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# CORPORATE Information

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### **A** NUAL General Meeting

Date and time: Friday, May 31, 2002 at 11:00 a.m.  
Venue: 7/F, Paul Y. Centre, 51 Hung To Road  
Kwun Tong, Kowloon, Hong Kong

### **S** TOCK Exchange Listing

New York Stock Exchange, Inc.  
Trading Symbol: CSH

### **P** RINCIPAL Place of Business

8/F, Paul Y. Centre  
51 Hung To Road  
Kwun Tong  
Kowloon  
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Telephone: (852) 2372-0130  
Fax: (852) 2537-6591

### **R** EGISTERED Office

Clarendon House  
2 Church Street  
Hamilton HM11  
Bermuda

### **C** OUNSEL

**Conyers Dill & Pearman**  
2901 One Exchange Square  
8 Connaught Place  
Central  
Hong Kong  
Telephone: (852) 2524-7106  
Fax: (852) 2845-9268

### **I** NDEPENDENT Public Accountants

**Deloitte Touche Tohmatsu**  
26/F Wing On Centre  
111 Connaught Road Central  
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Fax: (852) 2541-1911

### **R** EGISTRAR, Transfer Agent

Bermuda:  
**Butterfield Corporate Services Limited**  
Rosebank Centre  
11 Bermudiana Road  
Pembroke, Bermuda  
Telephone: (441) 295-1111  
Fax: (441) 295-6759

United States:  
**The Bank of New York**  
620 Avenue of Americas  
6th Floor  
New York 10011

For Shareholder Inquiries:  
Shareholder Relations Department-11E  
P.O. Box 11258  
Church Street Station  
New York, NY 10286  
Telephone: (800) 524-4458  
E-mail address: Shareowner-svcs@bankofny.com

For Certificate Transfers and Address Changes:  
Receive and Deliver Department-11W  
P.O. Box 11002  
Church Street Station  
New York, NY 10286  
Website: <http://www.stockbny.com>

### **P** UBLIC Relations

**Citigate Dewe Rogerson Inc.**  
1440 Broadway  
New York, NY 10018  
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### **F** ORM 20-F

Form 20-F for China Enterprises Limited will be available upon request after its filing with the Securities and Exchange Commission before the statutory deadline

I am pleased to present the annual results of China Enterprises Limited (“China Enterprises” or the “Company”) and its subsidiaries (the “Group”) for the year ended December 31, 2001.

Pursuant to a special resolution passed at the annual general meeting held on May 31, 2001, the name of the Company was changed from China Tire e-commerce.com Limited to China Enterprises Limited. This is the result of a strategic review of the Group’s investments in light of the impending structural changes occurring in China. With a changing political and socio-economic landscape, it is imperative that the Group expands its vision to encompass investments in other high growth industries. Going forward the Group intends to actively search for potential investments in the Greater China region with emphasis on achieving a diversified portfolio of assets consisting of industrial and consumer related investments.

For the existing investments in tire manufacturing, I regret to report that persistent competition and tough operating conditions depressed overall results for the year under review. Tire prices in China declined by approximately 3-5% despite softer raw material prices. In addition, customer claims for replacement tires, especially truck tires, dampened the bottom lines of our tire subsidiaries.

Despite the above, the Group managed to increase revenue by 20% to Rmb2.71 billion for the year (2000: Rmb2.26 billion). This was mainly due to increased sales volume especially for domestic radial tires and the abolishment of the 10% consumption tax effected January 1, 2001. Sales of radial tires made up approximately 19.5% of the total revenues in 2001 while export sales constituted 23.0% (2000: 28.8%). Volume wise, the Group sold a total of 6.2 million units of vehicle tires, 34 million units of bicycle tires and 2.5 million units of wheelbarrow tires for the year.

However, losses from continuing operations before taxation and minority interest was Rmb97.9 million (2000: Rmb76.7 million) and net losses from continuing operations after tax and minority interest was Rmb50.3 million for the year (2000: Rmb58.2 million). During the year, the Company decided to dispose of its entire interest in Double Happiness Tyre Industries Company Limited, a 55% held subsidiary of the Company which was deemed to be non-performing and resulted in an aggregate disposition loss of Rmb28.6 million, which together with its losses from operations of Rmb5.3 million, was included in the consolidated statements of operations and comprehensive loss under discontinued operations. As a result, consolidated net losses of China Enterprises was Rmb135.4 million for the year ended December 31, 2001 (2000: Rmb79.4 million).

As for the various tire subsidiaries, the Hangzhou factory continued to be the best performer and recorded a 29% increase in its revenue to Rmb2.06 billion as a result of increased sales volume. In view of stronger local brand and better margins achieved in the domestic market, less effort was spent on export and hence, export sales fell by 11% relative to last year. In particular, radial tires sold well in the domestic market and contributed to 24% of total revenue. Gross margin also improved due to more efficient procurement efforts and the appointment of distribution agents. The Hangzhou factory achieved net income of Rmb53.5 million for the year of 2001 compared to a net loss of Rmb1.6 million last year.

The Yinchuan tire factory experienced a decline of 5% in turnover to Rmb619.4 million compared to the last year as a result of competitive pricing. The factory incurred a net loss of Rmb162.2 million in the year 2001 compared to a net loss of Rmb47.8 million in 2000.

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# CHAIRMAN'S Statement

In the fourth quarter of 2001, the Company received notification from the New York Stock Exchange ("NYSE") that the Company failed to maintain a minimum total average market capitalization of US\$15 million over a consecutive 30 trading-day period. A business plan was submitted to the NYSE in early 2002 that outlined the Company's plan to comply with the NYSE's listing requirements. The Company will be subject to an 18-month monitoring period by the NYSE. There is no assurance that the NYSE will accept the plan and decide to allow the Company to remain listed. In the event that the Company's shares cease to be listed on the NYSE, the Company will consider an alternative trading venue.

In the next few years, we see the greatest opportunities in China's services sector, which to-date has not developed as fast as the industrial sector, and which is now significantly open to foreign investment in many areas that were heretofore barred or restricted. Examples of this include tourism, especially domestic and outbound tourism, and various consumer services. Many economists forecast China real GNP growth of about 7% per annum over the next decade, which would double the size of the PRC economy over that period. We believe that the services sector may grow at a rate higher than the overall economy and certain service sectors will register outstanding growth in the coming years. The Company intends to strategically focus on such very high growth areas in its greater China investment strategy.

On February 1, 2002, Million Good Limited ("Million Good"), a wholly owned subsidiary of China Enterprises, entered into a conditional subscription agreement to subscribe for 4,800,000,000 new shares of HK\$0.01 each representing 34.6% in the enlarged issued share capital of Ananda Wing On Travel (Holdings) Limited ("AWT (Holdings)") ("Shares") at a subscription price of HK\$0.027 per Share ("Subscription"). Total consideration for the Subscription amounted to HK\$129.6 million.

On the same day, China Enterprises entered into a conditional convertible note agreement pursuant to which AWT (Holdings) will issue a convertible note to the Company or its nominee with a principal amount of HK\$120.0 million, which entitles the holder thereof to convert into Shares at any time during the two years from the date of issue of the convertible note at an initial conversion price of HK\$0.032 per Share, subject to adjustments.

Closing of the subscription and the convertible note is expected to occur on or before April 30, 2002.

AWT (Holdings) is a leading travel operator based in Hong Kong whose major business includes provision of package tours, travel, transportation and other related services. The investment in AWT (Holdings) is one of the Company's steps towards the goal of portfolio diversification.

China's accession to the World Trade Organization marks an important milestone signifying the emergence of China as an economic and political powerhouse. Not only will it open China's doors to foreign goods and services, it will help eliminate domestic protectionism on fundamentally weak companies. Despite a gradual upward trend in commodities prices such as natural rubber and volatility in oil prices, the Group is confident that the Company will be able to sustain and strengthen its leading position in the China tire market. The perpetual value-enhancing goal of increasing sales volume with marginal increases in resources will be our prime objective of all our tire subsidiaries.

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# CHAIRMAN'S Statement

In line with the Group's strategic plans, the Board will continue to seek investment opportunities that will increase shareholder's value with the aim to diversify away from over dependence on a single vertical business. With China's rapidly growing consumerism, in particular, tourism, the Company's investment into travel and related businesses will be the initial step in achieving greater value for our shareholders.

**Dr. Chan Kwok Keung, Charles**  
*Chairman*

April 16, 2002

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# REVIEW of Operations

During the year, a subsidiary and an associate were acquired, while the Company decided to dispose of its entire interest in a number of its non-performing subsidiaries to improve the Group's overall performance. The Company achieved revenues in a record high of Rmb2.71 billion, representing a 20% increase over the fiscal year 2000.

## OPERATIONS Update

### **Hangzhou Zhongce Rubber Co., Limited ("Hangzhou Zhongce")**

Hangzhou Zhongce reported an increase in sales volume of approximately 12% to reach 4.7 million sets of automotive tires in year 2001. For fiscal year 2001, revenues from tire operations increased by 28.6% to Rmb2.1 billion as a result of strong sales volume in vehicle, truck, bicycle and wheelbarrow tires. This impressive growth is attributable to the strong local brand and the abolishment of 10% consumption tax effective January 1, 2001, which stimulates the sales of radial tires by approximately 1.3 times compared with last year.

### **Double Happiness Tyre Industries Corporation Limited ("Double Happiness")**

In late September 2001, the Company's management adopted a plan to sell its entire interest in Double Happiness, which consisted of a bias tire factory and an incomplete radial tire factory. The Company subsequently entered into a share transfer agreement with a third party to sell the bias tire factory for a consideration of Rmb41.0 million. The completion of the sale is pending upon certain approvals from the governmental authorities. The Company transferred substantially all its risks and benefits of ownership of the factory to the buyer in early December 2001 after received the total sales proceed of Rmb41.0 million. The Company plans to dispose of the incomplete radial tire factory based on an estimated selling price of Rmb30.0 million.

### **Yinchuan C.S.I. (Greatwall) Rubber Co., Limited ("Yinchuan CSI")**

Yinchuan CSI experienced another difficult year in 2001. Revenues for tire operations decreased by 5.4% to Rmb619.4 million in fiscal year 2001. The decrease in revenues was mainly due to a reduction in selling prices in order to maintain market competitiveness.

### **Yantai C.S.I. Rubber Co., Limited ("Yantai CSI")**

The Company decided to sell its interest in Yantai CSI in the fourth quarter of 2001. The Company subsequently entered into a share transfer agreement with a third party to dispose of its entire interest in Yantai CSI and the respective shareholder's advance of Rmb20.2 million to Yantai CSI for an aggregate consideration of Rmb26.0 million. The transaction was considered completed in January 2002 as approval from the relevant governmental authorities has been obtained and the Company transferred substantially all its risks and benefits of ownership of Yantai CSI to the buyer. First installment of the proceeds of approximately Rmb13.0 million has been received and no material gain or loss is realized upon the completion of this disposition.

### **Shandong C.S.I. Synthetic Fiber Co., Limited ("Shandong Synthetic")**

Production of Shandong Synthetic has been suspended since October 1996. In the fourth quarter of fiscal year 2001, the Company decided to sell its interest in Shandong Synthetic. In January 2002, the Company signed a transfer agreement to sell its entire interest in Shandong Synthetic to its Chinese joint venture partner for a consideration of Rmb0.01 million and no material gain or loss is realized upon the completion of this disposition.

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## **Hangzhou Fu Chun Jiang Chemical Industrial Co., Limited (“Fu Chun Jiang”)**

On September 28, 2001, Hangzhou Zhongce entered into an agreement to form a new 20-year equity joint venture with Fu Yang Shi Industrial Group Co. located in Fu Yang Province. Hangzhou holds 51.24% of this new joint venture company known as Hangzhou Fu Chun Jiang Chemical Industrial Co., Limited, for an investment cost of approximately Rmb10.6 million (US\$1.3 million). The factory processes raw materials for Hangzhou Zhongce and produces raw materials to other customers.

## **Changes in Directors and Executive Officers**

Mr. Ho Kin Cheong, Kelvin was appointed as the secretary of the Company on October 12, 2001.

Mr. Allan Yap was appointed as a director and Vice Chairman of the Company on August 20, 2001 and November 5, 2001 respectively.

Mr. Michael Chen resigned as the Chief Financial Officer on January 30, 2002.

Mr. Lien Kait Long has been redesignated as the Chief Financial Officer on January 30, 2002.

## **Going Forward**

Although China Enterprises is well established in the domestic tire industry in China, we are working to further diversify our business in 2002.

A newly formed wholly owned subsidiary of the Company, Sincere Ocean entered into an agreement to form a new joint venture, Yutu Holdings Limited with Total Remarkable Limited and Yutu 801 Holdings Company Limited on August 20, 2001. Yutu Holdings Limited is a garment manufacturing company and is still in its development stage.

On February 1, 2002, Million Good Limited (“Million Good”), a wholly owned subsidiary of the Company, entered into a conditional subscription agreement to subscribe for 34.6% share capital of Ananda Wing On Travel (Holdings) Limited (“AWT (Holdings)”). Total consideration for the subscription amounted to HK\$129.6 million. On the same day, China Enterprises entered into a conditional convertible note agreement pursuant to which AWT (Holdings) will issue convertible note to the Company or its nominee with a principal amount of HK\$120.0 million, which entitles the holder thereof to convert into ordinary shares in AWT (Holdings) at any time during the two-year period from the date of issue of the convertible note. It is expected that both transactions will be completed not later than April 30, 2002.

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# REVIEW of Operations

AWT (Holdings) is a leading travel operator based in Hong Kong whose major business includes provision of package tours, travel, transportation and other related services. The investments in AWT (Holdings) and Yutu Holdings Limited are two of the strategic move towards the Company's goal in diversifying its business into different sectors.

**Mr. Lien Kait Long**  
*Chief Financial Officer*

April 16, 2002

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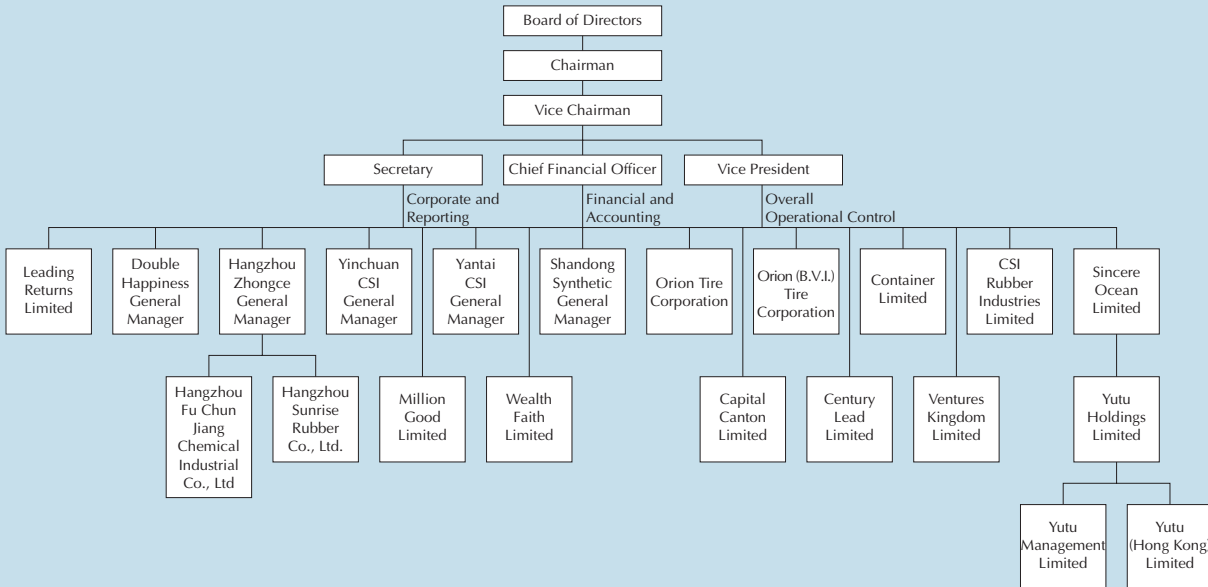
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# BOARD OF Directors And Management



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## **B** OARD of Directors

Dr. Chan Kwok Keung, Charles

Mr. Allan Yap

Ms. Dorothy Law

Mr. Richard Whittall

*Independent Director*

Mr. Terence Hui

*Independent Director*

Mr. David Edwin Bussmann

*Independent Director*

Mr. Michael A. Goldberg

*Independent Director*

## **M** ANAGEMENT

*Executive Officers*

Dr. Chan Kwok Keung, Charles

*Chairman*

Mr. Allan Yap

*Vice Chairman*

Mr. Sheng Yu

*Vice President and Deputy Chief Operating Officer*

Mr. Lien Kait Long

*Chief Financial Officer*

Mr. Ho Kin Cheong, Kelvin

*Secretary*

# FINANCIAL HIGHLIGHTS

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### **S** ELECTED Consolidated Financial Information

The following table presents the selected consolidated financial information of the Company as of and for the years ended December 31, 1997, 1998, 1999, 2000 and 2001.

