sales of imported motor vehicles in the first half of 2001 amounted to US\$2.1 billion, representing an increase of approximately 32.8% over the same period of last year. Among all the imported sedans, German and Japanese motor vehicles accounted for approximately 76% of the total value of the import sales.

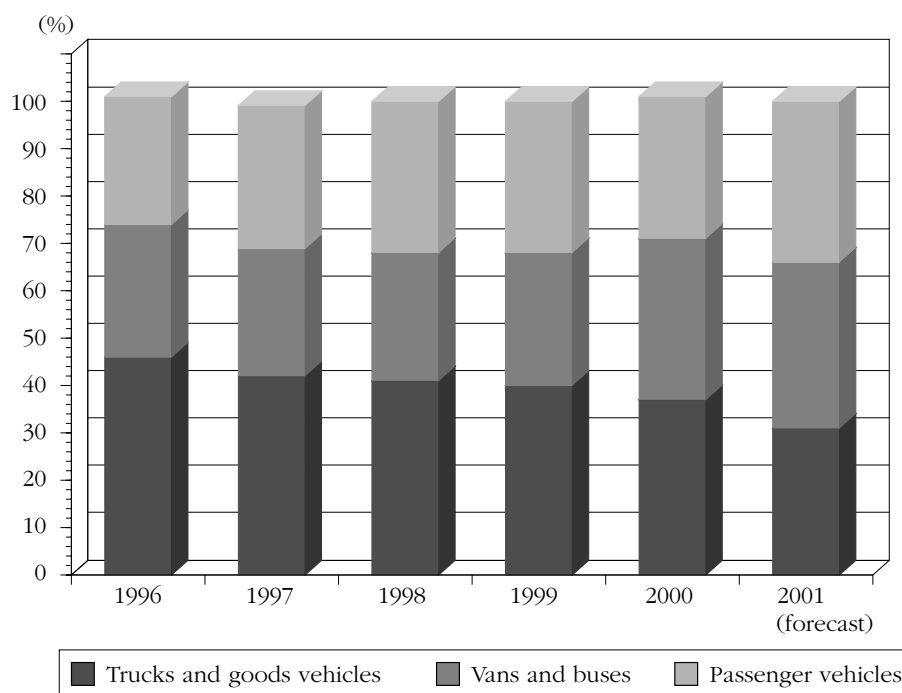
## INDUSTRY OVERVIEW

The current market for imported passenger vehicles in the PRC is dominated by the Japanese and European manufacturers. It is expected that such foreign manufacturers may benefit from recent moves by the PRC's environmental protection agency to strengthen emission standards for passenger vehicles and that foreign manufactured passenger vehicles which already comply with such standards may enjoy some advantage over domestically manufactured vehicles. It is also expected that the gradual reduction in import tariffs on foreign manufactured passenger vehicles after the PRC's accession to the WTO will further improve the competitiveness of such vehicles, insofar as price is concerned.

### DEMAND FOR PASSENGER VEHICLES IN THE PRC

The official statistics for the PRC motor vehicle market showed that passenger vehicles have been the fastest growing segment of the market in recent years. Sales of passenger vehicles have increased since 1996, while sales for the other categories have slackened. The growth in the demand for passenger vehicles is principally attributable to the growing demand of the private enterprises and from the growing middle class in the PRC.

