

Chairman's Statement



REVIEW OF RESULTS

During the reporting period, the gross domestic product of the PRC had increased by 8% as compared to the previous year. However, there was a decrease in the total volume of crops production by 9%. The trend of decline in the prices of crops persisted, representing a decrease of 8.3% over the same period in the previous year. The average income of farmers slightly increased by 2.1% from the same period of the previous year, which was less than the increase of the previous year. Owing to the factors of the structural adjustment in the agricultural industry, the decrease in the purchasing power of farmers and the "Three Withdrawals and Three Returns policy" (「三退三還」), this is the first time in the past five years that a negative growth rate in the agricultural industry was recorded. The total production value of the agricultural machinery industry declined by 7.2% from the previous year. The sales of large and medium tractors and small wheeled tractors in the PRC decreased by 37.3% and 21.7% respectively over the same period of the previous year, indicating a substantial decline in the profitability of the industry.

During the second half of 2000, there were substantial changes in the management of the Company. Confronted with severe adverse market conditions and keen competition in the industry, the management of the Company emphasized on controlling the decline in profitability in order to improve its results. The Company has adopted measures to strengthen its cost control, revamping its operation system, and enhancing the quality of the management. All these measures achieved preliminary effects and the results of the Company during the second half of the year improved. Operating loss decreased as compared with the first half of the year. As the macro economy did not achieve apparent improvement and the results were adversely affected by the unmarketable and outdated products of the Company, the Company recorded a loss for the year.

During the reporting period, the Company sold 9,542 units of large and medium tractors, representing a decrease of 28.25% over the same period in the previous year; 5,795 units of crawler tractors, representing a decrease of 34.34% over the same period as compared to last year; 3,747 units of large and medium wheeled tractors, representing a decrease of 16.23% over the same period in the previous year; and sold 63,887 units of small wheeled tractors,

representing a decline of 41.13% over the same period as compared to last year.

1. Target cost management and cost control

Facing the bleak situation of a falling demand of the market, the Company is determined to focus on exploring its internal potential and to implement cost control operating strategy as follows: (i) implement target cost management in different aspects such as product design, purchase of materials, production procedure and sales, and extended the cost analysis to the plants and major divisions; (ii) implement stringent assessment and awarding staff by assessing the effectiveness of the target cost management achieved by each unit in comparison to the wages of each unit (The assessment was conducted and accumulated on a monthly basis in order to ensure that the cost control index could be attained); (iii) actively pursue various improvement projects as well as improving production management through technological advancement and management innovation to reduce cost. The total variable cost of the Company's specialized plants decreased by 4.56% and the controllable expenses reduced by 4.46%. The unit cost of the small tractor declined by RMB1,000 on average which had effectively halted the downward trend of the results.

2. Transformation of operating system and internal reform

In order to survive the fierce competition in the market, the Company had further opened up the operations of certain specialized plants, actively exploring new operating system and the mode of operation. With regard to the subsidiaries, the Company set up remuneration policy on an annual basis, implemented risk pledging policy by senior management of each of the subsidiaries and put additional efforts in encouraging and awarding its staff. Besides, the Company promoted reform in personnel management, transformed the policies of appointment of staff and work allocation. There were apparent enhancement in the operation system of the Company and the awareness of the importance of competition among the staff.

3. Quality management system and product quality

The Company has passed the ISO9002 examination which was conducted by a third party. The Company had further reviewed and set its targets, amended and perfected its documentation in relation to its quality system, strengthened the examination and assessment of the quality system in compliance with the relevant requirements of the quality enhancement system. As a result, the achievement of having passed the examination could be consolidated. The Company had put more efforts on quality improvement and completed 48 projects with respect to quality improvements and 30 projects relating to quality assurance. A quality retrospective system has been established so that random inspection and assessment on the quality of products were strengthened. Consequently, there was significant improvement in the quality of our products. The zero hour assessed U-value of small tractors dropped by 4.46% as compared with the same period of the previous year. There was decrease in the zero hour assessed U-value of crawler tractors as well. The rates of compensation for crawler tractor and small tractor had decreased by 4.6% and 1.03% respectively.

PROSPECTS

The "Tenth Five-Year Plan Summary" of the State has set the target of attaining domestic economic growth rate at about 7% for the "Tenth Five-year" period and regarded recognising the status of the agricultural industry and increasing the farmers' income as the most important mission during the period. This paved the way for the creation of a better macro-economic environment and the implementation of more constructive policy which are more favourable for the agricultural industry and the agricultural machinery industry. All these factors will facilitate the long-term development of the agricultural and the agricultural machinery industries.

In 2001, the State will place its emphasis on the following agricultural works: the continued promotion of strategic structural adjustment in the agricultural production industry, fully enhancement of the quality and profitability of the agricultural industry; improve crop production to increase the farmers' income; expedite reform in the taxes and fees payable in villages in order to lessen the burden on farmers; increase investment to strengthen the construction of infrastructure in the agricultural industry and villages. The implementation of these measures is a process which will help to improve the gloomy situation in the agricultural and crop production industries and to increase the demand and halt the trend of further decline in demand. But as affected by the policy of "Three Withdrawals and Three Returns" (「三退三還」) and the impact of low price levels of crops and the slowdown in the growth of the farmers' income, the problem of excessive supply over demand for agricultural machinery is still eminent in 2001, and the market situation will be bleak. It is difficult to foresee any significant improvement in the business environment of the Company's tractor business.