The consolidated financial statements of the Company as of December 31, 2001 have been audited by Deloitte Touche Tohmatsu, independent public accountants, whose report on the consolidated financial statements of the Company as of December 31, 2001 and for the year then ended appears on page 25 of this Annual Report. The consolidated financial statements of the Company as of and for the years ended December 31, 1997, 1998, 1999 and 2000 have been audited by other independent public accountants. The selected financial information should be read in conjunction with, and is qualified in their entirety by reference to, the respective consolidated financial statements and their accompanying notes thereto.

The Company was incorporated on January 28, 1993 and acquired from China Strategic Holdings Limited ("CSH"), its interest in Hangzhou Zhongce on April 25, 1993 and in Double Happiness on April 16, 1993. CSH held its interests in Hangzhou Zhongce and Double Happiness from the time of their establishment on June 12, 1992 and April 16, 1992 respectively. The Company later entered into agreements to form new Sino-foreign equity joint ventures: Yantai CSI on October 29, 1993; Yinchuan CSI on December 6, 1993; Shandong Synthetic on May 28, 1994. The two joint ventures, Yantai CSI, and Yinchuan CSI, commenced operations effective from January 1, 1994. Shandong Synthetic commenced operations effective from January 1, 1995. The Company also acquired its 60% interests in Orion Tire and Orion BVI in March 1994 and accounted for these investments from May 1, 1994 and August 1, 1994 respectively. CSI Rubber Industries Limited, which was acquired by the Company from CSH on April 18, 1994, and was accounted for with effect from that date. Container Limited, a British Virgin Islands company, is a wholly owned subsidiary of the Company set up in 1998. Century Lead Limited and Capital Canton Limited, British Virgin Islands companies, are wholly owned subsidiaries of the Company set up on May 2, 2001. Leading Returns, Sincere Ocean, Ventures Kingdom, Wealth Faith and Million Good are wholly owned subsidiaries of the Company set up on July 4, 2001, August 17, 2001, October 24, 2001, November 19, 2001 and December 28, 2001 respectively. Hangzhou Zhongce entered into an agreement to form a new Sino-foreign equity joint venture, Fu Chun Jiang, on September 28, 2001.

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(Amounts in thousands, except number of shares and per share data)

## Selected Consolidated Financial Information of the Company

	Year ended December 31,					
	1997	1998	1999	2000	2001	
	(a)(b)(c)(d)(g) Rmb	(a)(b)(c)(d)(e)(g) Rmb	(a)(b)(c)(e)(g) Rmb	(a)(b)(c)(e)(g) Rmb	(a)(b)(c)(e)(f)(g) Rmb	US\$ (h)
<b>Consolidated Statements of Operations Data:</b>						
Revenues	2,249,740	2,148,572	2,088,508	2,260,422	2,707,305	326,969
Gross Profit (i)	320,945	337,003	226,888	223,844	240,144	29,003
Share of losses of an unconsolidated subsidiary (d)	(8,552)	(1,773)	-	-	-	-
(Impairment loss) recovery on loan receivable (c)	-	-	(34,935)	(14,962)	9,800	1,184
Income (Loss) before income taxes and minority interests	91,761	71,168	(75,311)	(76,686)	(97,906)	(11,824)
Provision for income taxes (k)	(14,203)	(15,413)	(3,583)	(5,348)	(2,454)	(296)
Minority interests (j)	(57,002)	(48,943)	13,349	23,837	50,045	6,044
Loss from discontinued operations (g)	(1,090)	(6,534)	(87,651)	(21,187)	(85,044)	(10,272)
Net income (loss) (k)	19,466	279	(153,196)	(79,384)	(135,359)	(16,348)
Basic and diluted income (loss) per share (l)	2.14	0.03	(16.83)	(8.75)	(15.01)	(1.81)
Weighted average number of common shares outstanding (l)	9,100,000	9,100,000	9,100,000	9,069,956	9,017,310	9,017,310
<b>Consolidated Balance Sheets Data:</b>						
Working Capital	431,837	611,680	562,108	453,999	346,678	41,869
Property, plant and equipment, net	1,467,028	1,220,496	749,911	1,052,142	924,678	111,676
Total assets	3,478,914	3,497,035	3,316,944	3,326,983	2,978,965	359,778
Current liabilities	1,378,610	1,410,756	1,487,942	1,673,725	1,558,660	188,244
Non-current portion of long-term bank loans	62,154	65,000	42,500	70,600	37,979	4,587
Due to Chinese joint venture partners	70,386	72,783	122,625	70,451	30,807	3,721
Minority interests	701,481	744,337	529,167	559,280	522,824	63,143
Shareholders' equity	1,206,635	1,200,885	1,041,662	952,627	804,197	97,125
<b>Consolidated Statements of Cash Flows Data:</b>						
Depreciation and amortization	81,960	103,029	104,036	109,985	118,399	14,299
Purchase of property, plant and equipment	(100,279)	(62,450)	(96,409)	(75,868)	(154,185)	(18,620)
Proceeds from disposal of subsidiaries	-	-	-	-	41,000	4,952
Proceeds from sales of available-for-sale securities	-	-	-	8,554	-	-
Investments in and advances to affiliates	-	-	-	(11,855)	929	112

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# FINANCIAL HIGHLIGHTS

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### Notes:

- (a) The Company acquired 51% of Hangzhou Zhongce and 55% of Double Happiness from China Strategic Holdings Limited (“CSH”) in April 1993. This acquisition was treated as a reorganization of entities under common control, which is accounted for in a manner analogous to a pooling of interests.
- (b) The Company entered into agreements to form three new Sino-foreign equity joint ventures: Chongqing CSI Tyre Co., Limited (“Chongqing CSI”) on October 6, 1993, Yantai CSI on October 29, 1993 and Yinchuan CSI on December 6, 1993. The three joint ventures, Chongqing CSI, Yantai CSI and Yinchuan CSI commenced operations effective from January 1, 1994. The Company also acquired its 60% interests in Orion Tire and Orion BVI, two international corporations, in March 1994 and accounted for these acquisitions from May 1, 1994 and August 1, 1994 respectively. Dalian CSI is a formerly 70% subsidiary owned by a Hong Kong incorporated company, CSI Rubber Industries Limited, which was acquired by the Company from CSH on April 18, 1994 and was accounted for with effect from that date.
- (c) As described in Note 10 to the consolidated financial statements, in late 1993, the Company acquired a majority interest in a formerly state-owned enterprise located in Chongqing, the PRC, through the formation of Chongqing CSI with Chongqing Tyre Chief Factory (“Chongqing Factory”). An amount of Rmb57.0 million (US\$6.6 million) was contributed by the Company into Chongqing CSI in late 1993 (the “date of contribution”) in accordance with the provisions of the joint venture agreement. Chongqing CSI commenced effective operations on January 1, 1994.

During 1995, the Company began to renegotiate the terms of the joint venture agreement of Chongqing CSI. Pending the outcome of the negotiations, the parties agreed that the capital injected by the Company amounting to Rmb57.0 million (US\$6.6 million) was treated as an interest-bearing loan (the “Loan”) to Chongqing Factory with effect from the date of contribution. The financial position and result of operations of Chongqing CSI have not been included in the consolidated financial statements since 1996. The Company has also made full provisions against recorded interest income on the Loan of approximately Rmb14.0 million for the years ended December 31, 1999. The Company formally terminated the joint venture agreement of Chongqing CSI (the “Termination”) which Chongqing Factory and the supervisory authority of Chongqing Factory (the “Supervisor”) agreed to the Termination as well as the transfer of the original investment by the Company in Chongqing CSI to other projects in the Chongqing region on April 10, 1997. Since the Company was unable to identify a suitable project in Chongqing in which it could reinvest, the Company initiated arbitration proceedings in early 1998 (the “Proceedings”) in the PRC against Chongqing Factory to enforce the Termination, and to recover the Loan and accrued interest up to June 30, 1998 as well as the related legal expenses for the Proceedings.

A judgement of the Proceedings (the “Judgement”) was obtained on March 31, 2000 that the joint venture agreement of Chongqing CSI was approved to be terminated and Chongqing CSI is to be liquidated in accordance with the relevant rules and regulations of the PRC. Under the Judgement, the Company was entitled to damages of approximately Rmb15.8 million and Chongqing Factory was discharged from other claims lodged by the Company. In view of the expected long duration of and the uncertainty of amounts to be recovered from the liquidation of Chongqing CSI, the Directors of the Company took a prudent view and made full provision for the outstanding loan and accrued interest in the prior years except for the Rmb0.2 million recovered in early 2001.

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# FINANCIAL HIGHLIGHTS And Information

During the year, the Company had recovered an additional amount of Rmb10.0 million for the loan from Chongqing Factory of which Rmb9.8 million was recorded as recovery on loan receivable in the year ended December 31, 2001.

- (d) The liquidation process of Dalian CSI was substantially completed in 1998 and the Company has thus ceased accounting for this investment since July 1998.
- (e) Container Limited, a British Virgin Islands company, is a wholly-owned subsidiary of the Company set up in 1998.
- (f) Century Lead Limited and Capital Canton Limited, British Virgin Islands companies, are wholly owned subsidiaries of the Company set up on May 2, 2001. Leading Returns, Sincere Ocean, Ventures Kingdom, Wealth Faith and Million Good, British Virgin Islands companies, are wholly owned subsidiaries of the Company set up on July 4, 2001, August 17, 2001, October 24, 2001, November 19, 2001 and December 28, 2001 respectively. Hangzhou Zhongce entered into an agreement to form a new Sino-foreign equity joint venture, Fu Chun Jiang on September 28, 2001.
- (g) Double Happiness was disposed of, while Yantai CSI and Shandong Synthetic were decided to be disposed of during the year. The Company has thus recorded the operating results of Double Happiness, Yantai CSI and Shandong Synthetic separately from continued operations as loss from discontinued operations.
- (h) The U.S. dollar convenience translation amounts have been translated using the unified exchange rate quoted by the People's Bank of China on December 31, 2001 of US\$1.00 = Rmb8.28. No representation is made that the Renminbi amounts could have been, or could be, converted into U.S. dollar at that rate on December 31, 2001 or at any other certain rate.

The unified exchange rates as of and during the years ended December 31, 1997, 1998, 1999, 2000 and 2001 were as follows:

	Year Ended December 31,				
	1997	1998	1999	2000	2001
<i>(Rmb equivalent of US\$1.00)</i>	<i>Rmb</i>	<i>Rmb</i>	<i>Rmb</i>	<i>Rmb</i>	<i>Rmb</i>
At unified exchange rate					
– end of year	8.28	8.28	8.28	8.28	<b>8.28</b>
– high	8.30	8.28	8.43	8.43	<b>8.28</b>
– low	8.29	8.28	8.24	8.05	<b>8.27</b>
– average	8.29	8.28	8.28	8.28	<b>8.28</b>

- (i) Gross profit is defined as revenues less cost of revenues.
- (j) Minority interests in the earnings of the subsidiaries were not recorded in the periods prior to the acquisition of the subsidiaries by the Company.

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# FINANCIAL HIGHLIGHTS

## And Information

- (k) The Company, CSI Rubber Industries Limited, Container Limited, Century Lead Limited, Capital Canton Limited, Leading Returns, Sincere Ocean, Ventures Kingdom, Wealth Faith and Million Good did not make any provision for Hong Kong profits tax throughout all reported periods as they did not have any current or deferred tax exposures.

Prior to the formation of the joint ventures, the PRC subsidiaries were state-owned enterprises and were taxed at the applicable tax rate of 33% on the taxable income as reported in their statutory accounts. In accordance with the relevant income tax laws applicable to Sino-foreign joint ventures in the PRC, the PRC subsidiaries are fully exempt from the Chinese State unified income tax for two years starting from the first profit-making year (after utilization of available losses carried forward), followed by a 50% reduction for the next three years thereafter ("tax holiday"). Accordingly, the PRC subsidiaries provided for income taxes according to the provisions of the tax holiday as well as other tax incentives granted by the relevant PRC authorities. See Note 13 to the consolidated financial statements for more details.

- (l) The calculation of basic and diluted income (loss) per share from 1997 to 2001 is based on the weighted average number of Common Stock outstanding during the years ended December 31, from 1997 to 2001. The weighted average number of Common Stock outstanding for 1997 to 1999 were 9,100,000, for 2000 was 9,069,956 and for 2001 was 9,017,310.

### CAPITAL Stock

The authorized share capital of China Enterprises is US\$700,000 which consists of 20,000,000 authorized shares of Supervoting Common Stock and 50,000,000 authorized shares of Common Stock, each of par value of US\$0.01.

As of December 31, 2001, there were 3,000,000 shares of Supervoting Common Stock and 6,017,310 shares of Common Stock outstanding. The Common Stock is listed on the New York Stock Exchange. Each share of Supervoting Common Stock is entitled to ten votes and each share of Common Stock is entitled to one vote in all matters upon which the Capital Stock is entitled to vote. Except for the difference in voting rights, the Supervoting Common Stock and the Common Stock rank pari passu in all respects.

### DIVIDEND

On July 3, 2001, the board of directors of China Enterprises announced that the Company will suspend the declaration and payment of any quarterly dividend until the profitability of the Company and its subsidiaries reach an acceptable level. During 2001, China Enterprises paid total dividends of US\$180,346.

Applicable Chinese laws and regulations require that, before a Sino-foreign equity joint venture enterprise (such as each PRC Subsidiary) distributes profits to investors, it must: (1) satisfy all tax liabilities; (2) provide for losses in previous years; and (3) make allocations, in proportions determined at the sole discretion of the board of directors, to a general reserve fund, an enterprise expansion fund and a staff welfare and incentive bonus fund.

Any future determination to pay a dividend to shareholders of the Company will also depend on the Company's results of operations and financial condition, and other factors deemed relevant by its Board of Directors.

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# MANAGEMENT DISCUSSION and Analysis

The following discussion and analysis should be read in conjunction with the consolidated financial statements and the notes thereto and the financial highlights and information contained in this Annual Report. The consolidated financial statements of the Company and its subsidiaries are prepared in conformity with generally accepted accounting principles in the United States of America ("U.S. GAAP").

## **T**HE Company

The Company is an investment holding company which has majority interests in six Sino-foreign equity joint venture enterprises in the People's Republic of China (the "PRC") and eleven other international joint ventures/subsidiaries (collectively known as the "Subsidiaries") as of December 31, 2001. The six Sino-foreign equity joint venture enterprises are Hangzhou Zhongce, Double Happiness, Yinchuan CSI, Yantai CSI, Shandong Synthetic and Fu Chun Jiang. The international joint ventures/subsidiaries are Orion Tire, a California corporation, Orion BVI, Container Limited, Century Lead, Capital Canton, Leading Returns, Sincere Ocean, Ventures Kingdom, Wealth Faith and Million Good, British Virgin Islands companies and CSI Rubber, a company incorporated in Hong Kong.

The Company derives its revenues from distributions of dividends by the Subsidiaries. Dividends are paid in accordance with the proportional interests of the parties to the respective Subsidiaries as detailed below:

Subsidiary	Company's Ownership Interest		Joint Venture Partner's Ownership Interest	
	Directly	Indirectly	Directly	Indirectly
Double Happiness	55%	—	45%	—
Hangzhou Zhongce	51%	—	49%	—
Yinchuan CSI	51%	—	49%	—
Yantai CSI	51%	—	49%	—
Shandong Synthetic	51%	—	49%	—
Fu Chun Jiang	51.24%	26.13%(1)	48.77%	73.87%
Orion Tire	60%	—	40%	—
Orion BVI	60%	—	40%	—
Container Limited	100%	—	—	—
CSI Rubber	100%	—	—	—
Century Lead	100%	—	—	—
Capital Canton	100%	—	—	—
Leading Returns	100%	—	—	—
Sincere Ocean	100%	—	—	—
Ventures Kingdom	100%	—	—	—
Wealth Faith	100%	—	—	—
Million Good	100%	—	—	—

(1) Held by Hangzhou Zhongce resulting in an effective ownership by the Company of 26.13%.

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- (2) Six of the Subsidiaries including Hangzhou Zhongce, Double Happiness, Yinchuan CSI, Yantai CSI, Shandong Synthetic and Fu Chun Jiang are collectively known as the “PRC Subsidiaries”.

Dividends from the PRC Subsidiaries are declared and paid at the discretion of the PRC Subsidiaries’ boards of directors and are subject to restrictions set forth in the joint venture contracts for the PRC Subsidiaries. The PRC Subsidiaries are also subject to restrictions set forth in Chinese laws and regulations applicable to these enterprises. Such regulations provide for distributions of profits (as determined under Chinese accounting principles) of a joint venture after allocations to certain benefit funds. Profits as determined under Chinese accounting principles will differ from profits calculated under U.S. GAAP. See also Note 17 to the consolidated financial statements.

