

# REPORT OF THE DIRECTORS

The directors herein present their report and the audited financial statements of the Company and the Group for the year ended 31 December 2002.

## 1. PRINCIPAL ACTIVITIES

The principal activities of the Company comprise the production and sale of agricultural tractors. Details of the principal activities of the subsidiaries are set out in note 16 to the financial statements. There were no significant changes in the nature of the Group's principal activities during the year.

## 2. RESULTS AND DIVIDENDS

The Group's loss for the year ended 31 December 2002 and the state of financial affairs of the Company and the Group at that date are set out in the financial statements on pages 35 to 80.

The directors do not recommend the payment of a final dividend for the year 2002.

## 3. FINANCIAL SUMMARY

A summary of the published results and of the assets and liabilities of the Group for the last five financial years, as extracted from the published audited financial statements, is set out below. The amounts for 1998 and 1999 have been adjusted for the effects of the retrospective changes in accounting policy for dividend declared after the respective balance sheet dates. This summary does not form part of the audited financial statements.

The financial summary has been prepared in accordance with the Hong Kong accounting standards.

Consolidated results

	Year ended 31 December				
	2002 RMB'000	2001 RMB'000	2000 RMB'000	1999 RMB'000	1998 RMB'000
Turnover	<b>2,300,223</b>	1,863,824	1,997,314	2,865,137	2,703,563
Profit/(loss) before tax	<b>(35,096)</b>	(97,607)	(168,056)	138,009	227,444
Tax	<b>(16,776)</b>	(16,786)	(13,142)	(44,294)	(75,972)
Profit/(loss) before minority interests	<b>(51,872)</b>	(114,393)	(181,198)	93,715	151,472
Minority interests	<b>(7,618)</b>	(3,406)	24,145	(13,594)	(19,033)
Net profit/(loss) from ordinary activities attributable to shareholders	<b>(59,490)</b>	(117,799)	(157,053)	80,121	132,439

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## Consolidated assets and liabilities

	2002 RMB'000	As at 31 December			
		2001 RMB'000	2000 RMB'000	1999 RMB'000	1998 RMB'000
Total assets	<b>3,334,388</b>	3,088,579	3,292,787	3,657,209	3,540,244
Total liabilities	<b>(1,180,321)</b>	(914,200)	(1,000,726)	(1,022,644)	(959,653)
Minority interests	<b>(105,225)</b>	(66,047)	(65,930)	(195,409)	(180,831)
Total	<b>2,048,842</b>	2,108,332	2,226,131	2,439,156	2,399,760

## 4. FIXED ASSETS

Details of movements in the fixed assets of the Company and the Group during the year are set out in note 13 to the financial statements.

## 5. SHARE CAPITAL

Details of movements in the share capital of the Company during the year are set out in note 34 to the financial statements.

During the year of 2002, the Company did not issue any convertible securities, options, warrants or similar rights.

## 6. PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's articles of association or the laws of the People's Republic of China (the "PRC") which would oblige the Company to offer new shares on a pro rata basis to its existing shareholders.

## 7. PURCHASE, SALE OR REDEMPTION OF LISTED SECURITIES OF THE COMPANY

Neither the Company, nor any of its subsidiaries purchased, sold or redeemed any of the Company's listed securities during the reporting period.

## 8. RESERVES

Details of movements in the reserves of the Company and the Group during the year are set out in note 35 to the financial statements.

## 9. DISTRIBUTABLE RESERVES

Details of the distributable reserves of the Company as at 31 December 2002 are set out in note 35 to the financial statements.

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## 10. MAJOR CUSTOMERS AND SUPPLIERS

For the year ended 31 December 2002, the five largest customers and suppliers respectively accounted for less than 30% of the total sales and purchases of the Group. Accordingly, information for the major customers and suppliers needed not be further disclosed.

## 11. DIRECTORS AND SUPERVISORS

The directors and supervisors of the Company during the year were as follows:

### **Executive directors:**

Mr. Fang Gang (resigned on 8 April 2002)  
Mr. Chen Li Wei (resigned on 8 April 2002)  
Mr. Dong Yong An  
Mr. Liu Da Gong (appointed on 8 April 2002)  
Mr. Liu Wen Ying  
Mr. Cui Qi Hong  
Mr. Shao Hai Chen (appointed on 8 April 2002)  
Mr. Li Teng Jiao  
Mr. Zhang Jing  
Mr. Cao Chun Guo  
Mr. Liu Shuang Cheng (appointed on 8 April 2002)

### **Independent non-executive directors:**

Mr. Lu Zhong Min  
Mr. Tao Xiang  
Mr. Chan Sau Shan, Gary  
Mr. Chen Zhi  
Mr. Hon Fong Ming (resigned on 14 June 2002)

### **Supervisors:**

Mr. Liu A Nan  
Mr. Zhao Zhong Hai  
Mr. Xu Wei Lin  
Ms. Wang Ai Ying  
Mr. Yang You Liang (resigned on 18 February 2002)  
Mr. Shao Jian Xin (appointed on 18 February 2002)

On 14 June 2002, the extraordinary general meeting of the Company approved the resignation of Mr. Hon Fong Ming as the independent non-executive director of the Company.