**Exhibit 1 – Sales of Motor Vehicles by Category in the PRC**

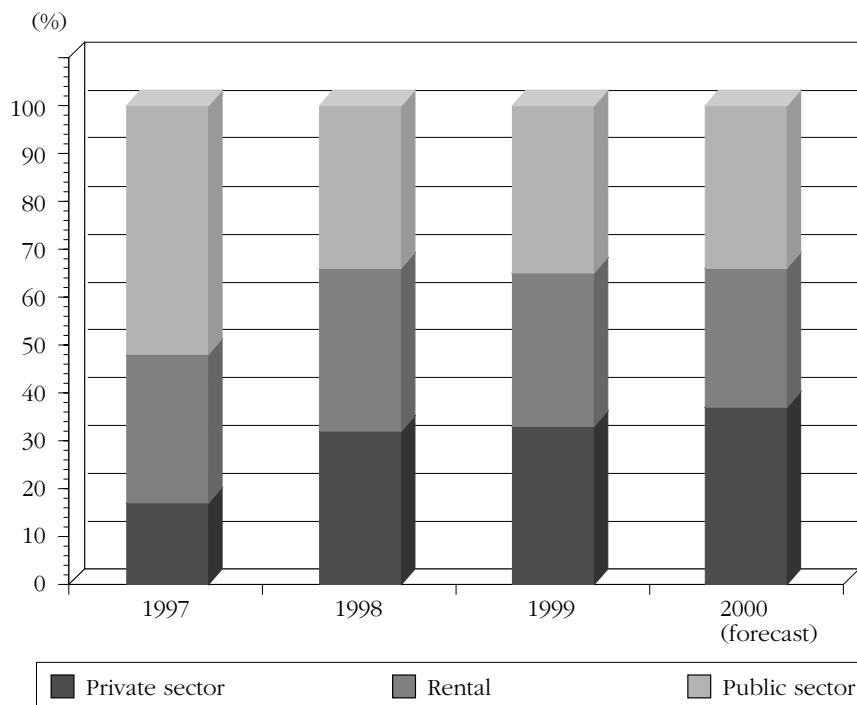


Source: *Forecast of Chinese Automobile Market 2001* by 國家信息中心 (State Information Centre) and 國家計委產業發展司 (State Development Planning Commission)

## INDUSTRY OVERVIEW

According to Forecast of Chinese Automobile Market 2001 by State Information Centre and State Development Planning Commission, private sector passenger vehicle buyers increased from approximately 16.9% in 1997 to 37.3% in 2000 (forecast) of the total passenger vehicle market in the PRC. Passenger vehicle buyers from the private sector have become increasingly selective on product quality and comfort, while the preference of public sector is principally affected by government policy which give direction on the different class of passenger vehicles to be used by officials of different rankings.

**Exhibit 2 – Demand for Passenger Vehicles by Sector in the PRC**



Source: *Forecast of Chinese Automobile Market 2001* by 國家信息中心 (State Information Centre) and 國家計委產業發展司 (State Development Planning Commission)

According to BMW AG, its sales in the PRC in 2000 recorded an increase of more than 100% comparing to that in 1999 and BMW was the top-selling luxury brand with a market share of approximately 24% of the luxury motor vehicle segment in the PRC.

According to the China Automobiles Market Forecast 2001 by 國家信息中心 (State Information Centre) and 國家計委產業發展司 (State Development Planning Commission), the number of luxury and mid-market passenger vehicles sold in the PRC:

Year	Number of cars Sold	% change
1997	278,660	
1998	270,803	-2.8%
1999	290,369	7.2%

## INDUSTRY OVERVIEW

### REGULATORY FRAMEWORK

#### **Importation of motor vehicles and auto parts and accessories into the PRC**

Under the relevant PRC laws and regulations, importing of passenger vehicles and auto parts and accessories should be carried out by foreign trade corporation authorised by MOFTEC, and distribution of both domestic and imported motor vehicles should be carried out by licensed resellers authorised by the State Planning and Development Commission of the PRC and the State Administration of Industry and Commerce of the PRC. These licensed vehicles resellers in the PRC usually engage a foreign trade corporation in the PRC for importing the passenger vehicles and auto parts and accessories into the PRC. After the motor vehicles and auto parts and accessories are imported, resellers will be able to distribute the motor vehicles to the end customers in the PRC. As no member of the Group in the PRC is a licensed motor vehicles reseller or a foreign trade corporation, the Group can only be a supplier of these licensed motor vehicles resellers in the PRC. Resellers in Hong Kong will also need to engage a foreign trade corporation to first import the motor vehicles and auto parts and accessories into the PRC before distributing the same to the end customers in the PRC. However, foreign invested enterprises which are incorporated in the free trade zones in the PRC are allowed to import and trade motor vehicles and auto parts and accessories directly to end customers within the free trade zones. CNA Anhua (Tianjin), a 70% owned joint venture of the Company, was incorporated in Tianjin Free Trade Zone in April 1999. As such, the Group is allowed to import and distribute motor vehicles and auto parts and accessories directly to end customers in Tianjin Free Trade Zone under the PRC laws and regulations.