During 1995, the Company began to renegotiate the terms of the joint venture agreement of Chongqing C.S.I. Tyre Co. Limited (“CQ”). Pending the outcome of the negotiations, the parties agreed that the capital injected by the Company amounting to Rmb57.0 million (US\$6.6 million) was treated as an interest-bearing loan (the “Loan”) to Chongqing Factory with effect from the date of contribution. The financial position and results of operations of CQ have not been included in the consolidated financial statements since 1996. The Company has also made full provisions against recorded interest income on the Loan of approximately Rmb14.0 million for the year ended December 31, 1999.

The Company formally terminated the joint venture agreement of CQ (the “Termination”) with Chongqing Factory and the supervisory authority of Chongqing Factory (the “Supervisor”) agreed to the Termination as well as the transfer of the original investment by the Company in CQ to other projects in the Chongqing region on April 10, 1997. Since the Company was unable to identify a suitable project in Chongqing in which it could reinvest, the Company initiated arbitration proceedings in early 1998 (the “Proceedings”) in the PRC against Chongqing Factory to enforce the Termination, and to recover the Loan and accrued interest up to June 30, 1998 as well as the related legal expenses for the Proceedings.

A judgement of the Proceedings (the “Judgement”) was obtained on March 31, 2000 that the joint venture agreement of CQ was approved to be terminated and CQ is to be liquidated in accordance with the relevant rules and regulations of the PRC. Under the Judgement, the Company was entitled to damages of approximately Rmb15.8 million and Chongqing Factory was discharged from other claims lodged by the Company. In view of the expected long duration of and the uncertainty of amounts to be recovered from the liquidation of CQ, the Directors of the Company took a prudent view and made full provision for the outstanding loan and accrued interests in the prior years except for the Rmb0.2 million recovered in early 2001.

During the year, the Company had recovered an additional amount of Rmb10.0 million for the loan from Chongqing Factory of which Rmb9.8 million was recorded as recovery on loan receivable in the year ended December 31, 2001.

In late September 2001, the Company’s management adopted a plan to dispose of its entire interest in Double Happiness, which consisted of a bias tire factory and an incomplete radial tire factory. All of Double Happiness’s revenues was contributed by the bias tire factory as trading and manufacturing activities were only carried out in this factory.

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The Company subsequently entered into a share transfer agreement with a third party to dispose of its entire interest in the bias tire factory for a consideration of Rmb41.0 million. Although the completion of the sale is pending upon certain approvals being obtained from governmental authorities, the Company transferred substantially all its risks and benefits of ownership of the factory to the buyer in early December 2001 and accordingly, the Company recognized a net realized loss on such disposition of Rmb28.6 million during fiscal year 2001 and has ceased to account for the results of operations and the assets and liabilities of the factory from that date. The sale proceeds were received by the Company in cash during fiscal year 2001.

The Company has also recognized an impairment loss of Rmb31.2 million for the planned disposition of the incomplete radial tire factory based on an anticipated selling price of Rmb30.0 million during fiscal year 2002. The estimated selling price of Rmb30.0 million was derived from prior discussions with potential purchasers of the factory. Nevertheless, the Company is not currently engaged in negotiations with any prospective purchasers for the sale of this factory and there are no assurances that any sales will be concluded at such an estimated price. As a result, the Company believes it is reasonably possible that these estimates may be revised in the near-term. The failure to conclude a sale at that price would result in a revised loss.

In the fourth quarter of fiscal 2001, the Company decided to sell its interests in Yantai CSI and Shandong Synthetic. The Company had recorded an aggregate impairment charge of Rmb18.9 million for fiscal year 2001 representing management's best estimate of the loss to be recognized on sale of the Company's interests in these subsidiaries. The Company subsequently entered into a share transfer agreement with a third party to dispose of its entire interest in Yantai CSI and the respective shareholder's advance of Rmb20.2 million for an aggregate consideration of Rmb26.0 million. The sale was considered as completed in January 2002 as approval from the relevant governmental authorities has been obtained and the Company transferred substantially all its risks and benefits of ownership of Yantai CSI to the buyer. First installment of the sale proceeds of approximately Rmb13.0 million has been received and no material gain or loss is realized upon the completion of this disposition. In January 2002, the Company also signed a transfer agreement to sell its entire interest in Shandong Synthetic to its Chinese joint venture partner for a consideration of Rmb0.01 million.

On September 28, 2001, Hangzhou Zhongce entered into an agreement to acquire majority interests in a state-owned enterprise through the formation of a new Sino-foreign equity joint venture, Fu Chun Jiang, which is principally engaged in the manufacture and trade of tire rubbers and carbon powder. Besides, a newly formed wholly owned subsidiary, Sincere Ocean entered into an agreement to form a new joint venture, Yutu Holdings Limited ("Yutu") on August 20, 2001, which together with its subsidiaries, is engaged in garment manufacturing and the provision of management services.

## **A**CCOUNTING Presentation

The acquisitions of the PRC Subsidiaries were accounted for under the purchase method of accounting. Under this method, the purchase price is allocated to the fair value of the net assets acquired and any excess is considered to be goodwill. In addition, the Company only acquired majority controlling interests in the PRC Subsidiaries, which requires allocation to the minority holders of their proportionate interests in the PRC Subsidiaries' income.

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The operating results of Double Happiness, Yantai CSI and Shandong Synthetic have been segregated from continuing operations and reported as a separate line item on the consolidated statement of operations. The Company has also restated its prior years' financial statements to present the operating results of Double Happiness, Yantai CSI and Shandong Synthetic as discontinued operations.

## **R**ECENT Changes in Accounting Standards

For a discussion of recent accounting pronouncements and their impact on the Company, see the "Summary of Significant Accounting Policies – Recent Accounting Pronouncements" in Note 3(u) to the consolidated financial statements.

## **R**ESULTS of Operations

References to the Company and the Subsidiaries in the following discussion of results are based upon the audited consolidated financial statements of the Company for the years ended December 31, 2001 and 2000.

Consolidated revenues arising from continuing operations amounted to Rmb2.71 billion, representing a 20% increase over the fiscal year 2000 revenues of Rmb2.26 billion. This was mainly due to an increase in sales volume, especially in the domestic radial tire market. Export sales constituted approximately 23.0% of the total turnover in fiscal year 2001 as compared with 28.8% of total turnover in fiscal year 2000, representing a decline of Rmb28.8 million over the monetary amount in fiscal year 2000. China Enterprises sold a total of 6.2 million units of vehicle tires, 34 million units of bicycle tires and 2.5 million units of wheelbarrow tires in fiscal year 2001.

The Company's gross margin from continuing operations fell from 9.9% for the year 2000 to 8.9% for the year 2001. The decline was substantially due to Yinchuan CSI, whose margin was adversely affected by weak selling prices and provisions for warranty claims. On the other hand, Hangzhou Zhongce increased its margin to 11.8% in fiscal year 2001 compared to 10.1% for the previous year. The better margin was mainly achieved through efficiency gains in outsourcing procurement, repositioning Hangzhou Zhongce's competitive products and increasing sales of its radial tire products. In general, the Company was able to achieve a better margin on its export sales in fiscal year 2001, despite a decline in the sales volume.

The Company was able to generate Rmb240.1 million of gross profit from continuing operations in fiscal year 2001 versus Rmb223.8 million in fiscal year 2000 due to an increase in revenues, despite a marginal decrease in margins of approximately 10.4%.

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Due to the competitive sales environment, selling and administrative expenses increased to Rmb278.9 million in 2001, 9.8% up from Rmb254.0 million in 2000. It also accounted for a decrease as a percentage of revenues from 11.2% in 2000 to 10.3% in 2001. Included in operating expenses, a write-off of Yinchuan CSI's goodwill of Rmb4.0 million and a provision for an amount due from a related company by a subsidiary amounting to Rmb27.0 million was recorded (2000: Nil).

Net interest expenses amounted to Rmb37.1 million in the year of 2001 compared with Rmb29.6 million in the year of 2000. This was mainly due to a lower interest income derived from bank deposits of the Company which was offset by the lower interest rate charged on the bank borrowings of the Subsidiaries.

The recovery of loan from Chongqing Factory amounting to Rmb9.8 million is recorded in impairment/recovery on loan receivable in fiscal year 2001 while a provision for the compensation receivable amounting to Rmb15.0 million was made last year.

Equity in losses of affiliates increased to Rmb2.5 million for the fiscal year 2001, compared to Rmb2.0 million last year which was mainly due to the increase in operating losses of the affiliate.

Provision for income taxes was Rmb2.5 million for the year of 2001 compared to Rmb5.3 million for the year of 2000 which was principally due to the net effect of an increase in taxable profit of Hangzhou Zhongce and the recognition of a deferred tax benefit.

Loss shared by minority interests increased to Rmb50.0 million in 2001 from Rmb23.8 million in 2000 which was mainly due to increase in operating losses of Yinchuan CSI.

Loss from discontinued operations increased to Rmb85.0 million in 2001 from Rmb21.2 million in 2000 which was mainly due to the loss on planned disposition of Double Happiness, Yantai CSI and Shandong Synthetic during 2001.

The Company's consolidated net loss was Rmb135.4 million (US\$16.3 million) for the year ended December 31, 2001.

## LIQUIDITY and Capital Resources

References to the "Company" in the discussion of "Liquidity and Capital Resources" are based upon the audited consolidated financial statements of the Company and its Subsidiaries for the years ended December 31, 2001 and 2000.

In 2001, net cash provided by operating activities and financing activities was approximately Rmb143.0 million and Rmb85.8 million, respectively. Net cash used in investing activities was approximately Rmb162.3 million, which resulted in a net increase in cash and cash equivalents of Rmb66.5 million.

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The Company primarily used the cash flows from operating activities to fund its capital expenditures and working capital requirements. Other than those already set out in the audited consolidated financial statements of the Group, no transactions, arrangements and other relationships with unconsolidated entities or other persons, that are reasonably likely to affect materially the liquidity or the availability of or requirement for capital resources of the Group had been entered into during the year. For the year ended December 31, 2001, the Company had capital expenditures of Rmb154.2 million, representing an increase of approximately 103.2% from the capital expenditures of Rmb75.9 million for the year ended December 31, 2000. The Company also increased the amount of pledged deposits by approximately 3 times to Rmb57.8 million in 2001, compared to Rmb11.5 million in 2000.

The Company's working capital requirements for continuing operations also fluctuated between years. From December 31, 2000 to December 31, 2001, net accounts receivable decreased from Rmb511.9 million to Rmb489.5 million, short-term bank loans increased from Rmb637.7 million to Rmb755.3 million, and long-term bank loans (including current portion) decreased from Rmb91.6 million to Rmb72.6 million. Total bank borrowings as of December 31, 2001 amounted to Rmb827.9 million, representing an increase of 13.5% over total bank borrowings of Rmb729.3 million as of December 31, 2000.

In addition, cash and cash equivalents increased from Rmb347.4 million at December 31, 2000 to Rmb453.3 million at December 31, 2001.

There are no material restrictions, including foreign exchange controls, on the ability of the Subsidiaries to transfer funds to the Company in the form of cash dividends, loans, advances or product/material purchases. With respect to the PRC Subsidiaries, there are restrictions on the payment of dividends and the removal of dividends from China due to the Company's reinvestment program for tax purposes. In the event that dividends are paid by the PRC Subsidiaries, they would reduce the amount available for the reinvestment program and accordingly taxes would be payable on the profits not reinvested. The Company believes such restrictions will not have a material effect on the Company's liquidity or cash flows.

For the related party transaction, please see Note 18 to the consolidated financial statements. In the opinion of management, existence of this relationship has no material effect on the Company's liquidity or cash flows.

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A summary of contractual obligations and commitments is as follows:

Contractual Obligations	Total	Payments Due by Period			
		2002	2003 – 2005	2006 – 2007	2008 and beyond
Short-Term Debt	791,329,800	791,329,800	–	–	–
Long-Term Debt	72,600,000	36,000,000	36,600,000	–	–
Capital Expenditure	62,226,000	62,226,000	–	–	–
Operating Leases	3,293,948	2,216,977	624,304	307,334	145,334
<b>Total Contractual Cash Obligations</b>	<b>929,449,748</b>	<b>891,772,777</b>	<b>37,224,304</b>	<b>307,334</b>	<b>461,557</b>

Over the last few years, the cash provided to the Company is principally by internally generated funds and bank borrowings. The Company had working capital of Rmb346.7 million and Rmb454.0 million as of December 31, 2001 and 2000, respectively. The Company paid a total of Rmb49.0 million in interest on indebtedness. In the opinion of the Company, the cash on hand of Rmb453.2 million is sufficient to fund its liquidity needs for the future.

For the fiscal year 2001, the Company entered into commitments for capital expenditure for construction of factory premises and purchases of equipment of approximately Rmb62.2 million, which are expected to be disbursed during the year ending December 31, 2002.

The Company leases certain of its warehouses under non-cancelable operating leases. Rental expenditures under operating leases were Rmb4.8 million, Rmb3.1 million and Rmb5.2 million for the years ended December 31, 1999, 2000 and 2001, respectively.

Other Commercial Commitments	Total Amounts Committed	Amount of Commitment Expiration Per Period			
		2002	2003 – 2005	2006 – 2007	2008 and beyond
Guarantees	190,850,000	190,850,000	–	–	–
<b>Total Commercial Commitments</b>	<b>190,850,000</b>	<b>190,850,000</b>	<b>–</b>	<b>–</b>	<b>–</b>

Hangzhou Zhongce has undertaken to guarantee certain bank loan facilities granted by certain banks to an affiliate in the PRC amounting to approximately Rmb190.9 million in fiscal year 2001.

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# MANAGEMENT DISCUSSION and Analysis

## **E**XCHANGE Rate Risk

The exchange rate between the Renminbi and the U.S. Dollar as quoted by the People's Bank of China was around Rmb8.28 to US\$1.00 in 2001. Recently, the PRC economy has exposed to the economic crisis in Asia; however, the central government of the PRC has from time to time adopted various measures designed to stabilize the economy, regulate growth and control inflation. Therefore management believes that it is unlikely that there will be any devaluation of the Renminbi against the U.S. Dollar. The Company therefore does not anticipate any exchange rate fluctuation which would have a material adverse effect on the financial performance and asset values of the Company when measured in terms of U.S. Dollar.

The PRC Subsidiaries import approximately 30-40% of natural rubber, a major raw material for tire manufacturing from major producing countries such as Malaysia and Thailand. Other raw materials, such as steel cord and carbon black are mainly sourced domestically.

Imported raw materials in China are subject to an overall tariff and tariff paid can be offset against credit given on exports. The import tariffs on rubber products were 12% in 2001. The PRC Subsidiaries plan to increase their level of exports. With the foreign currency proceeds obtained from export sales, the PRC Subsidiaries will be able to satisfy the foreign currency requirement for purchases of imported raw materials. The Company does not use derivative instruments to manage risks.

As export sales of the Group during year 2001 fell by 4.4% relative to last year, their exposure to exchange rate risk was correspondingly lowered.

## **I**NFLATION

China economy had experienced increase in general price level in the fiscal year 2001, and the country's GDP grew slowly. The general inflation rate in China was approximately -3.0%, 0.4% and 0.7% per annum in 1999, 2000 and 2001 respectively. As a result of the low level of inflation rate, the Company benefited from the general decrease in cost of locally sourced raw materials and operating expenses which help to partially offset the negative impact of decrease in selling price of tires.

## **T**AX Regulations

Under the tax regulations which came into effect on January 1, 1994, the PRC Subsidiaries are subject to value-added tax ("VAT") and consumption tax ("CT") generally calculated at 17.0% and 10.0% respectively, except that the 10% CT in radial tire products was abolished on January 1, 2001. It stimulates domestic sales of radial tires in the PRC Subsidiaries in the year of 2001.

Hangzhou Zhongce and Yinchuan CSI were granted approval by the local tax bureau for the application of a reduced tax rate. They were entitled to 15% and 12% on the applicable Chinese State unified income tax in fiscal year 2001 respectively.

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# MANAGEMENT DISCUSSION and Analysis



## Hangzhou Zhongce

Hangzhou Zhongce – Summary Financial Information

Note	For the year ended December 31, 2000	For the year ended December 31, 2001
	<i>(amounts in thousands Rmb)</i>	
Revenues	1,605,842	<b>2,064,783</b>
Gross profit	162,115	<b>244,397</b>
Operating income <sup>(1)</sup>	49,115	<b>97,023</b>
Net (loss) income	(1,637)	<b>53,502</b>

(1) Operating income means income before income taxes, net interest expenses and equity in loss of an affiliate.