As Mr. Yang You Liang resigned the duties of supervisor of staff representative, the Company elected Mr. Shao Jian Xin as supervisor of staff representative on 18 February 2002 in accordance with the Company's articles of association. The appointment was effective on 18 February 2002.

On 8 April 2002, the extraordinary general meeting was held by the Company to approve the resignation of Mr. Fang Gang and Mr. Chen Li Wei as executive directors of the Company, and to approve the appointment of Mr. Liu Da Gong, Mr. Shao Hai Chen and Mr. Liu Shuang Cheng as executive directors of the Company. The appointment was effective on 8 April 2002.

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## 12. DIRECTORS' AND SENIOR MANAGEMENT'S BIOGRAPHIES

Biographical details of the directors of the Company and the senior management of the Group are set out on pages 18 to 20 of the Annual Report.

## 13. SERVICE CONTRACTS OF THE DIRECTORS AND THE SUPERVISORS

Mr. Fang Gang, Mr. Chen Li Wei, Mr. Dong Yong An and Mr. Zhao Zhong Hai entered into service contracts with the Company on 8 May 2000. Mr. Liu Wen Ying, Mr. Cui Qi Hong, Mr. Li Teng Jiao, Mr. Zhang Jing, Mr. Cao Chun Guo, Mr. Liu A Nan, Mr. Xu Wei Lin, Ms. Wang Ai Ying and Mr. Yang You Liang have entered into service contracts with the Company on 12 September 2000. Mr. Shao Jian Xin has entered into service contract with the Company on 18 February 2002. Mr. Liu Da Gong, Mr. Shao Hai Chen, Mr. Liu Shuang Cheng have entered into service contracts with the Company on 8 April 2002. These service contracts are the same in all material respects, details of which are set out as below:

- (i) Each service contract commences from the date of the contract to 7 May 2003;
- (ii) The total annual salaries payable to each of the executive directors each year for the three years term will be RMB40,000, RMB44,000 and RMB48,400 respectively. The total annual salaries payable to each of the supervisors each year for the three years term will be RMB24,000, RMB26,400 and RMB29,040 respectively; and
- (iii) Furthermore, each executive director or supervisor is entitled to a bonus upon completion of each full year of service. The bonuses payable to each of the executive directors each year for the three years term will not be more than RMB20,000, RMB22,000 and RMB24,200 respectively. The bonuses payable to each of the supervisors each year for the three years term will not be more than RMB12,000, RMB13,200 and RMB14,520 respectively.

Save as aforesaid, none of the directors has entered into any service contract with the Company which is not terminable by the Company within one year without payment of compensation, other than statutory compensation.

## 14. DIRECTORS' AND SUPERVISORS' INTERESTS IN CONTRACTS

During the year, no director or supervisor had a material interest in any contract of significance to the business of the Group to which the Company, its holding company, or any of its subsidiaries or fellow subsidiaries was a party.

## 15. CONTRACTS OF SIGNIFICANCE

None of the Company or any of its subsidiaries has entered into any contract of significance, other than those as disclosed in the connected transactions, with the controlling shareholder at any time during the year ended 31 December 2002.

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## 16. SUBSTANTIAL SHAREHOLDERS

As at 31 December 2002, the following shareholders holding interests of 10% or more of the issued share capital of the Company were recorded in the register of interests required to be kept by the Company pursuant to Section 16(1) of the Securities (Disclosure of Interests) Ordinance of Chapter 396 of the laws of Hong Kong ("SDI Ordinance"):

Shareholders	Class	Number of shares ( <i>'000 shares</i> )	Percentage of total shares (%)
China First Tractor Group Company Limited (the "Holding")	State-owned legal person shares	450,000	57.32
The HKSCC Nominees Limited	H shares	329,060	41.92

Save as disclosed above, no other parties held any interest in the share capital of the Company as required to be recorded in the register of issued shares kept by the Company under Section 16(1) of the SDI Ordinance.