Neither foreign investment enterprises nor foreign companies is allowed under the current foreign investment policy of the PRC to engage in trading of motor vehicles. However, according to the Protocol on the Accession of the PRC, trading restrictions in the PRC will be relaxed after China's entry to the WTO. It is provided under the said Protocol that foreign companies will be allowed to engage in trading of motor vehicles in the form of joint ventures in five economic zones namely, Shenzhen, Zhuhai, Shangtou, Xiamen and Hainan and six cities namely, Beijing, Shanghai, Tianjin, Guangzhou, Dailian and Qingdao following China's entry to the WTO and that restrictions will be further relaxed within five years thereafter. Since no relevant laws or regulations in this aspect have been promulgated, there is no assurance that restrictions on trading of motor vehicles in the PRC will be relaxed favourably to the Group in the future.

## INDUSTRY OVERVIEW

### IMPORT TAX AND QUOTA ON IMPORTED PASSENGER VEHICLES IN THE PRC

Import barriers like tariffs, import quotas and import licenses provide a degree of protection to the PRC domestic motor vehicle industry. The import tax applied to the Group for motor vehicles in the PRC is a graduated scale for based on the tank volume of the motor vehicles. Currently the graduated scale is as follows:

Engine volume (cc)	Tax Rate %
Below 1,500 cc	43.8
Between 1,500 cc to 3,000 cc	43.8
3,000 cc above	50.7

On 1st October, 1997, the PRC Government reduced import tariffs to an average of 17%. In particular, tariffs on imported passenger vehicles were further reduced to between 43.8% to 50.7% with effective from 1st January, 2002. Any further reduction in import tariff would enhance the price competitiveness of imported motor vehicles.

Under the existing system, only PRC trading companies, industrial and trading corporations, international economic and technological co-operation companies and enterprises with foreign investments and car manufacturers can apply for import quotas and import licenses.

### PROVISION OF TECHNICAL SERVICES IN THE PRC

In the PRC, as at 1st January, 2002 the provision of technical services by foreign companies to PRC companies is subject to the Regulations on the Administration of Technology Import Export of the PRC(中華人民共和國技術引進出口管理條例), which were approved by the State Council on 31st October, 2001. These new regulations supersede the Regulations on the Administration of Technology Import Contracts of the PRC(中華人民共和國技術引進合同管理條例), which were promulgated by the State Council on 24th May, 1985, and its implementing rules, which were approved by the State Council on 30th December, 1987 and promulgated by MOFTEC on 20th January, 1988. Under the new regulations, except for prohibited and restricted technology, contracts for the provision of technical services under the category of free technology are no longer subject to the approval of MOFTEC or its local authorised delegate and will become effective immediately upon signing of the contracts rather than upon receipt of MOFTEC approval. The agreement entered into in January 2000 between North Anhua and GAPL for the provision of technical services was approved by MOFTEC in September 2000 under the superseded regulations.

## **INDUSTRY OVERVIEW**

### **MOTOR VEHICLE FINANCING**

In 1998, the People's Bank of China granted an approval to The Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China and China Construction Bank to offer motor vehicle financing services. In 1999, China Construction Bank extended its motor vehicle financing services to about 400 of its branches and the branch list keeps on growing. In the same year, the People's Bank of China granted approvals to other commercial banks in the PRC for offering motor vehicle financing services.

General Motors Acceptance Corp. and Ford Motor Company have also expressed interests in offering motor vehicle financing to the motor vehicles buyers in the PRC, pending approvals by the relevant PRC government authorities. As foreign banks will be permitted to conduct businesses with local companies in the PRC within five years after the PRC's accession into the WTO, the Directors believe that such permission will allow corporate buyers of motor vehicles to have more financial flexibility in motor vehicle purchases. The Directors are of the view that the availability of motor vehicle financing will facilitate sales of motor vehicles along with the greater acceptance of consumer spending with consumer financing in the PRC.

### **WTO**

It is anticipated that the PRC's accession to the WTO may open up more opportunities for foreign companies with respect to the importation and sale of goods and the provision of services in the PRC.

It is expected that as a result of the PRC's entry into the WTO, import tariffs on passenger vehicles will be reduced gradually. Import tariffs are expected to be reduced over the next 6 years to 25%. It is also expected that import tariffs on auto parts and components imported from the European Union will be reduced gradually in general.