### For the years ended December 31, 2001 and 2000

For fiscal year 2001, revenues from tires operations increased by Rmb458.9 million or 28.6% to Rmb2,064.8 million as a result of strong sales volume in vehicle, truck, bicycle and wheelbarrow tires. However, export sales of tires fell by 11.0% due to better margin achieved in domestic market.

Total revenue for the year consisted of 72% from the vehicle tires, 19% from the bicycle tires, 4% from the wheelbarrow and 5% from others. Of the vehicle tires, 24% were derived from sales of radial tires which amounted to Rmb499.1 million and 48% were from bias tires which amounted to Rmb978.4 million.

Gross profit amount increased 50.8% to Rmb244.4 million for the year of 2001 due to the following:

- 1) Outsourcing of natural rubber led to improved quality and lower cost;
- 2) Radial tires production achieved a certain level of economies of scale;
- 3) Abolishment of the 10% consumption tax effective January 1, 2001; and
- 4) Less competition in bicycle tire manufacturing as the other competitors had either scaled down their business volume or exited the market.

Despite an increase in warranty claims from customers, operating profit increased 97.5% to Rmb97.0 million for the year resulting in a net profit of Rmb53.5 million for the year in review (compared to a net loss of Rmb1.6 million in the previous year).

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## Yinchuan CSI

### Yinchuan CSI – Summary Financial Information

Note	For the year ended December 31, 2000 <i>(amounts in thousands Rmb)</i>	For the year ended December 31, 2001
Revenues	654,580	<b>619,420</b>
Gross profit (loss)	61,729	<b>(10,741)</b>
Operating loss (1)	(40,220)	<b>(159,191)</b>
Net loss	(47,828)	<b>(162,189)</b>

(1) Operating loss means loss before income taxes and net interest expenses.

### For the years ended December 31, 2001 and 2000

Revenues for tire operations in fiscal year 2001 were Rmb619.4 million, compared to fiscal year 2000 of Rmb654.6 million, a decrease of Rmb35.2 million or 5.4%. The decrease in revenues was mainly due to a reduction in selling prices in order to maintain the market competitiveness.

Yinchuan CSI incurred a gross loss of Rmb10.7 million in fiscal year 2001 as compared to a gross profit of Rmb61.8 million in fiscal year 2000. The loss was mainly attributable to the effect of decrease in selling prices.

Yinchuan CSI had an operating loss of Rmb159.2 million in fiscal year 2001 compared with Rmb40.2 million in fiscal year 2000. Other than the effect of negative gross margin as discussed above, the increase in operating loss was principally due to the increase in general provision for doubtful debts as settlement from debtors was slower than expected. This was also contributed by an increase in transportation expenses on sales of goods as the amount was mostly borne by Yinchuan CSI in fiscal year 2001 with a view to stimulate sales and a write-off of its goodwill of Rmb4.0 million.

Net loss was Rmb162.2 million in fiscal year 2001 compared with Rmb47.8 million in fiscal year 2000. The increase in net loss was primarily due to the negative margin, and the increase in general provision for doubtful debts and transportation expenses.

### Double Happiness, Yantai CSI, Shandong Synthetic, Fu Chun Jiang, CSI Rubber, Container Ltd, Orion Tire, Orion BVI, Century Lead, Capital Canton, Leading Returns, Sincere Ocean, Ventures Kingdom, Wealth Faith and Million Good

No summary financial information have been provided for Double Happiness, Yantai CSI and Shandong Synthetic as they are segregated as discontinued operations and disclosed in Note 5 to the consolidated financial statements. Also, no summary financial information has been provided for Fu Chun Jiang, CSI Rubber, Container Ltd, Orion Tire, Orion BVI, Century Lead, Capital Canton, Leading Returns, Sincere Ocean, Ventures Kingdom, Wealth Faith and Million Good as their operations are insignificant when compared to the other subsidiaries.



# REPORT

## of Independent Public Accountants

### To the Board of Directors and the Shareholders of China Enterprises Limited

We have audited the accompanying consolidated balance sheet of China Enterprises Limited (formerly China Tire e-commerce.com Limited) and its subsidiaries as of December 31, 2001, and the related consolidated statements of operations and comprehensive loss, shareholders' equity and cash flows for the year then ended (all expressed in Renminbi). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Company as of December 31, 2000 and for the two years in the period ended December 31, 2000, before the reclassification of discontinued operations described in Note 5 to the financial statements, were audited by other auditors whose report, dated April 23, 2001, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such 2001 consolidated financial statements present fairly, in all material respects, the financial position of China Enterprises Limited and its subsidiaries as of December 31, 2001, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

We also audited the reclassifications described in Note 5 that were applied to present the disclosures of 2000 and 1999 financial information in respect of discontinued operations in the accompanying financial statements. In our opinion, such reclassifications are appropriate and have been properly applied.

As discussed in Note 3 to the financial statements, the Company changed its method of accounting for the impairment or disposal of long-lived assets effective January 1, 2001 to conform with Statement of Financial Accounting Standards No. 144.

### Deloitte Touche Tohmatsu

Hong Kong  
April 16, 2002

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# CONSOLIDATED STATEMENTS OF OPERATIONS and Comprehensive Loss

(Amounts in thousands, except number of shares and per share data)

		Year ended December 31,			
		1999	2000	2001	2001
		Rmb	Rmb	Rmb	US\$
<b>Revenues:</b>					
	– third parties	1,862,908	1,930,112	2,518,923	304,218
	– related parties	225,600	330,310	188,382	22,751
	<b>Total</b>	<b>2,088,508</b>	<b>2,260,422</b>	<b>2,707,305</b>	<b>326,969</b>
	<b>Cost of revenues</b>	<b>(1,861,620)</b>	<b>(2,036,578)</b>	<b>(2,467,161)</b>	<b>(297,966)</b>
	Gross profit	226,888	223,844	240,144	29,003
	Selling, general and administrative expenses	(235,535)	(253,995)	(278,851)	(33,678)
	Impairment loss on provision for goodwill	–	–	(4,023)	(486)
	Provision for an amount due from a related company	–	–	(27,000)	(3,261)
	<b>Operating loss</b>	<b>(8,647)</b>	<b>(30,151)</b>	<b>(69,730)</b>	<b>(8,422)</b>
	<b>Non-operating (expenses) income:</b>				
	Interest income	15,684	17,357	11,961	1,445
	Interest expenses	(45,263)	(46,963)	(49,034)	(5,922)
	Other income	–	–	1,583	191
	(Impairment loss) recovery on loan receivable	(34,935)	(14,962)	9,800	1,184
	Equity in losses of affiliates	(2,150)	(1,967)	(2,486)	(300)
	<b>Loss from continuing operations before income taxes and minority interests</b>	<b>(75,311)</b>	<b>(76,686)</b>	<b>(97,906)</b>	<b>(11,824)</b>
	Provision for income taxes	(3,583)	(5,348)	(2,454)	(296)
	Minority interests	13,349	23,837	50,045	6,044
	<b>Loss from continuing operations</b>	<b>(65,545)</b>	<b>(58,197)</b>	<b>(50,315)</b>	<b>(6,076)</b>
	<b>Discontinued operations</b>				
	Loss from discontinued operations, net of applicable income taxes of Rmb1,706 in 1999 and RmbNil in 2000 and 2001	(87,651)	(21,187)	(85,044)	(10,272)
	<b>Net loss and total comprehensive loss</b>	<b>(153,196)</b>	<b>(79,384)</b>	<b>(135,359)</b>	<b>(16,348)</b>

# CONSOLIDATED STATEMENTS OF OPERATIONS and Comprehensive Loss

(Amounts in thousands, except number of shares  
and per share data)

	Year ended December 31,			
	1999 <i>Rmb</i>	2000 <i>Rmb</i>	2001 <i>Rmb</i>	2001 <i>US\$</i>
<b>Basic and diluted loss per common share</b>				
Continuing operations	(7.20)	(6.41)	<b>(5.58)</b>	<b>(0.67)</b>
Discontinued operations	(9.63)	(2.34)	<b>(9.43)</b>	<b>(1.14)</b>
Net loss	(16.83)	(8.75)	<b>(15.01)</b>	<b>(1.81)</b>
Weighted average number of common shares used in the calculation of basic and diluted loss per share	9,100,000	9,069,956	<b>9,017,310</b>	<b>9,017,310</b>

See accompanying notes to consolidated financial statements.

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# CONSOLIDATED

## Balance Sheets (Amounts in thousands, except number of shares and their par values)

As of December 31,

	2000 <i>Rmb</i>	2001 <i>Rmb</i>	2001 <i>US\$</i>
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	347,387	453,272	54,743
Restricted cash	11,451	57,779	6,978
Accounts receivable, net of allowance for doubtful receivables of Rmb149,423 in 2000 and Rmb181,545 in 2001	511,887	489,471	59,114
Inventories	656,641	711,174	85,890
Trading securities	390	220	27
Prepaid expenses, deferred assets and other current assets	40,038	44,584	5,385
Due from related companies	161,325	101,161	12,218
Current assets of discontinued operations	398,605	47,677	5,758
<b>Total current assets</b>	<b>2,127,724</b>	<b>1,905,338</b>	<b>230,113</b>
Investments in and advances to affiliates	105,437	102,022	12,322
Due from Chinese joint venture partners	–	6,506	786
Loan receivable, net	200	–	–
Prepayments for equipment	8,031	20,380	2,461
Property, plant and equipment, net	724,073	782,215	94,470
Deferred income taxes	–	8,127	982
Other assets	10,061	1,660	200
Goodwill, net	8,605	3,876	468
Non-current assets of discontinued operations	342,852	148,841	17,976
<b>Total assets</b>	<b>3,326,983</b>	<b>2,978,965</b>	<b>359,778</b>

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# CONSOLIDATED Balance Sheets

(Amounts in thousands, except number of shares and their par values)

	As of December 31,		
	2000 Rmb	2001 Rmb	2001 US\$
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Current liabilities:			
Short-term bank loans	637,691	755,330	91,224
Long-term bank loans – current portion	27,000	36,000	4,348
Accounts payable and other payables	309,406	530,644	64,087
Accrued liabilities	42,687	69,502	8,394
Due to ultimate parent company	1,348	1,772	214
Taxes other than income	18,796	32,348	3,907
Income taxes payable	1,209	1,391	168
Current liabilities of discontinued operations	635,588	131,673	15,902
Total current liabilities	1,673,725	1,558,660	188,244
Long-term bank loans net of current portion	64,600	36,600	4,420
Due to Chinese joint venture partners	70,451	30,807	3,721
Loans from related companies	–	24,498	2,958
Non-current liabilities of discontinued operations	6,300	1,379	167
Total liabilities	1,815,076	1,651,944	199,510
Minority interests	504,683	484,229	58,482
Minority interests of discontinued operations	54,597	38,595	4,661
Total minority interests	559,280	522,824	63,143
Obligations and commitments (Note 16)			
Shareholders' equity:			
Supervoting common stock – par value US\$0.01 per share (20,000,000 shares authorized; 3,000,000 shares outstanding at December 31, 2000 and 2001)	244	244	29
Common stock – par value US\$0.01 per share (50,000,000 shares authorized; 6,017,310 shares outstanding at December 31, 2000 and 2001)	526	526	64
Additional paid-in capital	1,040,994	1,039,501	125,543
Dedicated capital	36,118	37,549	4,535
Accumulated other comprehensive losses	(543)	(543)	(65)
Accumulated deficit	(124,712)	(273,080)	(32,981)
Total shareholders' equity	952,627	804,197	97,125
Total liabilities and shareholders' equity	3,326,983	2,978,965	359,778

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See accompanying notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF Shareholders' Equity

(Amounts in thousands, except number of shares and per share data)

	Shares of supervoting common stock	Shares of common stock	Supervoting common stock Rmb	Common stock Rmb	Additional paid-in capital Rmb	Dedicated capital Rmb	Accumulated other compre- hensive losses Rmb	Retained earnings (Accumulated deficit) Rmb	Total Rmb		
Corporate Information	Balance at January 1, 1999	3,000,000	6,100,000	244	532	1,044,636	33,416	(543)	122,600	1,200,885	
	Net loss	-	-	-	-	-	-	-	(153,196)	(153,196)	
	Transfer to dedicated capital	-	-	-	-	-	1,776	-	(1,776)	-	
	Dividends declared (Rmb0.662 per share)	-	-	-	-	-	-	-	(6,028)	(6,028)	
Chairman's Statement	Balance at December 31, 1999	3,000,000	6,100,000	244	532	1,044,636	35,192	(543)	(38,400)	1,041,661	
	Net loss	-	-	-	-	-	-	-	(79,384)	(79,384)	
	Review of Operations	Issuance of shares for stock options exercised	-	10	-	-	-	-	-	-	-
		Repurchase of shares	-	(82,700)	-	(6)	(3,642)	-	-	-	(3,648)
Board of Directors and Management	Transfer to dedicated capital	-	-	-	-	-	926	-	(926)	-	
	Dividends declared (Rmb0.662 per share)	-	-	-	-	-	-	-	(6,002)	(6,002)	
Financial Highlights and Information	Balance at December 31, 2000	3,000,000	6,017,310	244	526	1,040,994	36,118	(543)	(124,712)	952,627	
	Net loss	-	-	-	-	-	-	-	(135,359)	(135,359)	
	Released on disposition of discontinued operations	-	-	-	-	-	(11,578)	-	-	(11,578)	
	Transfer to dedicated capital	-	-	-	-	-	13,009	-	(13,009)	-	
Management Discussion and Analysis	Dividends declared (Rmb0.1655 per share)	-	-	-	-	(1,493)	-	-	-	(1,493)	
	Balance at December 31, 2001	3,000,000	6,017,310	244	526	1,039,501	37,549	(543)	(273,080)	804,197	

See accompanying notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF Cash Flows

(Amounts in thousands)

	Year ended December 31,			
	1999 Rmb	2000 Rmb	2001 Rmb	2001 US\$
Cash flows from operating activities:				
Net loss	(153,196)	(79,384)	(135,359)	(16,348)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:				
Loss on disposition of discontinued components	–	–	78,721	9,507
Minority interests	(87,124)	(40,758)	(57,841)	(6,985)
Equity in losses of affiliates	2,150	1,967	2,486	300
Deferred income taxes	–	–	(8,127)	(981)
Impairment loss provision for available-for-sale securities	2,123	1,941	–	–
Impairment loss provision (recovery) on loan receivable	34,935	14,962	(9,800)	(1,184)
Impairment loss provision for long-lived assets	136,538	3,852	–	–
Impairment loss provision for goodwill	–	–	4,023	486
Provision for an amount due from a related company	–	–	27,000	3,261
Unrealized loss of trading securities (US treasury bond)	3,234	–	–	–
Loss on disposal of available-for-sale securities	–	2,943	–	–
(Gain) loss on disposal of property, plant and equipment	(2,052)	3,468	21,323	2,575
Depreciation and amortization	104,036	109,985	118,399	14,299
Changes in operating assets and liabilities (net of effects of acquisition and disposal):				
Accounts receivable, net	16,530	(20,357)	(25,536)	(3,084)
Trading securities (US treasury bond)	(82,800)	79,734	–	–
Inventories	(82,583)	(78,986)	(48,825)	(5,897)
Prepaid expenses, deferred assets and other current assets	57,751	(7,501)	3,910	472
Due from related companies	(23,577)	(43,787)	32,414	3,915
Other assets	16,726	(3,668)	(1,795)	(217)
Accounts payable and other payables	76,530	147,139	119,352	14,415
Accrued liabilities	(58,836)	47,270	14,880	1,797
Taxes other than income	(4,160)	16,906	7,584	916
Income taxes payable	(6,983)	(1,359)	182	22
Net cash (used in) provided by operating activities	(50,758)	154,367	142,991	17,269

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# CONSOLIDATED STATEMENTS OF Cash Flows (Amounts in thousands)

		Year ended December 31,			
		1999	2000	2001	2001
		Rmb	Rmb	Rmb	US\$
	Cash flows from investing activities:				
	Proceeds from sales of available-for-sale securities	–	8,554	–	–
	Increase in restricted bank deposits	–	(11,451)	(46,328)	(5,595)
	Investments in and advances to affiliates	–	(11,855)	929	112
	Purchase of property, plant and equipment	(96,409)	(75,868)	(135,212)	(16,329)
Corporate Information	Proceeds from disposal of property, plant and equipment	2,099	3,784	2,267	273
Chairman's Statement	Proceeds from disposal of trading securities	–	–	170	20
	Repayment of loan receivables	–	–	10,000	1,208
Review of Operations	Acquisition of a subsidiary, net of cash acquired	–	–	4,120	498
	Proceeds from disposal of a business component, net	–	–	1,734	209
Board of Directors and Management	Net cash used in investing activities	(94,310)	(86,836)	(162,320)	(19,604)
	Cash flows from financing activities:				
	Payment of dividends to shareholders	(6,028)	(6,002)	(1,493)	(180)
Financial Highlights and Information	Repurchase of common stock	–	(3,648)	–	–
	Payment of dividends to minority interests	(123,071)	(1,299)	(66)	(8)
Management Discussion and Analysis	Increase (decrease) in due to ultimate parent company	3,366	(2,936)	424	51
	(Repayment) advance of loans from a related company	(2,678)	(295)	24,198	2,923
	Net increase in short-term bank loans	22,553	25,479	113,739	13,736
	Proceeds of long-term bank loans	60,500	–	68,189	8,235
Report of Independent Public Accountants	Repayment of long-term bank loans	(18,000)	(38,900)	(80,000)	(9,662)
	Decrease (increase) in due from/to Chinese joint venture partners	112,147	(44,604)	(20,230)	(2,443)
	Payment of capital lease obligations	–	–	(18,973)	(2,291)
	Net cash provided by (used in) financing activities	48,789	(72,205)	85,788	10,361
	Net (decrease) increase in cash and cash equivalents	(96,279)	(4,674)	66,459	8,026
	Cash and cash equivalents, beginning of year	510,150	413,871	409,197	49,420
	Cash and cash equivalents, end of year	413,871	409,197	475,656	57,446



# CONSOLIDATED STATEMENTS OF Cash Flows

(Amounts in thousands)

	Year ended December 31,			
	1999 Rmb	2000 Rmb	2001 Rmb	2001 US\$
Supplemental disclosures of cash flow information:				
Cash paid during the year for:				
Interest paid	45,263	46,963	49,034	5,922
Net income tax paid (refunded)	6,983	1,359	(182)	(22)
Supplemental schedule of non-cash investing and financing activities:				
Capital lease obligations incurred	–	–	18,973	2,291
Long-term advance from a Chinese joint venture partner capitalized in a subsidiary	–	–	19,600	2,367
Details of acquisition:				
Fair value of assets acquired (including cash acquired of Rmb4,120)	–	–	50,644	6,116
Minority interests acquired	–	–	(10,058)	(1,215)
Loan advance capitalized in connection with the acquisition	–	–	(10,569)	(1,276)
Liabilities assumed	–	–	30,017	3,625

See accompanying notes to consolidated financial statements.