## 17. DIRECTORS' AND SUPERVISORS' INTERESTS IN SHARES

As at 31 December 2002, none of the directors or supervisors of the Company held any shares in the Company. None of the directors or supervisors had interest in the share capital in, or debentures of, the Company or any of its associated companies (as defined in the SDI Ordinance). The Company did not grant to any directors and supervisors or their respective spouse or children under 18 years of age any right to subscribe for securities in, or debenture of, the Company and none of the above persons exercised any of such right.

## 18. CONNECTED TRANSACTIONS

The Group's connected transactions (as defined in the Listing Rules) are set out in note 41 to the financial statements. Save as disclosed in note 41(a) and (c) to the financial statements, the Board of Directors of the Company had approved the entering into of the Financial Services Agreement between China First Tractor Group Finance Company Limited ("FTGF"), the Holding and its subsidiaries. An extraordinary general meeting will be convened to approve the Financial Services Agreement and an announcement will be published to disclose the details in respect thereof. With respect to the connected transactions conducted between the Holding and its subsidiaries prior to the entering into of the Financial Services Agreement with FTGF, the Company has disclosed the same to the Stock Exchange.

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Save for such transactions, the Company also has the following connected transactions:

- (i) On 6 December 2002, the Company entered into an Agreement of the Joint Venture Yituo (Luoyang) Fuel Jet Co., Ltd. with the Holding and Yituo (Luoyang) Diesel Co., Ltd ("YLDC"). The registered capital of Yituo (Luoyang) Fuel Jet Co., Ltd. was RMB52,000,000 of which RMB39,000,000 was contributed by the Holding by means of assessed assets, accounting for 75% of the registered capital; RMB9,360,000 was contributed by YLDC in cash, accounting for 18% of the registered capital; and RMB3,640,000 was contributed by the Company in cash, accounting for 7% of the registered capital.

Since the Holding is a controlling shareholder of both the Company and YLDC, the investment constituted a connected transaction of the Company pursuant to 14.23 of the Listing Rules. Since the investment of the Company amounting to RMB3,640,000 (approximately HK\$3,430,000) which was higher than HK\$1,000,000 but less than 3% of the net book value of the tangible assets in the accounts recently published by the Company, it was not subject to the approval of shareholders. The Company made an announcement in respect of the investment in Hong Kong newspapers on 10 December 2002 pursuant to 14.25 (1) of the Listing Rules.

After reviewing the current year's connected transactions, the independent non-executive directors of the Company confirm that:

- (i) the transactions were carried out in the normal and usual course of business of the Group;
- (ii) the transactions were carried out either (a) on normal commercial terms (as compared with transactions of similar nature carried out by similar entities in the PRC) or (b) (if no similar condition to be compared with) on terms that are fair and reasonable so far as the shareholders of the Company are concerned; and
- (iii) the transactions were carried out (a) in accordance with the terms of agreement governing such transactions or (b) if no relevant agreement, on terms no less favourable than terms available to the third parties.

## 19. APPLICATION OF THE PROCEEDS FROM THE H SHARES ISSUE

The Company raised approximately RMB1,615,500,000 (approximately HK\$1,507,500,000) by the issue of 335,000,000 new H shares (the "Shares") under the initial public offering of the Company's H Shares listed on The Stock Exchange of Hong Kong Limited on 23 June 1997 and two subsequent partial exercises of over-allotment option.

The proceeds, other than those amounting to RMB1,119,775,000 which have been spent and disclosed in the previous annual and interim reports, were also applied to the following purposes during the year:

- approximately RMB60,950,000 were applied to financing the purchase of fixed assets for the power diesel engine project in 100/105, and to appreciation in projects under construction.
- the balance of the proceeds were used as additional working capital of the Company.

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## 20. DIRECTORS' AND SUPERVISORS' INTERESTS IN COMPETING BUSINESS

During the year and up to the date of this report, none of the directors or supervisors of the Company are considered to have interests in a business which competes or is likely to compete, either directly or indirectly, with the businesses of the Group, as defined in the Listing Rules.

## 21. STAFF QUARTER

As all staff quarters have been retained by the controlling shareholder, the Company does not have any staff quarters to sell to its staff. Pursuant to its existing policy, the staff of the Company shall buy the staff quarters at their own expenses (including quarters retained by the controlling shareholder).

## 22. HOUSING POLICY

Regarding the allocation of housing subsidies policy promulgated by the State, the Company has not yet received the details of the implementation rules and the policy still cannot be implemented. The Company currently does not have any plans or intention regarding the implementation of housing subsidies allocation policy. As such, the Company believes that the policy did not have any significant impact on the financial statements of the Company for the year 2002.