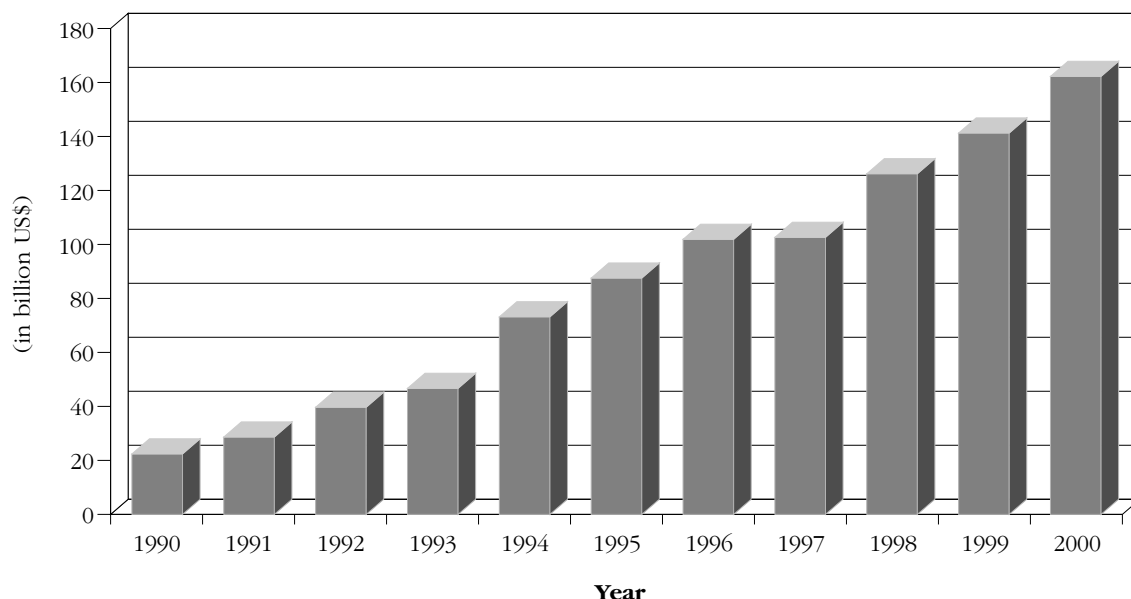
The Directors believe that the Group is well-equipped to meet the growing demand in the passenger vehicle market in the PRC as more private corporations and individuals in the PRC are becoming able to afford high quality imported vehicles, such as those supplied by the Group, as a result of the rapid economic growth in the PRC. In view of the close relationship maintained by the Group with its suppliers, the strong distribution network provided by its business partners, including North Anhua, and the potential relaxation of foreign trade restrictions and reduction in import tariffs in the PRC subsequent to its accession to the WTO, the Directors are of the view that the PRC's accession to the WTO will be beneficial to the Group's operations. Demand for imported vehicles will increase as the prices of the imported vehicles become more competitive with those of the locally manufactured cars.

## INDUSTRY OVERVIEW

### CAR RENTAL BUSINESS IN THE PRC

The Directors believe that prosperous tourism industry, intense business activities, modernised spider web like highway network and high living standard in the aforementioned regions contributed to their car rental industry prosperity. By the same token, the Directors believe that the growth and the development of the PRC car rental industry will be correlated to the growth of PRC tourism industry, business activities, the development of the PRC highway network and the Chinese living standard in the future.