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# NOTES TO CONSOLIDATED FINANCIAL Statements

(Amounts in thousands, except number of shares, per share/share option data and unless otherwise stated)

## 1. ORGANIZATION and Principal Activities

China Enterprises Limited (the “Company”) was incorporated in Bermuda on January 28, 1993. Its shares have been listed on the New York Stock Exchange since 1993.

Pursuant to a special resolution passed by the shareholders of the Company on May 31, 2001, the Company changed its name from China Tire e-commerce.com Limited to China Enterprises Limited.

As of December 31, 2001, the Company had the following subsidiaries (together with the Company, collectively referred to as the “Group”):

\* Hangzhou Zhongce Rubber Co., Limited (“HZ”, located in Hangzhou, Zhejiang, the People’s Republic of China (the “PRC”));

\* Double Happiness Tyre Industries Corporation Limited (“DH”, located in Taiyuan, Shanxi, the PRC);

\* Yinchuan C.S.I. (Greatwall) Rubber Co., Limited (“YC”, located in Yinchuan, Ningxia, the PRC);

\* Shandong C.S.I. Synthetic Fiber Co., Limited (“SD”, located in Laizhou, Shandong, the PRC);

\* Yantai C.S.I. Rubber Co., Limited (“YT”, located in Yantai, Shandong, the PRC);

\* Hangzhou Fu Chun Jiang Chemical Industrial Co., Limited (“FCJ”, located in Hangzhou, Zhejiang, the PRC);

CSI Rubber Industries Limited (“CSI Rubber”, incorporated in Hong Kong);

Orion Tire Corporation (“Orion Tire”, incorporated in the United States of America (the “US”));

Orion (B.V.I.) Tire Corporation (“Orion BVI”, incorporated in the British Virgin Islands (the “BVI”));

Container Limited (“Container”, incorporated in the BVI);

Century Lead Limited (“Century Lead”, incorporated in the BVI);

Capital Canton Limited (“Capital Canton”, incorporated in the BVI);

Leading Returns Limited (“Leading Returns”, incorporated in the BVI);

Sincere Ocean Limited (“Sincere Ocean”, incorporated in the BVI);

Ventures Kingdom Limited (“Ventures Kingdom”, incorporated in the BVI);

Wealth Faith Limited (“Wealth Faith”, incorporated in the BVI); and

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# NOTES TO CONSOLIDATED FINANCIAL Statements

(Amounts in thousands, except number of shares, per share/share option data and unless otherwise stated)

## 1. ORGANIZATION and Principal Activities – continued

Million Good Limited (“Million Good”, incorporated in the BVI).

All of these subsidiaries are distinct legal entities with limited liability.

\* These subsidiaries are collectively known as the “PRC Subsidiaries”.

Details of these subsidiaries are summarized as follows:

	HZ	DH	YC	SD	YT	FCJ	CSI Rubber	Orion Tire	Orion BVI	Orion Container	Century Lead	Capital Canton	Leading Returns	Sincere Ocean	Ventures Kingdom	Wealth Faith	Million Good
Legal status	Sino-foreign equity joint venture	Same as HZ	Same as HZ	Same as HZ	Same as HZ	Same as HZ	Limited liability company	Same as CSI Rubber	Same as CSI Rubber	Same as CSI Rubber	Same as CSI Rubber	Same as CSI Rubber	Same as CSI Rubber	Same as CSI Rubber	Same as CSI Rubber	Same as CSI Rubber	Same as CSI Rubber
Principal activities	Manufacture of rubber tires	Same as HZ	Same as HZ	Inactive	Same as HZ	Manufacture and trade of tire rubbers and carbon powder	Investment holding	Inactive	Inactive	Investment holding	Investment holding	Investment holding	Investment holding and financing	Investment holding and financing	Investment holding and financing	Investment holding and financing	Inactive
Registered capital/ Issued capital (amount as stated)	Rmb470 million	Rmb280 million	Rmb668 million	US\$9 million	Rmb60 million	Rmb4.61 million	HK\$2 million	US\$1 million	US\$100 million	US\$1 million	US\$1 million	US\$1 million	US\$1 million	US\$1 million	US\$1 million	US\$1 million	US\$1 million
Percentage of ownership by the Company (%)	51	55	51	51	51	51.24 *	100	60	60	100	100	100	100	100	100	100	100
Term of joint venture (if applicable)	50 years from the date of issuance of business license	Same as HZ	Same as HZ	Same as HZ	Same as HZ	20 years from the date of issuance of business license	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

\* FCJ is held by HZ resulting in an effective ownership by the Company of 26.13%.

The PRC Subsidiaries conduct their operations in the PRC. The Company is, accordingly, subject to special considerations and significant risks not typically associated with investments in equity securities of the United States and Western European companies. These include, among others, risks associated with the political and economic environment, foreign currency exchange, import restrictions and legal system in the PRC.

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# NOTES TO CONSOLIDATED FINANCIAL Statements

(Amounts in thousands, except number of shares, per share/share option data and unless otherwise stated)

## 1. ORGANIZATION and Principal Activities – *continued*

On July 4, 2001, October 24, 2001 and November 19, 2001, the Company established three wholly owned subsidiaries, namely, Leading Returns, Ventures Kingdom and Wealth Faith, respectively, at an investment cost of US\$1 (amount as stated) each. Their principal activities are investment holding and financing.

On August 17, 2001, the Company set up Sincere Ocean, a wholly-owned subsidiary in the BVI, at an investment cost of US\$1 (amount as stated). Its principal activity is to hold a 33.33% interest in an affiliate, Yutu Holdings Limited (“Yutu”), a company also incorporated in the BVI, which together with its subsidiaries, is engaged in garment manufacturing and the provision of management services.

## 2. BASIS of Presentation

The consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). This basis of accounting differs from that used in the statutory financial statements of the PRC Subsidiaries, which were prepared in accordance with the accounting principles and the relevant financial regulations applicable to enterprises with foreign investments as established by the Ministry of Finance of the PRC.

The principal adjustments made to conform the statutory financial statements of the PRC Subsidiaries to U.S. GAAP included the following:

- Additional allowance for doubtful receivables;
- Additional allowance for inventory obsolescence;
- Additional provision to write-down inventories to net realizable value;
- Additional impairment loss provision for long-lived assets;
- Additional provision for warranty expenses;
- Increase in depreciation expense for property, plant and equipment to more accurately reflect the estimated economic useful lives of these assets;
- Non-capitalization of interest expense related to the financing of certain construction-in-progress which have been temporarily suspended from construction; and
- Reclassification of appropriation of income to staff welfare and incentive bonus fund as a charge to income.

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## 3. SUMMARY of Significant Accounting Policies

### (a) Basis of Consolidation

The consolidated financial statements include the assets, liabilities, revenue and expenses of the Company and all of its majority owned and controlled subsidiaries. All significant intercompany balances and transactions have been eliminated on consolidation. Investments in 50% or less owned companies over which the Company exercises significant influence but not control, are accounted for using the equity method. Under the equity method, the Company's proportionate share of the affiliate's net income or loss is included in the consolidated statement of operations.

### (b) Revenues

Revenues represent the invoiced value of goods, net of value-added tax ("VAT") and other sales taxes, supplied to customers. Revenues are recognized upon delivery and acceptance of goods by the customers. The Company permits the return of damaged or defective products and accounts for these returns as deduction from sales. Accordingly, the Company provides allowances for the estimated amounts of those returns at the time of revenue recognition based on historical experience adjusted for known trends.

### (c) Shipping and Handling Fees and Costs

Costs for transportation of products to customers is recorded as a component of selling, general and administrative expense (see Note 22).

### (d) Cash and Cash Equivalents

The Company considers cash on hand, demand deposits with banks and liquid investments with an original maturity of three months or less when purchased to be cash and cash equivalents. Included in cash and cash equivalents as of December 31, 2000 and 2001 were United States dollar deposits of US\$32,761 (Rmb271,435) and US\$18,960 (Rmb156,890), respectively.

Cash and cash equivalents included in the consolidated statements of cash flows included cash and cash equivalents of discontinued operations totaling Rmb61,810 and Rmb22,384 as of December 31, 2000 and 2001, respectively.

### (e) Marketable Securities

The Company determines the appropriate classification of marketable securities at the time of purchase and reevaluates such designation at each balance sheet date. Marketable securities are classified as either trading or available-for-sale. Trading securities are carried at fair value, based on quoted market prices, with unrealized gains and losses included in the consolidated statement of operations for the year. Investments in marketable securities classified as available-for-sale are also carried at fair value, with unrealized gains or losses excluded from the consolidated statement of operations and reported as other comprehensive income. If the decline in fair value is determined to be other than temporary, the amount of write-down to fair value is included in the determination of operating results for the year as a realized loss. The cost of securities sold is based on the average cost method and income earned is included in other income.

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## 3. SUMMARY of Significant Accounting Policies – *continued*

### (e) **Marketable Securities – *continued***

For the years ended December 31, 1999 and 2000, write-downs of the carrying amounts of the Group's available-for-sale securities in the amounts of Rmb2,100 and Rmb1,900, respectively, were considered to be impairment losses other than temporary and were included in the determination of the operating results of the Group for these years. The Group sold all of these securities in fiscal 2000 at a loss of approximately Rmb2,900.

### (f) **Inventories**

Inventories are stated at the lower of cost, on an average cost basis, or market value. Costs of work-in-progress and finished goods comprise direct materials, direct labor and an attributable proportion of production overheads. Provision for potentially obsolete or slow-moving inventory is made based on management's analysis of inventory levels.

### (g) **Property, Plant and Equipment**

Property, plant and equipment are stated at cost of acquisition less accumulated depreciation and provision for impairment loss. The cost of major improvements and betterments is capitalized whereas the cost of maintenance and repairs is expensed in the year incurred.

Depreciation of property, plant and equipment is computed using the straight-line method over the assets' remaining estimated economic useful lives and an estimated residual value of 4% to 10% of the costs except for land use rights which have no residual value. The estimated useful lives of property, plant and equipment are as follows:

Land use rights	50 years
Buildings	20 years
Machinery and equipment	10 years
Motor vehicles	5 years
Furniture, fixtures and office equipment	5 years

Construction-in-progress represents factory and office buildings under construction and plant and machinery pending installation. This includes the costs of construction, the costs of plant and machinery and interest capitalized on borrowings during the period of construction or installation. Assets under construction are not depreciated until construction is completed and the assets are ready for their intended use. Interest capitalized were Rmb1,546, Rmb1,580 and nil for the years ended December 31, 1999, 2000 and 2001, respectively.

### (h) **Goodwill**

Goodwill is capitalized and amortized on a straight-line basis over its expected useful economic life of 20 years. Accumulated amortization was Rmb5,617 at December 31, 2000 and Rmb6,323 at December 31, 2001.

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## 3. SUMMARY of Significant Accounting Policies – *continued*

### (i) Impairment

The Company reviews its long-lived assets, including goodwill, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may no longer be recoverable. An impairment loss, measured based on the fair value of the asset, is recognized if expected future undiscounted cash flows are less than the carrying amount of the assets.

In October 2001, the Financial Accounting Standards Board (the “FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”. This standard prescribes the recording and reporting of impairment on disposal of certain Long-Lived Assets. The Company adopted this standard as of January 1, 2001 (see Note 5).

### (j) Income Taxes

The Company accounts for income taxes using the liability method in accordance with SFAS No. 109, “Accounting for Income Taxes”. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases and to operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply when those temporary differences are expected to reverse. Valuation allowances are established to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all of, the deferred tax asset will not be realized.

### (k) VAT and Consumption Tax (“CT”)

All the PRC Subsidiaries are subject to VAT and CT. They are recognized on an accrual basis and revenues are recorded net of these taxes.

### (l) Foreign Currencies

The companies in the Group other than Orion Tire and Orion BVI maintain their books and records in Renminbi, their functional currency. Foreign currency transactions are translated into Renminbi at the applicable exchange rates quoted by the People’s Bank of China (the “unified exchange rates”) prevailing at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies are translated into Renminbi using the applicable unified exchange rates prevailing at the balance sheet dates. Non-monetary assets and liabilities are translated at the unified exchange rates prevailing at the time the assets or liabilities were acquired. The resulting exchange differences are included in the consolidated statement of operations.

Orion Tire and Orion BVI maintain their books and records in United States dollar. For consolidation purposes, their balance sheets were translated into Renminbi using the unified exchange rates prevailing at the balance sheet date. Their statements of operations are translated using a weighted average rate for the period. Exchange differences arising on the translation of these financial statements are treated as translation adjustments and included in the accumulated other comprehensive losses account within shareholders’ equity in the consolidated financial statements.

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## 3. SUMMARY of Significant Accounting Policies – *continued*

### (I) Foreign Currencies – *continued*

The Company's share capital is denominated in United States dollar. For financial reporting purposes, the United States dollar capital amounts have been translated into Renminbi at the respective exchange rates prevailing at the capital injection dates.

The Renminbi currently is not generally a freely convertible currency. The State Administration for Foreign Exchange, under the authority of the People's Bank of China, controls the conversion of Renminbi into foreign currencies. The value of the Renminbi is subject to changes in central government policies and to international economic and political developments affecting supply and demand in the China Foreign Exchange Trading System market.

The PRC Subsidiaries conduct their business substantially in the PRC, and their financial performance and position are measured in terms of Renminbi. Any devaluation of the Renminbi against the United States dollar would consequently have an adverse effect on the financial performance and asset values of the Company when measured in terms of United States dollar. The PRC Subsidiaries' products are primarily sold in the PRC for Renminbi. Thus, their revenues and profits are predominantly denominated in Renminbi, and will have to be converted to pay dividends to the Company in United States dollar. Should the Renminbi devalue against the United States dollar, such devaluation would have a material adverse effect on the Company's profits and the foreign currency equivalent of such profits repatriated by the PRC Subsidiaries to the Company. The Company currently is not able to hedge its Renminbi – United States dollar exchange rate exposure in the PRC because neither the People's Bank of China nor any other financial institutions authorized to engage in foreign exchange transactions in the PRC offers forward exchange contracts.

The translation of Renminbi (Rmb) amounts into United States dollar (US\$) amounts are included solely for the convenience of readers in the United States of America and have been made at US\$1.00 = Rmb8.28, the unified exchange rate on December 31, 2001. No representation is made that the Renminbi amounts could have been, or could be, converted into United States dollar at that or at any other rate.