In 2001, the State will continue the adoption of an active fiscal policy and increase the investments in the construction of infrastructure. The commencement of the strategic development plan in the western region, the transmission of gas from the west to the east, the project of water delivery from the south to the north and the environmental conservation project, the construction of railways, roads and irrigation system and the increase in construction relating to the urbanization of villages will stimulate the demands for engineering machinery as well as the road machinery. These factors provide room for further development in the markets of the related business of the Company.

In view of the situation and business operation of the Company, the development strategies of the Company include the following: to consolidate the business of tractors, strengthen the

operations of the road machinery and the engineering machinery. Furthermore, the Company will speed up the development of harvester machinery and agricultural machinery, the development of the business of spare parts and accessory, diversify its business and reinforce its cost management. The Company will expedite transformation of internal operating divisions to rationalize the internal operation and the management system. Measures will also be taken to reinforce the cost control and to explore any internal potential to raise its core competitiveness in order to improve the results of the Company. In 2001, the Company will adopt the following measures:

I. Conducting an in-depth renovation of the sales system and placing more emphasis on marketing

Based on the market demand, the Company will further rationalize, refine and standardize the operations of its existing sales service centres, renovating the existing sales networks and enhancing the profitability of its operations. The Company will strengthen the measures to be taken in promoting sales, improvement of the marketing and demonstration of the new products as well as the increase on flexibility, focus and effectiveness of the sales strategies. Also, the Company will further refine, increase the function of sales networks, expedite network renovation and review the work of the "three tier guarantee service points" (「三包(tm)A 務站」) and prepare end user profiles for the new products. The Company will follow up after-sale services and the quality of products and make quicker and more accurate feedback to market information. The Company will consolidate the existing markets and will explore markets for new products at the same time. The Company will strengthen its tender for government and corporate projects in respect of purchase of crawler tractors. Besides, the Company will put more efforts in developing the markets of road roller and engineering machinery in the western region.

II. Strengthening the development of new products and speeding up adjustment in product mix

- (1) The Company will expedite the rate of renovation of crawler tractors and exert efforts to promote the products of 902 and 1002 energy-saving models, develop various deviated models and expand scope of application in an attempt to halt the downward trend in sales as well as to consolidate their positions in the market.
- (2) The Company will expedite the development of Dongfanghong 30/40 wheeled tractor and based on the existing models, further development will be made to the models of 304, 300A, 404, 450 and 454. There will also be development of horticultural models, deviated transportation models and corresponding auxiliary products will also be developed in order to meet the demand for expanding the economic scale of the agricultural industry so that the volume of export can be increased.
- (3) The Company will speed up the launch of LF80-90 and 1004/1204 large wheeled tractors in the market with the objectives of increasing its market share in the PRC and enlarging the volume of exports as well as enhancing the quality and the refining functions.
- (4) The Company will increase its investment in the road machinery and engineering

machinery as well as enhancing their functions and standard. Also, the Company will expedite the development of YZ25GD and YZ16G road rollers, large bitumen mixing equipment and 9-12 M pavers, TY165 and T100 industrial bulldozers so as to make use of the advantages of these accessory machinery to meet the needs of the development in the western region. The Company will expedite its cooperation with the foreign enterprises in order to speed up its growth so as to facilitate this business as the principle business of the Company.

- (5) The Company will step up the development of harvester, improve the quality standard, increase its species and expand the scale in order to benefit from the policy of economy of scale. In the meantime, the Company will develop and conduct research on the major accessory agricultural machinery. Its leading products can therefore exploit the synergy of its fully equipped products of the agricultural machinery of the Company. This can facilitate mutual development of the business which aims at carrying out the production of large agricultural machinery.



- III. The Company will adopt more effective measures and reinforced its internal cost control

The Company will lower the production costs by means of implementing measures such as target cost management, reforming the purchase of raw materials, renovating the distribution of spare parts and proceeding with valuable engineering project so as to increase its profitability and its price competitiveness.

- IV. Fully utilization of existing assets and exploring internal potential

The Company will utilize the excessive processing and storage facilities of the specialized plants to engage in and organize the development of spare parts and accessories businesses in order to increase the asset utilization rate.

The Company will reinforce its strategic development plan, review and evaluate its strategies in respect of the acquisition and merger to reorganize the business of the Group. By strengthening the optimization of resources and renovation in management, it is anticipated that transformation of the Company's system can be procured with emphasis on simplicity and efficiency. The Company has appointed A.T. Kearney Co. Ltd. as its management consultants.

The Company will make good use of its capital and its advantages of advanced technology and sales network as a result of rationalizing strategies and optimization of resources. The

Directors considers that the Company is able to improve its results in the near future and to procure the development of the Company. Consequently, the Company will resume a more positive development.



By order of the Board
Fang Gang
Chairman

Luoyang, the PRC
25 April 2001