## 23. STAFF'S BASIC MEDICAL INSURANCE

Since September 2001, the Company has been implementing the staff's basic medical insurance scheme of Luoyang towns and townships. Under the procedures and their implementing rules, the Company shall make contribution to the basic medical insurance calculated at a certain percentage of the total wages of the staff which is stated as staff welfare. The Company assessed that the implementation of the policy would not create a significant impact on the financial statements of the Company as the medical expenses for the staff were also stated as staff welfare in the past.

## 24. DESIGNATED DEPOSIT AND DEPOSIT DUE

The Company had a sum of RMB80,433,000 deposited with one of the Company's subsidiaries FTGF which is a non-banking financial institution approved by the People's Bank of China and is principally engaged in providing financial and monetary services to group members of China First Tractor Group Company Limited (including the Company and its subsidiaries). The Company did not have any deposits other than those aforesaid deposited with any non-banking financial institution.

The Company granted a loan of RMB70,000,000 and a loan of RMB2,000,000 to two of its subsidiaries, Yituo (Luoyang) Building Machinery Co., Ltd. and Guizhou Zhenning Biological Industrial Co., Ltd. respectively. These loans were granted in the form of designated deposits deposited with FTGF and a commercial bank in the PRC. The Company did not have any designated deposit other than those aforesaid. All the cash deposits of the Company were deposited with commercial banks in the PRC in compliance with the relevant laws and regulations. The Company has not experienced any incident of not being able to withdraw bank deposits when due.

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## 25. POLICIES ON UNIFIED INCOME TAX

The corporate income tax of the Company is subject to 33% tax rate based on its assessable profits.

## 26. LAND USE RIGHTS

Under the land leasing agreement entered into between the Company and the Holding on 4 June 1997, the Company is entitled to the right of use of land for 50 years from the effective date of the agreement. Furthermore, the Company possesses the ownership certificates of the buildings.

## 27. SIGNIFICANT EVENTS

- (1) On 30 May 2002, the Board of Directors decided to revoke the resolution on an additional investment of RMB15,695,000 in the Company's subsidiary Yituo (Luoyang) Harvester Co., Ltd. ("YLHC"), and made a resolution on 25 October 2002 on an additional investment of RMB3,600,000 in YLHC. Upon completion of the capital increase, the Company holds 93.91% of the equity interest in YLHC.
- (2) In June 2002, the Company acquired a 79.67% equity interest in FTGF for approximately RMB240,000,000 and carried out a restructuring. The acquisition would help the Group in strengthening centralized management of internal financial resources and provide a platform for the Group's internal financing.
- (3) On 2 September 2002, the Board of Directors made a resolution approving the confirmation of the 125MN hotdie forging press project of the forge. The project would involve a total investment of approximately RMB121,450,000. The commencement of production by the project will help raise the Company's technical standards and capabilities, offering strength assurance to the Company's leading products in their participation in the competition on the Chinese domestic and international market.
- (4) On 25 October 2002, the Board of Directors made a resolution approving the comprehensive design proposal for the power diesel engine project in the investment of the YTR105 series. Phases I and II of the project are expected to involve an additional investment of RMB80,910,000 for establishing an output capacity of 40,000 units of medium power diesel engine.
- (5) On 18 November 2002, amendments to the Articles of Association of the Company were approved at an extraordinary general meeting of the Company. In the amended Articles of Association, "dealing in import and export of products made by the Company (including its members) and related technology." was included into the business scope of the Company.
- (6) On 3 December 2002, the Company established Yituo (Luoyang) Building Construction Machinery Co., Ltd. ("YLBC") with a third party by cash contribution of approximately RMB6,406,000. The Company holds 35% of its registered capital. The principal business of YLBC is the manufacture and sale of road and building machinery as well as parts and related products.



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## 28. POST BALANCE SHEET EVENT

Details of the significant post balance sheet event of the Group is set out in note 44 to the financial statements.

## 29. CODE OF BEST PRACTICE

In the opinion of the Directors, the Company has complied with the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") throughout the fiscal period covered by the annual report.

## 30. MATERIAL LITIGATION

During the period of this report, none of the Company, the Directors, Supervisors nor senior officers of the Company had engaged in any material litigation or arbitration.

## 31. AUDIT COMMITTEE

The Company has an audit committee which was established in accordance with the requirements of the Code, for the purposes of reviewing and providing supervision over the Group's financial reporting process and internal controls. The audit committee comprises three independent non-executive directors of the Company.

## 32. AUDITORS

Ernst & Young retired and a resolution for their reappointment as auditors of the Company will be proposed at the forthcoming annual general meeting.

By order of the Board of Directors

**Dong Yong An**

*Chairman*

Luoyang, the PRC

25 April 2003