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## 3. SUMMARY of Significant Accounting Policies – *continued*

### (m) Dedicated Capital

In accordance with the relevant laws and regulations for Sino-foreign equity joint venture enterprises, the PRC Subsidiaries maintain discretionary dedicated capital, which includes a general reserve fund, an enterprise expansion fund and a staff welfare and incentive bonus fund. The respective boards of directors of the PRC Subsidiaries will determine on an annual basis the amount of the annual appropriations to dedicated capital. In 1999, 2000 and 2001, certain PRC Subsidiaries appropriated 5% respectively of the profits after tax as reflected in their statutory financial statements to the general reserve fund, enterprise expansion fund and staff welfare and incentive bonus fund. The Company's proportionate interest in appropriations to the general reserve fund and the enterprise expansion fund are reflected in the consolidated balance sheets under shareholders' equity as dedicated capital; however, the appropriation for the staff welfare and incentive bonus fund is charged to consolidated statements of operations and the unused portion is recorded as a current liability.

### (n) Basic and Diluted Income (Loss) per Share

The Company calculates basic and diluted income (loss) per share in accordance with SFAS No. 128, "Earnings Per Share". Basic earnings per share is computed using the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted-average number of common shares and common stock equivalent shares outstanding during the period. Common stock equivalent shares such as shares issuable upon the exercise of stock options are excluded from the computation if their effect is antidilutive. During 1999, 2000 and 2001, all outstanding options were anti-dilutive (see Note 15). The weighted-average number of common shares outstanding for 1999, 2000 and 2001 was 9,100,000, 9,069,956 and 9,017,310, respectively.

### (o) Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

### (p) Financial Instruments

The Group's financial instruments that are exposed to concentration of credit risk consist primarily of its cash and cash equivalents, accounts receivable and amounts due from related companies. The Group's cash and cash equivalents are high-quality deposits placed with banking institutions with high credit ratings; therefore, the credit risk is limited. The accounts receivable and amounts due from related companies largely represent amounts due from the Group's customers (including related companies) and are typically on an open account basis. In no period did sales to any one customer accounts for 10% or more of the Group's sales. The Group maintains allowances from estimated potential bad debts losses and believes that no significant credit risk exists as credit losses, when realized, have historically been within the range of management's expectations.

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## 3. SUMMARY of Significant Accounting Policies – *continued*

### (p) **Financial Instruments – *continued***

The carrying amounts of financial instruments which consists of cash and cash equivalents, restricted cash, accounts receivable, trading securities, amounts due from related parties, short-term and long-term bank loans, accounts payable and other payables, and amount due to ultimate parent company are carried at cost which approximate fair value due to the short-term nature of these instruments. The interest rates on the Group's bank loans approximate those which would have been available for loans of similar remaining maturity at the respective year ends. The fair value of amounts due to Chinese joint venture partners and loans from related companies is not determinable. The Company does not use derivative instruments to manage risks. On January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", which did not have any impact on the Company's financial position or results of operations.

### (q) **Comprehensive Income (Loss)**

The Company reports comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income". Comprehensive income consists of net income (loss) and other gains and losses affecting shareholders' equity that, under U.S. GAAP are excluded from net income (loss). Comprehensive loss for 1999, 2000 and 2001 only represents its net loss and has been disclosed within the consolidated statements of operations and comprehensive loss.

### (r) **Segment Information**

The Company reports information about operating segments on a basis consistent with the Company's internal organization structure as well as information about geographic areas and major customers in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information".

### (s) **Related Parties**

Parties are considered to be related to the Company if the parties that, directly or indirectly, through one or more intermediaries, control, are controlled by, or are under common control with the Company. Related parties also include principal owners of the Company, its management, members of the immediate families of principal owners of the Company and its management and other parties with which the Company may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. A party which can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests is also a related party.

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## 3. SUMMARY of Significant Accounting Policies – *continued*

### (t) Stock-Based Compensation

The Company accounts for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion (“APB”) No. 25, “Accounting for Stock Issued to Employees”. Compensation expense related to employee stock options is recorded only if, on the date of grant, the fair value of the underlying stock exceeds the exercise price. The Company adopted the disclosure only requirements of SFAS No. 123, “Accounting of Stock-Based Compensation”, which allows entities to continue to apply the provisions of APB No. 25 for transactions with employees and provide pro-forma net income or loss and pro-forma earnings or loss per share disclosures for employee stock grants as if the fair-value-based method of accounting as prescribed in SFAS No. 123 had been applied to these transactions.

### (u) Recent Accounting Pronouncements

In June 2001, the FASB issued SFAS No. 141, “Business Combinations”, and SFAS No. 142, “Goodwill and Other Intangible Assets”. These statements establish accounting and reporting for business combinations.

SFAS No. 141 requires all business combinations completed after June 30, 2001, be accounted for under the purchase method of accounting. This standard also establishes for all business combinations made after June 30, 2001, specific criteria for the recognition of intangible assets separately from goodwill. SFAS No. 141 also requires that the excess of fair value of acquired assets over cost (negative goodwill) be recognized immediately as an extraordinary gain, rather than deferred and amortized. Adoption of SFAS No. 141 did not have a significant impact on the Company’s consolidated financial statements.

SFAS No. 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the identification of reporting units for purposes of assessing potential future impairments of certain intangible assets, including goodwill. SFAS No. 142 also requires the Company to complete a transitional goodwill impairment test in six months from the date of adoption. The Company plans to adopt SFAS No. 142 effective on January 1, 2002 and is currently assessing but has not yet determined the impact of SFAS No. 142 on its financial position and results of operations.

In August 2001, the FASB also issued SFAS No. 143, “Accounting for Asset Retirement Obligations”, which is effective for financial statements issued for fiscal years beginning after June 15, 2002. SFAS No.143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. Management is currently assessing, but has not yet determined, the impact of this standard will have on the Company’s financial position and results of operations.

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## 3. SUMMARY of Significant Accounting Policies – *continued*

### (v) Reclassifications

Certain prior year amounts in the accompanying consolidated financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on the results of operations or financial position for any year presented.

## 4. ACQUISITION

In September 2001, HZ capitalized an amount of Rmb10,569 (“Purchase Price”) previously advanced to the Chinese joint venture partner of FCJ for a 51.24% interest in that company. There were no differences between the Purchase Price and the estimated fair values of the net assets acquired. Cash acquired through the acquisition was Rmb4,120. This acquisition is immaterial to the Group’s results from operations and financial position.

## 5. DISCONTINUED Operations

During 2001, the Company decided to dispose of certain of its subsidiaries which included DH, YT and SD, which have previously been reported under the operating segments “DH”, “Others” and “Others”, respectively, under SFAS No. 131.

### (a) DH

DH consisted of a bias tire factory and a radial tire factory under construction. All of DH’s revenue was contributed by the bias tire factory as trading and manufacturing activities were only carried out in this factory. In fiscal 1995, DH temporarily suspended construction of the radial tire factory. Total costs incurred for the factory up to December 31, 2001, net of provisions, were approximately Rmb82,365 and had been included in construction-in-progress under property, plant and equipment. In early 2000, an appraisal (the “First Appraisal”) of the replacement costs of the facilities was conducted by a third party PRC asset appraiser based on an assumption that the construction of the factory would be resumed. In the absence of a definite financing plan, the directors of the Company performed an assessment (the “Assessment”) of the fair value of the assets of the factory as of December 31, 1999 based on the net present value of expected future cash flows from the factory. Based on the results of the First Appraisal and the Assessment, an aggregate potential impairment loss provision was recorded for the year ended December 31, 1999 to write-down the carrying value of the facilities of the factory by approximately Rmb122,000.

In early 2001, a further appraisal (the “Second Appraisal”) of the fair market value of the facilities of the factory was conducted by a third party international appraiser under an assumption that the assets would be disposed to a willing third party buyer. Based on the result of the Second Appraisal, the Directors of the Company considered that no further provision was required for the carrying value of the facilities of the factory for the year ended December 31, 2000.

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## 5. DISCONTINUED Operations – *continued*

### (a) DH – *continued*

In late September 2001, the Company's management adopted a plan to dispose of its entire interest in DH and subsequently entered into a share transfer agreement with a third party to dispose of its entire interest in the bias tire factory for a consideration of Rmb41,000. Although the completion of the sale is pending upon certain approvals being obtained from governmental authorities, the Company transferred substantially all its risks and benefits of ownership of the factory to the buyer in early December 2001 and accordingly, the Company recognized a net realized loss on such disposition of Rmb28,588 during fiscal 2001 and has ceased to account for the results of operations and the assets and liabilities of the factory from the disposal date. The sales proceeds were received by the Company in cash during fiscal 2001.

The Company has also recognized an impairment loss of Rmb31,187 for the planned disposition of the incomplete radial tire factory calculated on the basis of anticipated sales value of Rmb30,000 which is expected to be received in fiscal 2002 less a loss of Rmb73,728 from the waiver of loan advances by the Company to the factory.

The estimated selling price of Rmb30,000 was derived from prior discussions with potential purchasers of the factory; however, the Company is not currently engaged in negotiations with any prospective purchaser. Accordingly, the amount is subject to risks and uncertainties related to the Company's ability to secure agreements with third parties. There are no assurances that any sale will be concluded at such price. As a result, the Company believes it is reasonably possible that these estimates may be revised in the near-term. The failure to conclude a sale at that price would result in a revised loss.

Interest expense incurred on the outstanding loans used to finance the construction of the factory, amounting to Rmb1,856, Rmb1,856 and Rmb1,113 for the years ended December 31, 1999, 2000 and 2001, respectively, has been included in loss from discontinued operations.

### (b) YT

In the fourth quarter of fiscal 2001, the Company decided to sell its interests in YT in consequence of the change in business climate on the demand of traditional pneumatic tire. The Company had recorded a non-cash impairment charge of Rmb16,774 to write down the carrying value of the long-lived assets for fiscal 2001 representing management's best estimate of the loss to be recognized on sale of the Company's interests in this subsidiary. The Company subsequently entered into a share transfer agreement with a third party to dispose of its entire interest in YT and the respective shareholder's advance of Rmb20,167 for an aggregate consideration of Rmb26,000 representing the carrying value as of December 31, 2001. The sale was considered completed in January 2002 as approval from the relevant government authorities has been obtained and the Company transferred substantially all its risks and benefits of ownership of YT to the buyer. First installment of the sale proceeds of approximately Rmb13,000 was received in February 2002.

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## 5. DISCONTINUED Operations – continued

### (c) SD

Since October 1996, production at SD has been suspended due to unfavourable market conditions for synthetic nylon cord fabric. Management of SD and the Company, together with the Laizhou City Government, had been in the process of formulating a plan for the future operations of SD. As no concrete plan had been agreed among all parties, the Company had recorded an impairment charge on its long-lived assets of Rmb14,538 in fiscal 1999 and Rmb3,852 in fiscal 2000 based on the estimated future cash flows for SD.

During 2001, the Company had approved and committed to a plan to sell its interest in SD and recognized an additional impairment charge of Rmb2,172 representing management's best estimate of the loss to be recognized on its sale. In January 2002, the Company signed a transfer agreement to sell its entire interest in SD to its Chinese joint venture partner for a consideration of Rmb10 approximating the carrying value as of December 31, 2001.

Accordingly, the operating results of DH, YT and SD have been segregated from continuing operations and reported as a separate line item on the consolidated statement of operations. The Company has also restated its prior years' financial statements to present the operating results of these subsidiaries as discontinued operations.

Operating results of the discontinued operations are summarized below:

	Year ended December 31,		
	1999 <i>Rmb</i>	2000 <i>Rmb</i>	2001 <i>Rmb</i>
Revenues	533,902	555,187	446,663
Loss from operations of discontinued components before income taxes and minority interests (including impairment write-downs for those business components of Rmb136,538 in 1999 and Rmb3,852 in 2000 and loss on disposition of Rmb78,721 in 2001)	(159,720)	(38,107)	(92,840)
Provision for income taxes	(1,706)	–	–
Minority interests	73,775	16,920	7,796
Loss from discontinued operations	(87,651)	(21,187)	(85,044)

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## 5. DISCONTINUED Operations – continued

The components of assets and liabilities of the discontinued operations included in the Company's consolidated balance sheets as of December 31, 2000 and 2001 are summarized below:

	2000 <i>Rmb</i>	2001 <i>Rmb</i>
Cash and cash equivalents	61,810	22,384
Accounts receivable, net	141,597	14,262
Inventories	192,224	10,131
Prepaid expenses, deferred expenses and other current assets	2,974	900
Current assets of discontinued operations	398,605	47,677
Due from Chinese joint venture partners	12,370	6,331
Property, plant and equipment, net	328,069	142,463
Other assets	374	47
Goodwill, net	2,039	–
Non-current assets of discontinued operations	342,852	148,841
Short-term bank loans	(193,186)	(64,164)
Long-term bank loans – current portion	(10,000)	(21,810)
Accounts payable and other payables	(341,157)	(22,974)
Accrued liabilities	(74,068)	(21,320)
Taxes other than income	(2,367)	(1,405)
Income taxes payable	(14,810)	–
Current liabilities of discontinued operations	(635,588)	(131,673)
Long-term bank loans net of current portion	(6,000)	(1,379)
Loan from a related company	(300)	–
Non-current liabilities of discontinued operations	(6,300)	(1,379)
Minority interests of discontinued operations	(54,597)	(38,595)
	44,972	24,871

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## 6. ASSET Impairment

The Company recognized an impairment loss provision for goodwill of YC of Rmb4,023 in fiscal 2001. YC has recurring losses from its existing bias tire products and the Company's management identified this as an indicator of asset impairment. This condition led to operating results and forecasted future results that were less than had been anticipated at the time of the Company's acquisition of YC. The Company revised its projections and determined that the projected results would not fully support the future amortization of the goodwill balance of YC resulting in the recognition of this non-cash impairment charge.

## 7. INVENTORIES

Inventories by major categories are summarized as follows:

	2000 <i>Rmb</i>	2001 <i>Rmb</i>
Raw materials	241,980	304,002
Work-in-progress	21,269	15,619
Finished goods	378,510	387,318
Supplies	14,882	4,235
	656,641	711,174

## 8. TRADING Securities

As of December 31, 2000 and 2001, trading securities comprised municipal bonds in the PRC of which Rmb170 was redeemed at its par value in fiscal 2001 resulting in no gain or loss on redemption.

For the year ended December 31, 1999, the Company had recorded an unrealized loss of approximately Rmb3,200 relating to an US treasury bond (the "Bond") purchased at its par value of US\$10,000 and maturing on August 15, 2029 which was included in the determination of the results of operations for 1999. Pursuant to a call option agreement entered into between the Company and a third party dated March 6, 2000, the third party had a right to call the Company to sell the Bond at a price of 98.19% of the par value of the Bond on or before April 5, 2000. On April 5, 2000, the third party exercised the option right and the Company sold the Bond at a gain of approximately Rmb1,800 which was included in the determination of the results of operations for fiscal 2000.

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## 9. INVESTMENTS in and Advances to Affiliates

In 1998, an agreement was entered into by HZ with three other PRC enterprises in Hangzhou, the PRC, to establish a Sino-foreign equity joint venture, Hangzhou Sunrise Rubber Co., Ltd. ("Hangzhou Sunrise"), to construct and operate a radial tire factory. The total investment and registered capital of this new joint venture is US\$29,980 (Rmb248,000). The equity interest owned by HZ is 49.2% and its investment commitment was satisfied by the contribution of its existing radial tire project under construction into Hangzhou Sunrise. The radial tire factory of Hangzhou Sunrise commenced operations in 2000.

On August 20, 2001, Sincere Ocean acquired a 33.33% of the outstanding issued share capital of Yutu for a nominal consideration of US\$3 (amount as stated) and advanced a shareholder loan of approximately Rmb1,700. On February 22, 2002, Sincere Ocean has advanced another loan of approximately Rmb1,700 to Yutu to finance its working capital.

The following table presents summarized financial information for the Group's investments in affiliates which are accounted for using equity method:

	1999 <i>Rmb</i>	2000 <i>Rmb</i>	2001 <i>Rmb</i>
Revenues	–	51,449	127,612
Operating loss	(4,371)	(3,794)	(7,148)
Net loss	(4,371)	(4,298)	(7,583)
Current assets	15,390	15,141	31,939
Non-current assets	413,420	477,660	479,557
Current liabilities	25,955	74,244	183,369
Non-current liabilities	159,000	179,000	96,153
Shareholders' equity	243,855	239,557	231,974

## 10. LOAN Receivable

In late 1993, the Company acquired a majority interest in a formerly state-owned enterprise located in Chongqing, the PRC, through the formation of Chongqing C.S.I. Tyre Co. Limited ("CQ") with Chongqing Tyre Chief Factory ("Chongqing Factory"). An amount of Rmb56,966 (US\$6,600) was contributed by the Company into CQ in late 1993 (the "date of contribution") in accordance with the provisions of the joint venture agreement, CQ commenced effective operations on January 1, 1994.