#### Foreign visitors spending in China

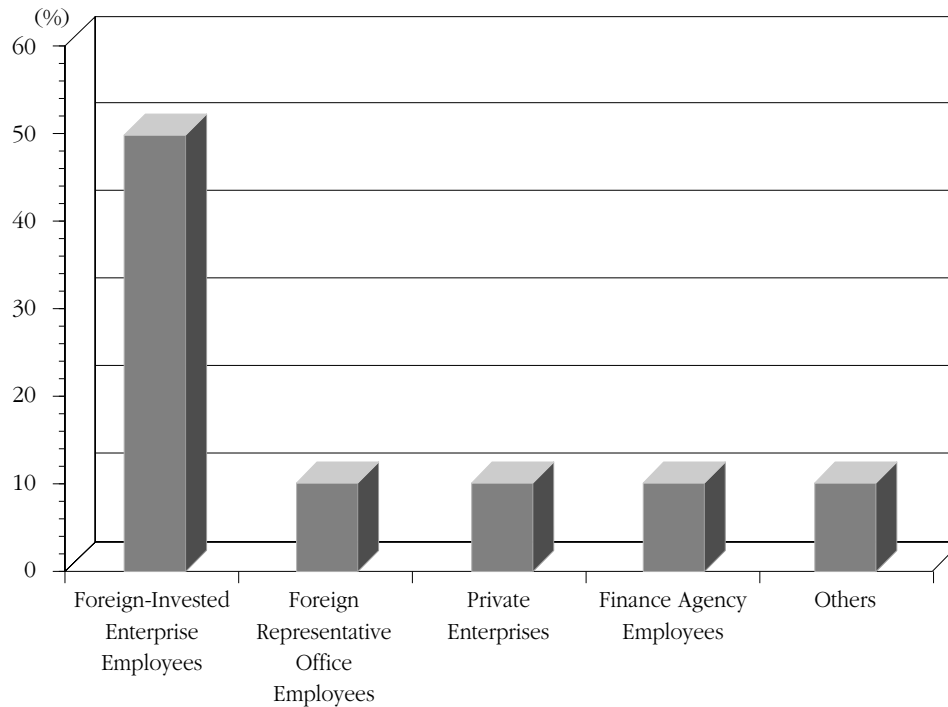


Source: *China Statistical Yearbook 2001*

Over the last decade, the number of people who visited China for leisure and business has increased drastically. The number of foreign visitor increased from 27 million in 1990 to 83 million in 2000. In terms of spending, in year 2000, foreign visitors spent US\$16.2 billion in China, representing a 636% increase over the past 10 years. It is anticipated that more and more tourists will be visiting and spending in China. The Directors believe that the booming of the tourism industry in the PRC will have a positive impact on the car rental industry in the PRC. Besides that, the Directors believe that the China's joining of the WTO will generate tremendous business opportunities in China. Instead of locking up their fund into a long-term purchase of a vehicle, most of the enterprises may decide to rent or lease vehicle when required, hence, car rental will become their primary means of inter-city business travel. Business operations and meetings, regardless of whether they are local, inter-provincial or international require vehicle rental service support. This is especially true in the case of group travel, where a comprehensive vehicle rental service for all grades of vehicle is required.

## INDUSTRY OVERVIEW

**The breakdown of vehicle rental users in the PRC**



*Source: Hertz Asia Pacific*

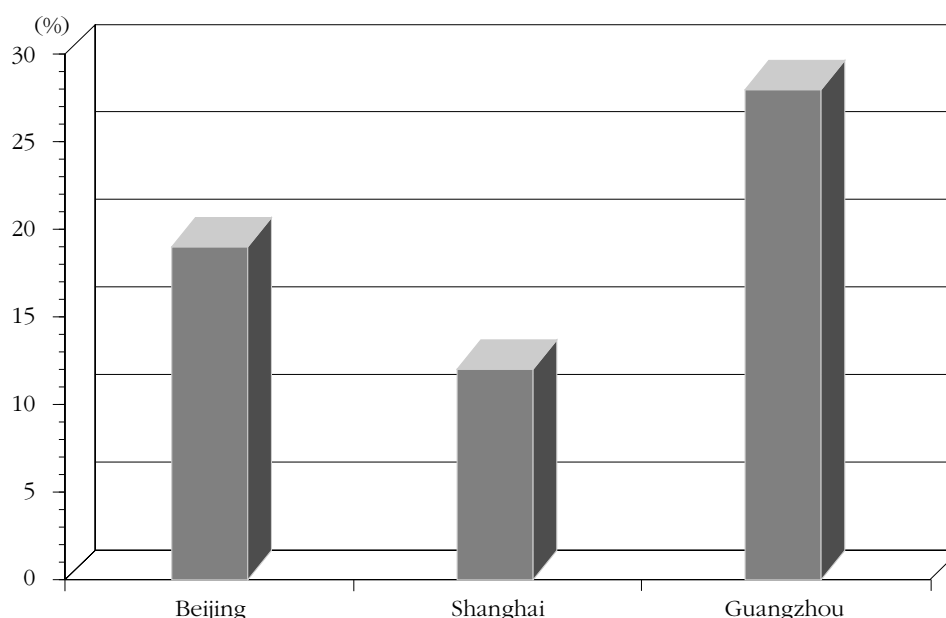
A modernized and well-developed highway network plays a key role in car rental industry. The PRC Government together with private investors have been pouring funds into road construction, improving the road condition and highway infrastructure between major cities in the PRC. According to the Road Department of China Ministry of Communications, during the first half of 2001, China has already spent RMB91.4 billion in highway construction projects, representing a RMB14.8 billion or an approximately 19% increase over the same period last year. In which, RMB43.1 billion, RMB26.1 billion and RMB22.2 billion were spent in the eastern region, the central region and the western region respectively. China targeted that the national road network will connect to 99.5% of rural towns and 93% of administrative villages by 2005, covering a total of 1.6 million kilometers in highways and more than 25,000 kilometers of expressways. The Directors believe that extensive construction of road infrastructure and highway coverage create incentives to road travellers to rent motor vehicles for both leisure and business travel uses.