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## 10. LOAN Receivable – *continued*

During fiscal 1995, the Company began to renegotiate the terms of the joint venture agreement of CQ. Pending the outcome of the negotiations, the parties agreed that the capital injected by the Company was treated as an interest-bearing loan to Chongqing Factory with effect from the date of contribution. Accordingly, the original capital contribution of Rmb56,966 (US\$6,600) was accounted for as a loan receivable (the “Loan”) from Chongqing Factory and the financial position and results of operations of CQ have not been included in the consolidated financial statements since fiscal 1996. The Company had also made full provision against recorded interest income on the Loan of approximately Rmb14,000 for the year ended December 31, 1999.

In fiscal 1997, the Company proposed to formally terminate the joint venture agreement of CQ (the “Termination”) with Chongqing Factory. Pursuant to an approval document issued by the supervisory authority of Chongqing Factory (the “Supervisor”) on April 10, 1997, the Supervisor agreed to the Termination as well as the transfer of the original investment by the Company in CQ to other projects in the Chongqing region. Since the Company was unable to identify a suitable project in Chongqing in which it could reinvest, the Company initiated arbitration proceedings in early 1998 (the “Proceedings”) in the PRC against Chongqing Factory to enforce the Termination, and to recover the Loan and accrued interest up to June 30, 1998 as well as the related legal expenses for the Proceedings. Provision amounted to approximately Rmb6,869 was made for the year ended December 31, 1998.

A judgement of the Proceedings (the “Judgement”) was obtained on March 31, 2000 that the joint venture agreement of CQ was approved to be terminated and CQ is to be liquidated in accordance with the relevant rules and regulations of the PRC. Under the Judgement, the Company was entitled to damages (the “Damages”) of approximately Rmb15,796 and Chongqing Factory was discharged from other claims lodged by the Company. The Damages was required to be paid to the Company within 45 days from the date of the Judgement. In view of the expected long duration of and the uncertainty of amounts to be recovered from the liquidation of CQ and after taking into consideration the compensation for financial losses to be paid by Chongqing Factory, the Directors of the Company made a provision against the outstanding principal balance of the Loan amounting to approximately Rmb34,935 for the year ended December 31, 1999. Such provision was included in the consolidated statement of operations in fiscal 1999.

Subsequent to the Judgement, Rmb200 was recovered from Chongqing Factory in early 2001. Accordingly, the remaining balance of the Loan as of December 31, 2000, other than the Rmb200 recovered in early 2001, was fully provided for and this provision amounting to Rmb14,962 was included in the consolidated statement of operations for the year ended December 31, 2000.

In fiscal 2001, the Company had recovered a total amount of Rmb10,000 for the loan of which Rmb9,800 was recorded as a non-operating income.

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## 11. PROPERTY, Plant and Equipment

Property, plant and equipment consist of the following:

At cost:

Buildings and land use rights  
Machinery and equipment  
Motor vehicles  
Furniture, fixtures and office equipment  
Construction-in-progress

Total  
Less: Accumulated depreciation and amortization

Net book value

	2000 <i>Rmb</i>	2001 <i>Rmb</i>
Buildings and land use rights	329,082	355,756
Machinery and equipment	677,033	824,841
Motor vehicles	21,985	23,463
Furniture, fixtures and office equipment	27,750	31,700
Construction-in-progress	84,708	64,033
Total	1,140,558	1,299,793
Less: Accumulated depreciation and amortization	(416,485)	(517,578)
Net book value	724,073	782,215

## 12. BANK Loans

As of December 31, 2000 and 2001, Rmb78,600 and Rmb34,100 of the long-term bank loans were guaranteed by related companies and Rmb16,000 and Rmb33,500 of the long-term bank loans were guaranteed by third parties, respectively. As of December 31, 2001, Rmb 10,000 of the long-term bank loans were secured by buildings and equipment of three of the PRC subsidiaries. Long-term bank loans bear average annual interest rates of approximately 7.2% in 1999, 8.0% in 2000 and 7.46% in 2001.

The outstanding balances of long-term bank loans from continuing operations as of December 31, 2001 were repayable as follows:

	Rmb
2002	36,000
2003	36,600
	72,600

Short-term bank loans included United States dollar loans of US\$4,840 (Rmb40,068) and US\$3,000 (Rmb24,830) as of December 31, 2000 and 2001, respectively.

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## 12. BANK Loans – continued

As of December 31, 2000 and 2001, Rmb578,641 and Rmb540,460 of the short-term bank loans were guaranteed by related companies and Rmb4,230 and Nil by third parties, respectively. Short-term bank loans of Rmb173,510 and Rmb106,310 were secured by buildings and equipment of three of the PRC Subsidiaries as of December 31, 2000 and 2001, respectively. The short-term bank loans carried average annual interest rates of approximately 6.1% in 1999, 6.5% in 2000 and 6.95% in 2001.

In addition to the above loan facilities provided by banks, the Group had available import credit facilities amounting to Rmb19,141 in 2000 and Rmb19,553 in 2001, of which Rmb18,291 in 2000 and Rmb18,703 in 2001 had been utilized. The Group also had available letters of credit facilities which were secured by bank deposits of the Group of Rmb48,301; no facilities were utilised as of December 31, 2001. As of December 31, 2000 and 2001, Rmb3,000 of the banking facilities were secured by buildings and equipment of one of the PRC subsidiaries. As of December 31, 2001, Rmb16,555 of the bank facilities were also secured by a guarantee given by a related company. Interest rates are generally based on the banks' best lending rates plus 1% to 2% per annum, subject to fluctuations at the banks' discretion. The banking facilities are subject to annual review by the banks.

## 13. PROVISION for Income Taxes

The components of loss from continuing operations before income taxes and minority interests are as follows:

	Year ended December 31,		
	1999	2000	2001
	<i>Rmb</i>	<i>Rmb</i>	<i>Rmb</i>
PRC	(8,704)	(36,464)	(105,742)
All other jurisdictions	(66,607)	(40,222)	7,836
	(75,311)	(76,686)	(97,906)

The Company was incorporated under the laws of Bermuda and, under current Bermuda law, is not subject to tax on income or on capital gains. The Company has received an undertaking from the Ministry of Finance of Bermuda pursuant to the provisions of the Exempted Undertakings Tax Protection Act, 1966, as amended, that in the event that Bermuda enacts any legislation imposing tax computed on profits or income, including any dividend or capital gains withholding tax, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of any such tax shall not be applicable to the Company or to any of its operations or the shares, debentures or other obligations of the Company until March 28, 2016. This undertaking is not to be construed so as to (i) prevent the application of any such tax or duty on such person as an ordinary resident in Bermuda; or (ii) prevent the application of any tax payable in accordance with the provision of the Land Tax Act, 1967 or otherwise payable in relation to any land leased to the Company in Bermuda.

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## 13. PROVISION for Income Taxes – continued

Except as stated in the following paragraphs, the subsidiaries of the Company are subject to income taxes calculated at tax rates (ranging from 16% to 44%) on the taxable income as reported in the statutory financial statements adjusted for taxation based on tax laws prevailing at their respective places of incorporation and operations.

In accordance with the relevant income tax laws applicable to Sino-foreign joint ventures in the PRC, the PRC Subsidiaries, other than FCJ, having a joint venture term of not less than 10 years and engaging in production industries, are fully exempt from the Chinese State unified income tax for two years starting from the first profit-making year (after utilization of available accumulated losses carried forward), followed by a 50% reduction of the Chinese State unified income tax for the next three years thereafter (“tax holiday”). In accordance with the same tax laws, the PRC Subsidiaries, other than FCJ, are also exempt from the PRC local income tax. Accumulated losses brought forward by the PRC Subsidiaries, not exceeding a period of five years, can be offset against the profits to arrive at the assessable profits for income tax computation purposes. A summary of the tax concessions available to the PRC Subsidiaries for 1999, 2000 and 2001 is as follows:

PRC Subsidiaries	Chinese State unified income tax rate (%)	Chinese local income tax rate (%)	Concession from Chinese State unified income tax	Concession from Chinese local income tax	Year of commencement of tax holiday
HZ	15.0	1.5	Specifically allowed to adopt a reduced tax rate of 10.0% for 1999 and 2000	Full exemption for 10 years starting from the commencement of tax holiday	1993
DH	24.0	3.0	None	Same as HZ	1992
YC	24.0	3.0	Specifically allowed to extend the 50% reduction for 1999, 2000 and 2001	Full exemption for 5 years starting from commencement of tax holiday followed by a 50% reduction for the next 3 years thereafter	1994
FCJ	30.0	3.0	None	None	N/A
YT	24.0	3.0	None	None	1994
SD	24.0	3.0	50% reduction in 1999	Same as Chinese State unified income tax	1995

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## 13. PROVISION for Income Taxes – continued

If the PRC Subsidiaries were neither in the tax holiday period nor had they been specifically allowed special tax concessions in 1999, 2000 and 2001, they would have recorded additional income tax expenses of Rmb5,871, Rmb32 and Rmb1,174, the consolidated net loss would have been increased by Rmb3,003, Rmb16 and Rmb599, and basic and diluted loss per share would have been increased to Rmb17.16 and Rmb15.08 for the years ended December 31, 1999 and 2001, respectively, and would have remained a loss per share of Rmb8.75 for the year ended December 31, 2000.

The Group provides for deferred income taxes in accordance with the requirements of SFAS No. 109 using the liability method, by which deferred income taxes are recognized for all significant temporary differences between the tax and accounting bases of assets and liabilities. The tax consequences of those differences are classified as current or non-current based upon the classification of the related assets or liabilities in the financial statements. A valuation allowance is provided for a portion of deferred tax assets, that is not currently realizable, since the realization of these benefits depends upon the ability of the relevant entity to generate income in future years.

The PRC Subsidiaries are required to provide for VAT and CT which are the principal taxes on the sales of tangible goods and the provision of certain specified services (“output VAT”). The general VAT rate applicable to the PRC Subsidiaries is 17% while CT is calculated at 10% on the domestic sales amount, except that the 10% CT on radial tire products was abolished since January 1, 2001. VAT and CT are recognized on an accrual basis and sales are recorded net of these taxes.

The reconciliation of the effective income tax rate based on loss from continuing operations before income taxes and minority interests stated in the consolidated statements of operations to the statutory income tax rates in Hong Kong, the PRC and the United States are as follows:

	1999 <i>Rmb</i>	2000 <i>Rmb</i>	2001 <i>Rmb</i>
Weighted average statutory tax rates	24%	22%	24%
Effect of tax holiday	5%	–	1%
Permanent differences relating to non-taxable income and non-deductible expenses	1%	(1%)	(5%)
Valuation allowance	(35%)	(28%)	(22%)
Effective tax rate	(5%)	(7%)	(2%)

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## 13. PROVISION for Income Taxes – *continued*

Provision for income taxes consists of:

	1999 <i>Rmb</i>	2000 <i>Rmb</i>	2001 <i>Rmb</i>
Current	3,583	5,348	10,581
Deferred	(22,696)	(20,380)	(40,988)
Adjustment of valuation allowance	22,696	20,380	32,861
	3,583	5,348	2,454

The tax impact of temporary differences give rise to the following deferred tax assets (liabilities):

	2000 <i>Rmb</i>	2001 <i>Rmb</i>
Allowance for doubtful receivables	30,883	40,163
Allowance for inventory obsolescence	1,099	1,052
Write-down of inventories to net realizable value	3,920	6,787
Provision for warranty expenses	4,057	7,416
Impairment loss provision for long-lived assets	–	180
Depreciation	4,017	3,691
Tax losses carried forward	21,341	49,315
Others	2,299	–
Valuation allowance for deferred tax assets	(67,616)	(100,477)
	–	8,127

As of December 31, 2001, the tax losses from continuing operations carried forward derived principally from one of the PRC Subsidiaries and certain other subsidiaries subject to US income tax, which amounted to Rmb138,694 and expire through 2004. The loss carry forwards can only be utilized by the subsidiaries generating the losses. The valuation allowance refers to the portion of the deferred tax assets that are not “more likely than not” going to be realized. The realization of these benefits depends upon the ability of the Company and its subsidiaries to generate income in future years. Except to the extent that a valuation allowance have been established, the Company believes the carry forwards benefits will be realized.

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## 14. CAPITAL Stock

### Capital Stock

Each share of Supervoting Common Stock is entitled to 10 votes whereas each share of Common Stock is entitled to one vote. The Common Stock is identical to the Supervoting Common Stock as to the payment of dividends. Except for the difference in voting rights described above, the Supervoting Common Stock and the Common Stock rank pari passu in all respects.

### Share Capital

The Company was incorporated with an initial share capital of 1,200,000 Common Stock with a par value of US\$0.01 each which was later reclassified to Supervoting Common Stock. On May 14, 1993, the authorized share capital of the Company was further increased from US\$12 to US\$700 by the creation of 50,000,000 shares of Common Stock of par value US\$0.01 each and 18,800,000 shares of Supervoting Common Stock of par value US\$0.01 each. 6,000,000 shares of Supervoting Common Stock (including the 1,200,000 Common Stock reclassified to Supervoting Common Stock) were issued to the ultimate parent company of the Company as a consideration for the transfer of two PRC Subsidiaries to the Company and on June 23, 1993, the Company redeemed 3,000,000 shares of its outstanding Supervoting Common Stock at their par value of US\$0.01 per share.

During fiscal 2000, the Company repurchased 82,700 shares of Common Stock at prices ranging from US\$5.00 to US\$6.13 per share and the aggregate cash consideration paid was Rmb3,648. These repurchased shares were cancelled during fiscal 2000. There were no further movements in share capital of the Company during fiscal 2001.

## 15. STOCK Options

Pursuant to an executive stock option scheme adopted on June 7, 1994, the Company grants options to officers and employees, and directors who are also employees, of the Company and its subsidiaries to subscribe Common Stock of the Company, subject to a maximum of 910,000 shares. Shares of Common Stock to be issued upon the exercise of options will be authorized and unissued shares. An independent committee (the "Committee") of the Board of Directors, consisting of non-employee directors has been formed to monitor and consider the granting of options under the scheme. The subscription price will be determined by the Committee, and will not be less than 80% of the average closing price of shares of Common Stock on the New York Stock Exchange over the five trading days immediately preceding the date of offer of the option.

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## 15. STOCK Options – *continued*

A summary of stock options activity during the three years ended December 31, 1999, 2000 and 2001 is as follows:

	Number of shares	Weighted average exercise price US\$
	<hr/>	<hr/>
Outstanding at January 1, 1999	430,000	10.25
Granted	380,000	5.88
Lapsed	(150,000)	10.25
	<hr/>	
Outstanding at December 31, 1999	660,000	7.73
Granted	20,000	9.94
Exercised	(10)	5.88
Lapsed	(440,000)	8.36
	<hr/>	
Outstanding at December 31, 2000	239,990	6.76
Lapsed	(219,990)	6.47
	<hr/>	
Outstanding at December 31, 2001	<u>20,000</u>	9.94

All the above share options vested immediately upon the date of grant and the exercise prices were set at 100% of the market prices of the shares of the Company prevailing at the dates of grant. Accordingly, no compensation expense was recognized in the consolidated statements of operations.

The weighted average remaining contractual life of the options outstanding at December 31, 2001 was approximately 8.1 years.

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## 15. STOCK Options – continued

Had compensation costs for the Company's stock options issued been determined based on the fair value of the stock options at the grant date, consistent with the provision of SFAS No. 123, the Company's net loss, and basic and diluted loss per share for the years ended December 31, 1999, 2000 and 2001 would have been adjusted to the pro forma amounts indicated below:

	1999 <i>Rmb</i>	2000 <i>Rmb</i>	2001 <i>Rmb</i>
Net loss:			
As reported	(153,196)	(79,384)	<b>(135,359)</b>
Pro forma	(160,273)	(80,332)	<b>(135,359)</b>
Basic and diluted loss per share:			
As reported	(16.83)	(8.75)	<b>(15.01)</b>
Pro forma	(17.61)	(8.86)	<b>(15.01)</b>

The fair value of each option grant is estimated using the minimum value method of the Black-Scholes option pricing model. The weighted-average assumptions used for grants made in fiscal 1999 and 2000 are as follows:

	1999	2000
Risk-free interest rate	5.17% p.a.	<b>5.68% p.a.</b>
Expected option life	5 years	<b>5 years</b>
Expected dividend yield	1.36%	<b>0.8%</b>
Volatility	40.28%	<b>68.72%</b>

## 16. OBLIGATIONS and Commitments

As of December 31, 2000 and 2001, the Group had outstanding capital commitments for construction of factory premises and purchases of equipment amounting to approximately Rmb26,203 and Rmb62,226, respectively.

The Group leases certain of its warehouses under non-cancellable operating leases expiring at various dates through 2008. Rental expense under operating leases was Rmb4,805, Rmb3,147 and Rmb5,156 for the years ended December 31, 1999, 2000 and 2001, respectively.

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## 16. OBLIGATIONS and Commitments – *continued*

The following is a schedule of future minimum lease payments required under operating leases that have initial or remaining non-cancellable lease terms in excess of one year as of December 31, 2001:

	<i>Rmb</i>
2002	2,217
2003	300
2004	162
2005	162
2006	162
2007 and later years	291
	<hr/>
Total minimum lease payments	3,294
	<hr/> <hr/>

## 17. DISTRIBUTION of Profit

Dividends from the PRC Subsidiaries will be declared based on the profits as reported in their statutory financial statements. Such profits will be different from the amounts reported under U.S. GAAP. As of December 31, 2000 and 2001, the PRC Subsidiaries had aggregate accumulated deficit of Rmb11,651 and Rmb66,587, respectively, as reported in their statutory financial statements.

In 1995, the board of directors of DH determined that the retained earnings as of December 31, 1994, in the amount of Rmb135,469, as stated in its statutory financial statements would be capitalized as additional paid-in capital in proportion to both joint venture partners' equity interest in DH and accordingly, would not be available for distribution to the joint venture partners. This arrangement was approved by relevant government authorities in fiscal 2000 and its effect was included in the statutory financial statements of DH for the year ended December 31, 2000.

The Company proposed and paid dividends of US\$728 (Rmb6,028), US\$725 (Rmb6,002) and US\$180 (Rmb1,493) for the years ended December 31, 1999, 2000 and 2001, respectively, on the outstanding Supervoting Common Stock and Common Stock.

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## 18. RELATED Party Balances, Transactions and Arrangements

### (a) Due from/to Related Companies

The amounts due from related companies primarily arise from sales of tires and are unsecured, non-interest bearing and repayable at the end of credit periods granted ranging from 90 days to 180 days. Historically, the Company has not experienced losses related to these receivables with the exception of an allowance for doubtful accounts amounting to Rmb27,000 charged to the consolidated statement of operations during fiscal 2001.

The loans from related companies represent funds advanced to the Company and are unsecured, non-interest bearing and have no fixed repayment terms. As of December 31, 2001, the related companies agreed that no repayment would be required before January 1, 2003.

### (b) Land Use Right

The Taiyuan municipal government had granted its approval for Taiyuan Rubber Factory, the Chinese joint venture partner of DH, to use the parcel of land on which DH's bias tire factory is located, but had not issued any land use right certificate. Taiyuan Rubber Factory had agreed in principle to lease the land to DH for the 50-year term of the joint venture and indicated that there would be a rent-free period during the initial five-year period, an annual fee of Rmb129 for the following five-year period, and an annual fee of Rmb258 for the remaining period of the lease. A lease contract had not yet been signed between the parties, and such lease would be subject to the prior formal transfer of the land use right to Taiyuan Rubber Factory from the Taiyuan municipal government. Taiyuan Rubber Factory had undertaken to bear any cost associated with the arrangements to be made for the transfer and to bear any loss which DH may suffer as a result of the failure to effect the transfer; such agreement ceased upon disposition of the Company's entire interest in the bias tire factory to a third party during fiscal 2001.

### (c) Management and Administrative Services Agreement

Pursuant to a management and administrative services agreement between the Company and the ultimate parent company in 1993 and renewed in 1997 and 2000, for a term of three years, the ultimate parent company will provide certain management services to the Company for an annual fee of US\$30 (Rmb248). In addition, the Company has agreed to reimburse the ultimate parent company for administrative services of approximately Rmb7,635, Rmb8,297 and Rmb4,127 for the years ended December 31, 1999, 2000 and 2001, respectively, rendered on behalf of the Company on a cost plus 5% basis.

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## 18. RELATED Party Balances, Transactions and Arrangements – *continued*

### (d) Sales to Related Parties

HZ recorded sales to related companies of approximately Rmb225,600, Rmb330,310 and Rmb184,202 for the years ended December 31, 1999, 2000 and 2001, respectively. YC also made sales to related companies of approximately Rmb4,180 for the year ended December 31, 2001. These transactions were carried out after negotiations between subsidiaries and the respective related companies in the ordinary course of business and on the basis of estimate market value as determined by management of the subsidiaries.

### (e) Indemnification from a Chinese Joint Venture Partner of Accounts Receivable Balance

The Chinese joint venture partner of DH have agreed to indemnify DH against any financial losses resulting from any uncollectible trade and other receivable balance transferred into DH by the predecessor state-owned enterprise upon the establishment of the joint venture. As of December 31, 2000, the Chinese joint venture partner of DH agreed to indemnify Rmb4,403 of these receivable balances; such arrangement ceased upon disposition of the Company's entire interest in the bias tire factory of DH to a third party during fiscal 2001.

### (f) Contingent Liabilities

As of December 31, 2000 and 2001, HZ has undertaken to guarantee, without charge, certain bank loan facilities of approximately Rmb294,750 and Rmb190,850, respectively, granted by certain banks to an affiliate in the PRC.

As of December 31, 2000 and 2001, YT has undertaken to guarantee, without charge, certain bank loan facilities of approximately Rmb2,500 and Rmb2,500, respectively, granted by a bank to a related company in the PRC.

### (g) Loan Guarantees Provided By Related Companies

Certain parties have guaranteed certain of the Group's bank borrowings at no cost to the Company. Details of the borrowings are shown in note 12.

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## 19. DUE From/To Chinese Joint Venture Partners

- (i) The amounts due from Chinese joint venture partners represent:
- (a) advances made from a PRC Subsidiary to the Chinese joint venture partner; and
  - (b) payment of various operating expenses by two of the PRC Subsidiaries on behalf of their Chinese joint venture partners.

These amounts are unsecured and non-interest bearing.

- (ii) The amounts due to Chinese joint venture partners represent:
- (a) the excess of the book value of the net assets contributed by the Chinese joint venture partners upon the formation of the PRC Subsidiaries over their shares of the registered capital of these joint venture enterprises;
  - (b) other working capital assets, consisting primarily of inventories, property, plant and equipment, less accounts payable and bank loans of the Chinese joint venture partners, loaned to the PRC Subsidiaries by the Chinese joint venture partners; and
  - (c) advances provided by the Chinese joint venture partners to the PRC Subsidiaries to finance their working capital requirements.

These amounts are unsecured and have no stipulated fixed repayment dates. The Chinese joint venture partners have agreed that no payment will be required in fiscal 2002. Interest was charged on Rmb22,600 and Rmb3,000 of the outstanding balance due to a Chinese joint venture partner at its effective cost of borrowing of 3.8% to 6.1% and 6.1% per annum for the years ended December 31, 2000 and 2001, respectively. The remaining outstanding balances are non-interest bearing.

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## 20. STAFF Retirement Plans

All of the Chinese employees of the PRC Subsidiaries are entitled to an annual pension on retirement, which is equal to their ending basic salaries at their retirement dates. The Chinese government is responsible for the pension liabilities to these retired employees. The PRC Subsidiaries are only required to make specified contributions to the state-sponsored retirement plan calculated at rates ranging from 17% to 23% of average monthly salaries for the years ended December 31, 1999, 2000 and 2001. The expenses reported in the consolidated statements of operations related to these arrangements were Rmb32,053, Rmb29,979 and Rmb21,438 for the years ended December 31, 1999, 2000 and 2001, respectively.

Pursuant to a new retirement plan regulation implemented by certain PRC municipal governments in 1996, certain PRC Subsidiaries and their employees were required to contribute 5% of the monthly salaries to designated bank accounts opened by these subsidiaries under the regulation. Upon retirement of the employees, they are entitled to withdraw the principal and related interest from these bank accounts to purchase housing. These bank deposits cannot be withdrawn for other uses by these PRC Subsidiaries. As of December 31, 2000 and 2001, such restricted bank deposits amounted to Rmb11,451 and Rmb9,478, respectively.

## 21. SEGMENT Information

The Group operates principally in the tire manufacturing industry and has two reportable segments for continuing operations based on the Company's major PRC Subsidiaries: HZ and YC. These reportable segments are strategic business units and are managed separately. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. All intercompany transactions have been eliminated.

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## 21. SEGMENT Information – continued

The remaining segment includes other subsidiaries of the Company except for DH, SD and YT which are presented separately under the discontinued operations segment. Corporate identifiable assets include primarily cash, loan receivable (Note 10) and goodwill. The chief operating decision maker evaluates the operating income of each segment in assessing performance and allocating resources between segments.

	(Rmb)	1999				Total	Discontinued operations
		Continuing operations					
		HZ	YC	Others	Corporate		
Corporate Information							
Chairman's Statement	Revenues	1,337,513	728,210	22,785	–	2,088,508	533,902
Review of Operations	Depreciation and amortization	38,992	41,648	545	4,459	85,644	18,392
Board of Directors and Management	Impairment loss on provision of long-lived assets	–	–	–	–	–	136,538
Financial Highlights and Information	Operating income (loss)	53,947	(18,062)	(23,025)	(21,507)	(8,647)	(19,667)
Management Discussion and Analysis	Impairment loss on loan receivable	–	–	–	34,935	34,935	–
	Equity in loss of an affiliate	2,150	–	–	–	2,150	–
	Identifiable assets	1,301,955	1,110,453	118,409	81,919	2,612,736	704,208
	Investment in an affiliate (included in identifiable assets above)	95,549	–	–	–	95,549	–
Report of Independent Public Accountants	Capital expenditures	47,543	37,498	25	–	85,066	11,343



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## 21. SEGMENT Information – continued

(Rmb)	2000					Discontinued operations
	HZ	Continuing operations			Total	
		YC	Others	Corporate		
Revenues	1,605,842	654,580	–	–	2,260,422	555,187
Depreciation and amortization	41,925	41,170	–	3,466	86,561	23,424
Impairment on provision of long-lived assets	–	–	–	–	–	3,852
Operating income (loss)	49,115	(40,220)	(11,989)	(27,057)	(30,151)	(20,705)
Impairment loss on loan receivable	–	–	–	14,962	14,962	–
Equity in loss of an affiliate	1,967	–	–	–	1,967	–
Identifiable assets	1,413,825	956,767	1,045	213,889	2,585,526	741,457
Investment in an affiliate (included in identifiable assets above)	105,437	–	–	–	105,437	–
Capital expenditures	38,780	19,846	–	–	58,626	17,242

(Rmb)	2001					Discontinued operations
	HZ	Continuing operations			Total	
		YC	Others	Corporate		
Revenues	2,064,783	619,420	23,102	–	2,707,305	446,663
Depreciation and amortization	52,559	41,843	2,047	706	97,155	21,244
Impairment loss on provision for goodwill	–	4,023	–	–	4,023	–
Provision for an amount due from a related company	27,000	–	–	–	27,000	–
Operating income (loss)	97,023	(159,191)	4,540	(12,102)	(69,730)	(23,656)
Recovery of impairment loss on loan receivable	–	–	–	9,800	9,800	–
Equity in losses of affiliates	2,486	–	–	–	2,486	–
Loss on disposition of discontinued components	–	–	–	–	–	78,721
Identifiable assets	1,545,627	897,998	231,955	106,867	2,782,447	196,518
Investments in and advances to affiliates (included in identifiable assets above)	102,022	–	–	–	102,022	–
Capital expenditures	118,364	20,360	5,512	–	144,236	9,949

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## 21. SEGMENT Information – continued

Revenues of the Group are primarily derived from sales of tires and their geographical analysis of revenues is as follows:

	Continuing operations			Discontinued operations		
	1999 <i>Rmb</i>	2000 <i>Rmb</i>	2001 <i>Rmb</i>	1999 <i>Rmb</i>	2000 <i>Rmb</i>	2001 <i>Rmb</i>
PRC	1,603,992	1,610,114	2,085,797	399,177	418,578	365,434
Middle East Countries	232,744	241,197	130,323	102,195	–	–
US and Canada	22,785	121,955	119,995	32,530	33,417	28,440
Others	228,987	287,156	371,190	–	103,192	52,789
	2,088,508	2,260,422	2,707,305	533,902	555,187	446,663

Identifiable assets of the Group are principally located in the PRC.

## 22. OTHER Supplemental Information

The following items are included in the consolidated statements of operations:

	Continuing operations			Discontinued operations		
	1999 <i>Rmb</i>	2000 <i>Rmb</i>	2001 <i>Rmb</i>	1999 <i>Rmb</i>	2000 <i>Rmb</i>	2001 <i>Rmb</i>
Foreign exchange losses, net	1,914	4,042	599	52	145	87
Interest income	15,684	17,357	11,961	693	848	192
Sales taxes	115,848	105,729	84,933	35,330	36,252	26,129
Shipping and handling costs	50,362	79,297	106,974	14,626	14,823	10,938

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## 23. LEGAL Proceedings

- (a) In December 1999, The Pacific Bank, N.A. (now known as City National Bank, "Pacific Bank") filed legal proceedings against Orion Tire for violating the rules set forth in a loan agreement relating to a non-revolving trade finance facility of approximately US\$2,082 and made formal demand for payment of the amount drawn down from the facility and accrued interest of approximately US\$2,085. In connection therewith, Pacific Bank also filed legal proceedings against the Company in the capacity of the guarantor of such facility.

During fiscal 2000, an agreed amount of US\$1,981 was paid by the Company to Pacific Bank as settlement of the amount due to Pacific Bank and the above legal case was settled.

- (b) In 1994, the Company acquired a 70% indirect interest in Dalian C.S.I. Rubber Co. Ltd. ("DL") from its ultimate parent company. Subsequent to the completion of the acquisition, the Company was made aware that the Chinese joint venture partner of DL had entered into another joint venture contract with a major United States manufacturer of tires and rubber products ("Tire Manufacturer"). The terms of the new joint venture contract involved the sale to the Tire Manufacturer of the same radial tire factory and related facilities (the "Assets") which were to have been contributed into DL by the Chinese joint venture partner under the original joint venture agreement.

On March 14, 1995, the Company and its subsidiary, Orion Tire filed a claim in the US against the Tire Manufacturer for compensation in connection with the Tire Manufacturer's alleged wrongful acquisition of the Assets.

In August 1999, the US District Court for the Central District of California (the "District Court") granted the Tire Manufacturer's motion for summary judgment to dismiss Orion Tire's merits of the case.

In November 2001, the US Court of Appeals for the Ninth Circuit reversed the judgment of the District Court and remanded Orion Tire's claim against the Tire Manufacturer for further proceedings. The Company and Orion Tire then proceeded to claim for economic advantage against the Tire Manufacturer. No representations regarding the outcome of the case can be made at this time. As of the date of this report, the directors of the Company believe the outcome of the proceedings will not have any material adverse financial effect on the Company or any of the operating subsidiaries.

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## 24. POST Balance Sheet Event

On February 1, 2002, Million Good, a wholly owned subsidiary of the Company incorporated in the BVI, entered into a conditional agreement to subscribe for 4,800,000,000 new ordinary shares of HK\$0.01 each (“Subscription Shares”) in Ananda Wing On Travel (Holdings) Limited (“Ananda”) at an issue price of HK\$0.027 per Subscription Share for an aggregate subscription price of HK\$129,600 (Rmb137,466 or US\$16,602) (“Subscription Agreement”). Ananda is a Hong Kong based travel company which mainly provides package tours, travel, transportation and other related services and its shares are listed on the Hong Kong Stock Exchange. The Company has joined as a party to the Subscription Agreement in order to guarantee the due and full performance of Million Good’s obligations under the Subscription Agreement. Upon issuance of Subscription Shares, Million Good will own approximately 34.6% of the then outstanding share capital of Ananda.

As part of the transaction, the Company entered into another agreement on the same date to subscribe for a two-year convertible note (the “Note”) to be issued by Ananda in the principal amount of HK\$120,000 (Rmb127,284 or US\$15,372) (“Convertible Note Agreement”). The Note will bear interest at a rate of 2% per annum payable semi-annually in arrears. The Company or its nominees has a right to convert the Note into ordinary shares of Ananda at a rate per share equal to HK\$0.032, subject to adjustments, at any time prior to the Note’s maturity date, which will be two years from the date the Note is issued.

In addition, three other independent parties also entered into agreements to subscribe for similar two-year convertible notes issued by Ananda in total principal amounts of HK\$250,000 (“Other Notes Agreements”). Following the issuance of Subscription Shares to Million Good, full conversion of all of the convertible notes and assuming no further issuance of new ordinary shares by Ananda, the Company and Million Good would collectively own approximately 33.6% of the then outstanding share capital of Ananda.

The closing of the Subscription Agreement is dependent on the satisfaction of several external conditions which include the approval of Ananda’s shareholders, a waiver from The Securities and Futures Commission of Hong Kong of all shares tender offer to the then existing shareholders of Ananda and certain other regulatory clearances. These conditions to closing were to be satisfied by March 31, 2002; however, all parties to the Subscription Agreement, Convertible Note Agreement and Other Notes Agreements agreed to extend the completion date of the transaction to April 30, 2002. The Company’s obligations under the Note Agreement will be conditional upon, among other things, the Subscription Agreement become unconditional.

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