## INDUSTRY OVERVIEW

In recent years, the living standard in the PRC has improved enormously. The annual individual disposal income of urban household in the PRC recorded a growth rate of approximately 30% from 1996 to 2000. People, in particular those receiving higher income but do not own vehicles will consider the option of renting cars for personal use. Taking Beijing as an example, there are more than 2 millions of licensed drivers, but only 1.2 million locally registered vehicles are running in Beijing city. It will be an attractive and flexible option for those 800,000 registered drivers who do not own vehicles to travel in rental cars, the same analogy will apply to other major cities in China such as Shanghai, Guangzhou and Xiamen etc. Also with the improvement in the living standard, more and more consumers are willing to pay a higher price for renting medium and premium cars for wedding and ceremonies. Thus, the Directors foresee an increasing demand of car rental for personal use as a result of the improvement of the living standard in the PRC.

**% of residents holding drivers license in selected major cities in the PRC**



*Source: Hertz Asia Pacific*

Based on incomplete statistics, there are presently more than 400 motor vehicle rental companies throughout China with a combined rental fleet of more than 40,000 vehicles, however, most motor vehicle rental companies are relatively small in size and only operate locally without a national presence or regional rental network. Only a few of the motor vehicle rental companies are of significant size. Most of them are joint ventures of state-owned enterprises or subsidiaries of vehicle manufactures and are only medium or small in size, and operate regionally. Their fleets are also limited in terms of selection of models and mostly comprise of older vehicles. The Group believes that the national car rental system and the reputation acquired from Hertz will be a cutting edge in the current PRC car rental market. The Directors believe that the Group will become one of the dominant and established players in the PRC car rental market.

# INDUSTRY OVERVIEW

## REGULATORY FRAMEWORK

### Car rental operation in the PRC

Pursuant to 外商投資租賃公司審批管理暫行辦法 (Provisional Measures on Administration of Examination of and Approval for Foreign Investment Rental Company) promulgated by MOFTEC in August 2001, a foreign company which meets the following conditions may apply to set up a sino-foreign joint venture company for engaging in car rental business in the PRC, as of 1st September, 2001:

- the foreign company possesses a total assets of not less than US\$50 million during the year prior to application for setting up such a joint venture company;
- the foreign company has not less than 3 years of experience in car rental operations;
- the Chinese partner possesses a total assets of not less than RMB100 million during the year prior to application for setting up such a joint venture company;
- such joint venture company is set up for an operation period of not more than 20 years with a registered capital of not less than US\$5 million, of which the Chinese partner's share of equity interest is not less than 20%; and
- the management team of such joint venture company comprises personnel who have not less than 3 years of experience in car rental operations.

Car rental business in the PRC is mainly governed by 汽租租賃業管理暫行規定 (Interim Regulations for Administration of Car Rental Business), which was jointly promulgated by the Ministry of Communication and the State Planning Commission on 26th February 1998. Under this regulation, a company must meet certain prescribed economic and technology requirements and obtain both a License for Operating Road Transportation (道路運輸經營許可證) and a Certificate for Road Transportation (道路運輸證) from the relevant administrative authority in order to engage in car rental business in the PRC.